

Question 2: Benefits and Challenges of Globalisation

Extract 6: How Brexit impacts globalisation

Key beliefs of globalisation like trade and immigration were among the factors that pushed the UK towards “Brexit” [a term used to describe UK’s decision to exit the European Union (EU)], leading many experts to wonder whether globalisation is still welcome in today’s world. UK’s vote to leave the EU in 2016 was a clear reminder that the UK public wasn’t happy with these policies, which experts said showed dissatisfaction with globalisation.

The EU, which comprises 27 European countries including the UK, allows free trade and free movement of people amongst its member countries. Experts warned that Brexit could disrupt trade links with the EU and jeopardize jobs in the UK.

Source: <https://www.cnn.com>, 28 Jun 2016

Figure 1: Euro/ Pound exchange rate 2016- 2021



Source: Bloomberg

Table 2: UK's annual inflation rate

Year	Annual inflation rate (%)
2016	0.7
2017	2.7
2018	2.5
2019	1.8

Source: <https://www.ons.gov.uk>

Extract 7: Damage of Brexit on UK

The economy has slowed, and many businesses have moved their headquarters to the EU. Business investment diminished by 11% between 2016 and 2019. Some international businesses have moved out of UK. Brexit's biggest disadvantage is its damage to the UK's economic growth. Most of this has been due to the uncertainty surrounding the final outcome. Uncertainty over Brexit slowed the UK's growth from 2.4% in 2015 to 1.6% in 2019. The UK government estimated that Brexit would lower the UK's growth by up to 6.7% over 15 years.

The British pound [UK's currency] fell immediately after the Brexit vote. That helps exports but increases the prices of imports. It has not regained its pre-Brexit high.

Source: The Balance, 24 Jan 2022

Extract 8: UK productivity, competitiveness and standard of living

The public debate over Brexit had not been based on a factual understanding of the state of the UK economy. The problems facing the UK were not caused by the EU but lies at home. Hence, leaving the EU will not eliminate these problems. The real issue is a pattern of persistent weaknesses in UK competitiveness, and its consequences for citizens. The lack of effective action on upgrading UK competitiveness has been a fundamental failure of the UK government. Brexit could trigger long over-due action by the UK government to boost productivity to enhance competitiveness. This rather than a wave of new trade agreements outside of the EU should be what UK should focus on.

UK prosperity has been lagging. GDP per capita remains well below other Western European countries in level and growth. Wage gains have stagnated, and the UK's standard of living has continued to lag peers. Prosperity has been uneven. Since the 1990s the UK registered the greatest income inequality of any European OECD country.

Changes in prosperity over the long term depend on productivity. Productivity is the central measure of competitiveness and a key driver of a nation's standard of living. The UK's weaknesses in productivity is the root cause of the nation's disappointing economic performance. UK productivity is lower than other peer countries in OECD.

The UK is underperforming because of weaknesses in competitiveness fundamentals. Infrastructure quality is weak and insufficient to support further growth. There are major skill shortages, especially in so-called 'middle skills'. UK spending on innovation lags leading European and global peers. Companies compete mostly on price and cost, rather than on

advanced innovation-based strategies. And it is the performance of exporters outside of London that drags down the country's overall productivity record.

Source: <https://www.hbs.edu>, September 2018

Extract 9: Impact of globalisation

Globalisation has long been a key driver of economic growth for many countries. It allows countries to produce and consume at more optimal levels through increased specialization and greater competition. Producers can enjoy economies of scale and reduce costs through the enlargement of markets. Consumers benefit from lower prices, and access to a wider variety of goods and services. International trade also helps to foster healthy competition, thus spurring technological progress and productivity growth.

Small economies must continue to embrace globalisation as they depend on global markets, free trade and free capital flows to sustain their livelihood. A willingness to adopt new technologies is key to helping these economies capture opportunities.

On the whole, however, countries' experience with globalisation have been mixed, with the gains and losses being unevenly spread out at the international and national levels. With respect to the gains from international trade, these have accrued mainly to regions with a high concentration of export-oriented industries while the wage gap between skilled and unskilled workers has widened with globalisation and the introduction of new technologies, resulting in rising inequality.

In recent years, concerns about the negative side effects of globalisation led to a shift towards trade protectionism as anti-globalisation sentiments rises in more countries.

Source: BIS Papers chapters in Bank for International Settlements (ed.), 2018

Extract 10: Coronavirus pandemic will cause a 'much bigger wave' of protectionism

Governments around the world will turn increasingly protectionist as they try to limit the economic damage from the coronavirus pandemic, a trade expert said.

"As the economic distress increases, the response by many governments will be to assist favored industries, favored sectors or sectors where they're particularly concerned about catastrophe, especially in jobs. And they will respond, most likely, by pursuing protectionism," she explained.

"But for each individual country, that's the solution that makes sense — so restrict trade, focus domestically, keep your own people as employed as you can and then don't worry about anyone else," she added. "But, of course, the net result is everyone else is worse off."

Source: <https://www.cnbc.com>, 9 Apr 2020

Questions

- (a) (i) With reference to Table 2, state what happened to the general price level of the UK from 2016 to 2019. [1]
- (ii) With the use of a diagram, explain how the change in exchange rate of the British pound observed in Figure 1 can lead to the change in general price level stated above. [5]
- (b) Explain how the UK's current account of the balance of payments is likely to be affected in the long run by international businesses moving out of the UK. [2]
- (c) Explain how "uncertainty over Brexit slowed the UK's growth". [4]
- (d) Discuss whether the government should boost productivity rather than sign new trade agreements to improve the UK's standard of living. [8]
- (e) Using economic analysis and the evidence provided, discuss whether countries should continue to embrace globalisation or pursue trade protectionism. [10]

[Total: 30]

Suggested Mark Scheme

(a)	(i)	With reference to Table 2, state what happened to the general price level of the UK from 2016 to 2019.	[1]
		It has increased.	
	(ii)	With the use of a diagram, explain how the change in exchange rate of the British pound observed in Figure 1 can lead to the change in general price level stated above.	[5]
		<p>Generally, depreciation increase in general price level (1 mark)</p> <p>Depreciation price of imports increases, including imports of raw materials and intermediate goods for production of goods and services rise in firms' cost of production fall in firms' profitability firms cut down production fall in SRAS upward shift of the SRAS curve rise in GPL imported inflation</p> <p>OR</p> <p>Depreciation fall in price of exports in terms of foreign currency and increase in price of imports in terms of domestic currency improvement in UK's BOT if the Marshall-Lerner condition ($PED_x + PED_m > 1$) holds increase (X-M) increase AD rightward shift of the AD along the upward-sloping or vertical portion of AD (assuming the economy is operating near or at full employment) increase in GPL demand-pull inflation</p> <p>Explanation of imported inflation or demand-pull inflation (3 mark) Diagram (1 mark)</p>	
(b)		Explain how the UK's current account of the balance of payments is likely to be affected in the long run by international businesses moving out of the UK.	[2]
		Fall in investments from overseas less profits repatriated overseas by foreign firms improvement in income balance improvement in current account balance, c.p.	
(c)		Explain how "uncertainty over Brexit slowed the UK's growth".	[4]
		<p>Uncertainty difficulty for firms to predict profitability of future investment projects slow down the pace of I slower increase in AD slower rise in RNY slower actual growth</p> <p>Slower increase in I slower increase in productive capacity slower increase in LRAS slower increase in the full employment level of RNY slower potential growth</p> <p>overall rate of increase in RNY is lower</p>	

	<p>OR</p> <p>Uncertainty expectations of profitability of future investments lower firms cutback on investment spending</p> <p>Uncertainty households withhold spending on goods and services as they increase precautionary savings fall in C fall in I and C fall in AD</p> <p>Uncertainty depreciation fall in price of exports and increase in price of imports increase (X-M) increase AD [as seen in a(ii)]</p> <p>Fall in AD likely to outweigh the increase in AD increase AD likely to be lesser slower increase in RNY</p> <p>Max 3 marks for an explanation that shows fall in RNY: Uncertainty firms reduce I or C fall in AD Fall in I fall in productive capacity over time fall in LRAS fall in RNY</p>	
(d)	<p>Discuss whether the government should boost productivity rather than sign new trade agreements to improve the UK's standard of living.</p>	[8]
	<p><u>Problems facing the UK economy</u></p> <p>Less competitive internationally as compared to its peers (due to lower productivity) hurt export competitiveness and country's ability to attract FDI</p> <p>Loss of vital trade links with other EU, increased outflow of FDI due to Brexit</p> <p>adverse impact on its BOP, economic growth in both the short and long term and employment and therefore its current and future SOL</p> <p><u>UK should boost productivity to improve its SOL</u></p> <p>As it is suffering from lower international competitiveness, boosting productivity is important in to improve SOL</p> <p>Boost productivity, e.g. through the upgrading the skills of its workforce or increase spending to encourage firms to adopt more up-to-date technology increase in output produce with the same amount of input lower unit COP lower prices of goods, including exports exports more competitive boost (X-M) increase AD rise in NY actual growth</p> <p>Boost productivity increase in productivity capacity increase LRAS potential growth</p> <p>increase AD & LRAS sustained increase in RNY increase in ability of the UK households to consume more goods and services improve their material SOL, and government can also increase their spending on merit goods like education and healthcare with higher tax revenue collected improve their non-material SOL</p> <p><u>Limitations of boosting productivity</u></p> <p>Effects of policy likely to be seen in the long term</p>	

Requires substantial government funding if UK government facing budget constraint, might need to give greater priority to spending particularly in those areas that address its weaknesses in competitiveness fundamentals as mentioned in Extract 8, since it is crucial for improvement in SOL in the long term and forgo or limit spending in other areas as a trade-off

UK should sign new trade agreements to improve its SOL

Given that EU is an important market for its exports and the loss of more preferential terms for its exports to these markets signing new trade agreements, especially other non-EU countries, will help the UK to compensate for loss of export market share to EU due to Brexit by growing its export market share in these other trading partners

Sign new trade agreements lower tariff barriers for UK exports lower prices of UK exports to these markets expand export market increase (X-M) increase AD increase in RNY

At the same time, to mitigate the outflow of FDI, sign new trade agreements and facilitate more capital flows I increase LRAS

sustained increase in RNY higher SOL as seen above

Limitations of signing trade agreements

While signing trade agreements will help to improve on UK exports' access to its trading partners' markets, its exports need to be sufficiently competitive to be able to compete with the exports from other countries

The lack of competitiveness of its exports is an issue that UK needs to deal with

Currently, as mentioned in Extract 8, the UK companies compete mostly on price and cost, rather than on advanced innovation-based strategies, and this is not a sustainable way for them to boost their exports in the long term.

Conclusion

The UK government need to complement the policy of signing new trade agreement with measures to boost productivity. Given the prospect of trade links with the EU being disrupted and the need to increase FDI inflow into the UK, the UK government should sign new trade agreements in the short term. However, it is also important to boost its productivity to ensure it is able to compete internationally in the long term as well.

Level	Description	Marks
2	For a balanced and well-developed answer that explains how boosting productivity and signing new trade agreements can improve UK's SOL with good use of the case materials.	4-6
	For an answer that only link to material aspect of SOL – max 5	

			For a one-sided answer that only explains how boosting productivity or signing new trade agreements can improve SOL with good use of the case materials – max 4		
		1	For a descriptive or less developed answer that explains how boosting productivity and signing new trade agreements can improve UK's SOL. Or for an answer with no link to SOL – max 3	1– 3	
		E2	A valid, well-argued evaluative judgement with an appropriate substantiation that is relevant to the issues raised in the context.	2	
		E1	Relevant point conclusion that is not elaborated nor substantiated.	1	
(e)		Using economic analysis and the evidence provided, discuss whether countries should continue to embrace globalisation or pursue trade protectionism.			[10]
		<p>Countries should continue to embrace globalisation as there are <u>microeconomic and macroeconomic benefits to be reaped</u></p> <p>As seen in Extract 9 para 1 & 2, some of these benefits include:</p> <ul style="list-style-type: none"> • It has enabled countries to reap benefits from trade based on the Theory of Comparative Advantage which highlights that if countries specialise in producing goods where they have comparative advantage (based on their factor endowment) and subsequently exchange for goods they have comparative disadvantage in, there will be an increase in economic welfare for all participating economies with countries being able to increase the consumption beyond their PPC. • It allows to reap internal economies of scale. Increased specialization and trade from globalisation allow a country to produce a good at a lower average cost of production when firms engage in mass production due to expansion of their markets overseas. This leads to a gain of larger market share and profits for the firms and increased consumer welfare as firms pass on the cost savings to them in terms of lower prices. • Freer trade will also enable to domestic firms to compete directly with foreign firms. As such, firms will have greater incentive to engage in R&D to improve their methods of production, thereby boosting a countries' pace of technological advancement and growth in the long run. <p><u>Evaluation</u></p> <p>However, the extent of benefit might differ across economies. Extract 9 suggests that small and export-oriented economies, whose exports take a larger proportion of the AD, should continue to embrace globalisation as they are more likely to benefit than economies with large domestic market.</p>			

However, not all countries think likewise. Some countries experience significant costs to globalisation, if not addressed appropriately, can outweigh the benefits (Extract 9 para 4). One important issue that countries need to be mindful of is that the gains of globalisation are not evenly distributed, with income gap widening, threatening its SOL eventually. As a result, some countries are turning to trade protectionism to address the problem.

Countries may pursue trade protectionism for the purpose to maintain/increase domestic production and employment level

With a weak global economic environment in recent years threatening the growth and employment and worsening inequity of many countries even further, there is for more tendency for countries to pursue trade protectionism. Thus, trade barriers are used in these countries to increase domestic production and employment level, avoiding the macroeconomic problem of high unemployment and low economic growth.

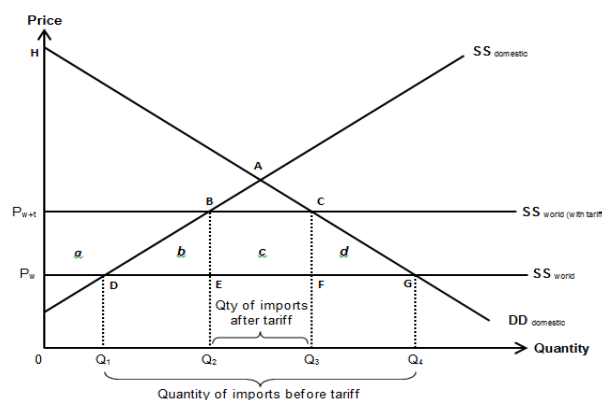


Figure 1: Effects of Imposition of Tariffs

For example, a country can impose tariff on the imports from its trading partners to protect its domestic industries from competition. This encourages the its citizens to substitute imports of with those produced by domestic industries instead. As shown in Figure 1 above, the imposition of tariff increases its domestic production from $0Q_1$ to $0Q_2$, preventing the firms from losses and retrenchments of workers, thus avoiding a fall in actual growth and unemployment.

Evaluation

There might be a need for trade protectionism in the short term to protect employment, especially in industries that are crucial for the economy, especially those with sizeable employment in the country so that massive unemployment can be prevented (Extract 10 para 2).

But the costs to pursuing trade protectionism in the long term are very high. Countries that engage in protectionism are likely to face retaliation from its trading partners as this policy is likely to make them poorer. Eventually all parties will suffer from a reduction in exports and therefore lower growth and employment. Hence, the net result is everyone is worse off (Extract 10 para 3).

Conclusion

In general, countries can benefit globalisation if the government pursue the right set of policies. Besides engaging in policies that enhances its benefits, such as signing trade agreements, governments also need to ensure that the costs are managed with appropriate policies, so the costs do not outweigh the gains.

Trade protectionism is not a viable long-term solution to address most of the problems a country faces. While there are short term gains from protectionism, the costs of trade protectionism are higher in general as the net result is a reduction of world trade volumes which can negatively impact the country in the long run.

Level	Description	Mark
2	For a balanced and well-developed answer that explains the benefits and/or costs of embracing globalisation and pursuing trade protectionism with good reference to the case materials. For a one-sided answer that only explains the benefits and/or costs of embracing globalisation or pursuing trade protectionism – max 5	5-7
1	For a descriptive or less developed answer explaining the benefits of embracing globalisation and the costs of pursuing trade protectionism.	1-4
	Evaluation	
E2	A valid, well-argued evaluative judgement with an appropriate substantiation that is relevant to the issues raised in the context.	2-3
E1	Relevant point conclusion that is not elaborated nor substantiated.	1