

2022 A-Level P2 Question 6

Singapore's Prime Minister has stated that 'Globalisation will be under pressure, but it is imperative for countries to cooperate, for businesses to operate across many geographies, to tap resources, to bring skills and talents and experiences together, and then serve markets all around the world.'

- a) Explain the benefits and costs of globalisation to Singapore. [10]
- b) Discuss the most appropriate policy measures that the Singapore government should tackle to increase the benefits and reduce the costs of globalisation. [15]

Part (a) - Question Analysis

Approach	Command Word	Explain
	Question Type	Consequences and effects
	Start point	Increase trade, capital flow and labour movement due to globalisation
	End Point	BUGPEES
Content and Context	Content	<ul style="list-style-type: none">- Benefits and costs of globalisation- AD/AS framework
	Context	Singapore

Introduction

Globalisation, a double-edge sword, refers to the integration or inter-connectedness of national economies through trade of goods and services, capital flows and labour migration. Singapore will see an increase in trade, capital flows, labour flows and in competition. Globalisation will help Singapore achieve the four macroeconomic objectives of sustained economic growth, low inflation, low unemployment, and a healthy balance of trade (BOT) position. However, globalisation also makes Singapore more susceptible to threats from global recessions and foreign competition.

Body Point 1: Benefits of globalisation to Singapore.

1. As a small and open economy, Singapore can benefit from access to external markets and capital due to the increase in trade.
 - Due to the differences in opportunities costs and factor endowments, it would be beneficial for countries to produce goods that they have comparative advantage in and to trade with each other.
 - With skilled labour and an increased access to capital, Singapore has a comparative advantage in capital-intensive industries producing high-end chemicals and pharmaceuticals products. The production of these goods in Singapore will incur a lower opportunity cost which leads to an increase in trade with these goods.

- In addition, the signing of Free Trade agreements and the removal of tariffs have facilitated better trade relations between Singapore and other countries such as United States, South Korea, China. Etc.
- Singapore will have greater access to the export market where the rise in exports is greater than the fall in imports. Hence, there will be an increase in Singapore's net exports (X-M), which in turn increases aggregate demand (AD) from AD1 to AD2 as shown in the Figure 1 below.
- With an increase in trade due to globalisation, it will also enable Singapore to acquire imports of higher quality of factor of production which increases productive capacity and potential growth in Singapore.
- In addition, with an increased in levels of trade, consumers in the trading companies with Singapore will be able to consume the goods at lower prices and will enjoy a greater variety of goods and services. This increases their material standard of living.
- **Multiplier effect:** As seen from figure 1, the increase in AD will result in a multiplied increase in real income. When there is an increase in national income, it will induce more consumption in the economy. National income will now rise by another round and will further increase consumption, production, output, and income.
- This process will then continue, with each round of increase becoming smaller; until the rise in income is too small to generate any further consumption.
- Through this multiplier process, the initial increase in investment expenditure would lead to an eventual increase in national income.
- From figure 1, this increase in investment expenditure leads to a multiplied increase of national income from Y1 to Y2, hence leading to higher actual growth.
- There is also a fall in demand-deficient and cyclical unemployment as the derived demand for labour to produce goods and services increases.

or

2. Globalisation **brings about freer flow of capital and labour, and the inflow of foreign direct investment (FDI)** has played an important role in boosting actual growth and potential growth in Singapore.
 - Globalisation brings about an increase in international capital flows such as the transfer of ideas, knowledge, skills, technology, and foreign direct investments.
 - Singapore relies heavily on attracting FDI to drive growth and will have to maintain an attractive corporate tax rate to attract inflows.
 - The inflow of FDI will increase Singapore's aggregate demand from AD1 to AD2 as shown in figure 1 and hence achieving actual growth and a decrease in unemployment.

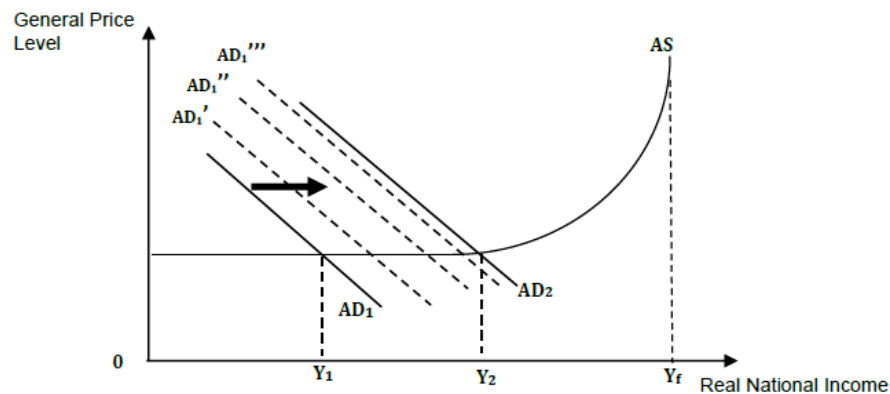


Figure 1: Impact of an increase in AD on the equilibrium level of real national income and general price level

- For example, there is an increase in investments in capital in sectors such as petrochemical, electronics, pharmaceuticals, machinery, and equipment in Singapore.
- This will boost Singapore's productive capacity and hence decreases inflationary pressures in the long run. In addition, the inflow of technology and skills will increase the quality of the factors of production, and this increases LRAS and potential growth.
- The freer mobility of labour enables more inflow of foreign talents will help with the transfer of knowledge and this improves the quality of human capital. This would as a result increases the productive capacity and potential growth of Singapore.
- The access to cheaper foreign labour and imported raw materials will also lower cost-push inflation in Singapore. This raises the short run aggregate supply curve from AS1 to AS2 as shown in Figure 2.
- There is also a decrease in general price levels from P1 to P2 because of the increase in productive capacity from greater quantity of capital and labour resources.
- Additionally, there will be a decrease in wage-push and import-push inflation due to access to cheaper foreign labour and imported raw materials that globalisation brings.

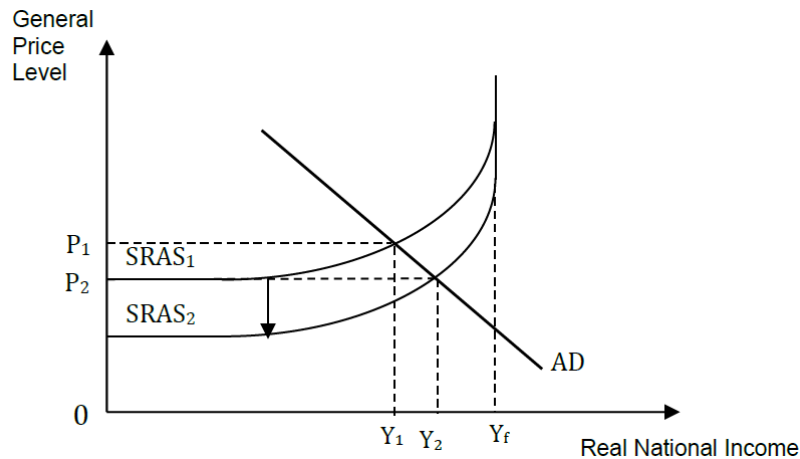


Figure 2: Impact of an increase in AS on the equilibrium level of real national income and a fall in general price level

Body Point 2: Costs of globalisation to Singapore.

3. With globalisation, Singapore will have **a greater reliance on external demand because of an increased in trade. This would make Singapore more susceptible to external shocks.**
 - Singapore would also be susceptible to the effects of global price changes as Singapore is heavily reliant on other countries for imported goods.
 - For example, Singapore experienced higher imported inflation due to the supply shock caused by the Russia Ukraine crisis.
 - The rising costs of imported raw materials was caused by inflation in other countries. The higher cost of production because of the increasing costs of raw materials would lead to a fall in SRAS and leading to an increase in cost-push inflation

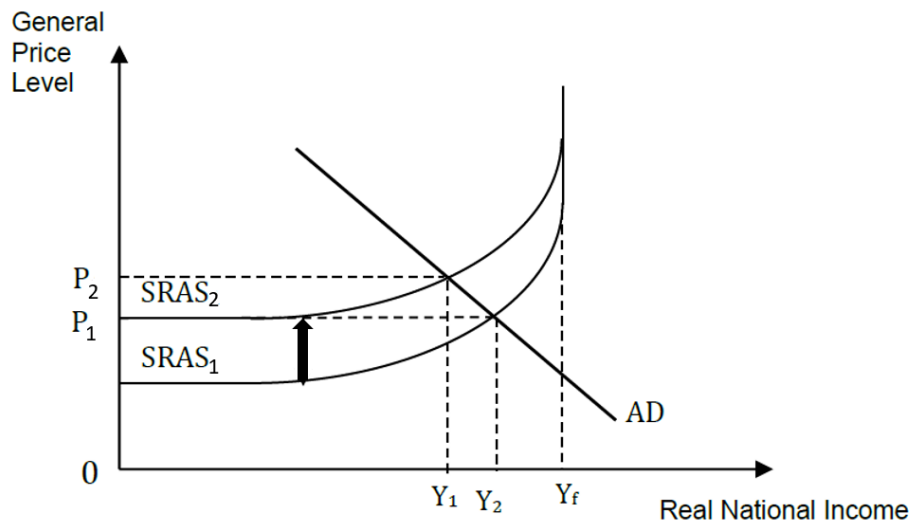


Figure 3: Impact of a decrease in SRAS on the equilibrium level of real national income and a rise in general price level

- With an increase in trade, Singapore may face an increase in structural unemployment.
- With a greater access to trade, there will be greater access to imported goods and services. This would lead to an increase in import expenditure and could worsen Singapore's Balance of Trade position.
- Globalisation may also cost Singapore to lose its comparative advantage to more innovative countries over time.
- Without relevant skillsets, workers would not be able to transition quickly to the sunrise industries, hence this leads to occupational labour immobility, and this will lead to structural unemployment.
- Additionally, globalisation will allow for a greater access to cheap foreign labour. They might displace the more expensive local workers. This would result in higher unemployment for these local workers and a widening of income gap among Singaporeans.

Conclusion

- There are both benefits and costs of globalisation to Singapore. As an open and small economy, Singapore will benefit extensively from an increased in free trade, freer flow of capital and labour to better fulfil her macroeconomic goals. On the other hand, Singapore would also be susceptible to economic and global shocks, and this may affect her macroeconomic performance.

Mark Scheme

Level	Knowledge, Understanding, Application, Analysis	Marks
L3	<p>Full display of AO1, AO2 and AO3 skills:</p> <p>For an answer that shows well-developed explanation of both the benefits and costs of globalization in Singapore</p> <ul style="list-style-type: none"> • clear and accurate explanation of both the benefits and costs with appropriate ADAS diagrams • appropriate examples of benefits and costs that are related to Singapore 	8-10
L2	<p>Uneven display of AO1, AO2 and AO3 skills:</p> <p>For an answer that shows under-developed explanation of the benefits and costs of globalization in Singapore</p> <ul style="list-style-type: none"> • lacks depth of analysis (i.e., limited effective use of relevant economic analysis or gaps in diagrammatic analysis) • lacks scope in explaining either benefits or costs of globalisation. • lacks appropriate examples of benefits or costs of globalisation 	5-7
L1	<p>Limited display of AO1 and AO2 skills:</p> <p>For an answer that shows limited knowledge of the benefits and costs of globalization in Singapore</p> <ul style="list-style-type: none"> • listing of points, unexplained statements, or descriptive response • many conceptual errors • irrelevant response • smattering of points • mere definition of relevant concepts 	1-4

b) Discuss the most appropriate policy measures that the Singapore government should tackle to increase the benefits and reduce the costs of globalisation. [15]

Part (b) - Question Analysis

Approach	Command Word	Discuss: provide relevant arguments based on different perspectives and a reasoned judgement
	Question Type	Policies
	Start point	Consequences of globalisation
	End Point	Policy measures
Content and Context	Content	<ul style="list-style-type: none"> • How each policy works and its limitations • Using FIRST framework in evaluating policies to tackle the consequences of globalization
	Context	Singapore

Introduction

- Presented with the diverse consequences of globalisation, the Singapore government plays a paramount role in maneuvering the city-state to maximise the benefits while minimizing the costs of globalisation.
- Singapore could consider enhancing our free trade agreements to increase benefits of globalisation through the diversification and increased access to export markets. Meanwhile, supply-side policies via skills upgrading and targeted tax rebates could be implemented to reduce the costs of globalisation.

Body Point 1: Embracing free trade agreements (FTAs) would bring out closer economic integration while reducing the cost of imports (ie. increasing benefits of globalisation).

- As a major trading nation, the Singapore government adopts the signing of Free Trade Agreement (FTA) to secure our economic ties and access to foreign markets, increasing global competitiveness. An FTA is a legally binding agreement between two or more countries to bring about closer economic integration.
- As of 2022, Singapore's trade architecture boosts 14 bilateral and 13 regional FTAs, providing Singapore-based businesses with access to preferential markets, free or reduced import tariffs, as well as enhanced intellectual property (IP) regulations. It also helps to diversify and increasing access to Singapore's export markets and reduce its vulnerability to supply shocks and recession faced by a single trading partner.
- With the removal of trade barriers, there would also be a decrease in price of Singapore's exports, boosting our export price competitiveness. Through establishing many trade ties with different economies, Singapore firms can export to a larger market, reaping substantial internal EOS due to the large output. Thus, they may lower the cost of production and may pass on to consumers in terms of lower prices. The lowering of average cost of production shifts SRAS to the right from SRAS₁ to SRAS₂, causing a fall

in the general prices from P_1 to P_2 in Figure 2, alleviating cost push inflation. With lower prices, this boosts the export competitiveness and provides Singapore a global competitive edge.

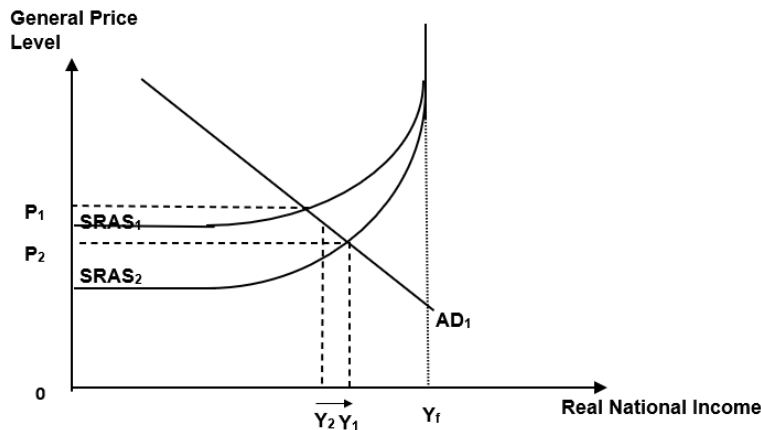


Figure 3: Impact of FTAs on SRAS

Intermediate Evaluation

- In signing these FTAs, domestic firms would face greater competition as there is an increase in flow of goods to Singapore, and the potentially cheaper imports would cause consumers to switch away from domestically produced goods.
- If Singapore firms are unable to compete, they may have to shut down instead of benefiting from having greater access to a bigger market. This could then undermine the benefits of signing FTAs.
- Moreover, the retrenched workers from these firms (which are unable to face up to competition from foreign firms) might not be able to enter the new industries as they lack skills required in the new industries, leading to structural unemployment.
- As such, to ensure the effectiveness of this trade policy, the government should ensure that domestic firms engage in supply side policies, to continuously innovate and stay competitive.

Body Point 2: Adopting supply-side policies would ensure Singapore's competitiveness as a trading and investment hub (ie. reducing costs of globalisation)

- A cost of globalisation includes greater accessibility to imported goods and services which were unavailable domestically, increasing import expenditure and possibly worsening Singapore's BOT. Similarly, if consumers switch from domestically produced goods to imported goods (due to perceived or real differences), this will result in a fall domestic consumption and thus fall in AD, resulting in higher demand deficient unemployment and lower/negative actual growth.
- Singapore may also consider providing more targeted tax rebates to foreign investment about technological advancements, allowing for the transfer of knowledge to industries in

Singapore and encouraging R&D efforts in product and process innovation. This allows Singapore to gain comparative advantage in sectors she seeks to develop, enhancing export price and non-price competitiveness. As firms improve their production techniques, the unit cost of production decreases, increasing SRAS from SRAS1 to SRAS2 in Figure 3, enabling producers to pass on the cost savings to consumers in the form of lowered prices. The lowered prices will improve price competitiveness of our exports in the global market. Meanwhile with R&D to improve product quality, this would improve exports' non-price competitiveness. Taken together, demand for exports and export revenue would increase, assuming $|PED_x| > 1$, reducing the costs of globalisation.

- Structural changes might also occur in the economy when Singapore specialise in industries with comparative advantage. Under the theory of comparative advantage, labour is perfectly mobile and those retrenched from the industries that lacks CA will be able to move into these sunrise industries. However, in reality, due to the lack of requisite skills, these workers are not able to transit immediately into the sunrise industries, leading to occupational labour immobility and hence structural unemployment.

Intermediate Evaluation

- Whilst this supply-side policy of more targeted tax rebates to incentivize R&D would ensure export competitiveness in the long run, it does not bear outcome immediately. It takes time to come up with substantially better production techniques and innovative products. Firms might also still not be willing to carry out R&D due to its high costs and uncertain outcome, especially with poor economic outlook.

Body Point 3 (optional): Employing fiscal policies to overcome susceptibility to external conditions as a small and open economy (ie. reducing costs of globalisation)

- As Singapore is more susceptible to external shocks, given that we are a small and open economy, the government can employ expansionary fiscal policy to promote economic growth.
- As countries become over-reliant on trading partners, they become susceptible to external shocks, which can be transmitted from one country to another through various channels such as trade and financial spillovers which can worsen economic situations of countries already embroiled in recession.
- A recent example would be the economic recession brought about by the Covid pandemic which impacted economies around the world, including Singapore's. The government implemented a slew of fiscal policies, rolling out the Resilience, Fortitude and Solidarity budget, spending billions of dollars in government spending.
- Also, transfer payments such as the Covid-19 Recovery Grant also work through the aggregate demand (AD) via an increase in consumption as households' disposable income increase.
- Assuming that the economy is operating with much spare capacity available, an increase in government spending with the slew of fiscal policies would result in an increase in AD.
- The economy then faces an unplanned running down of stocks of capital goods, with firms stepping up production of capital goods by hiring more resources such as labour (ie.

derived demand), leading to factor owners receiving extra income, raising national income in the first round. This induces more consumption in the economy. The additional consumption by the first group of factor owners will now create additional income for another group of factor owners in the economy. National income will now rise by another round, albeit by a smaller amount. This process will then continue, with each round of increase becoming smaller; until the rise in income is too small to generate any further consumption.

- This is represented by the rightward shift of AD from AD1 to AD2 in Figure 1. Assuming *ceteris paribus*, this results in a multiplied increase in real national income through the multiplier effect, from Y1 to Y2. Demand-deficient unemployment is also reduced as a result.

Intermediate Evaluation

- However, relying on expansionary fiscal policies to stimulate growth would not be feasible in the long run due to Singapore's small multiplier size.
- Due to our resource constraints and heavy reliance on imports, Singapore has a high marginal propensity to import (MPM). We also have a high MPS, due to our strong saving culture, and mandatory savings scheme via Central Provident Fund (CPF).
- With a small multiplier size, the increase in AD will bring about a smaller intended benefit in terms of increase in real national income, limiting the effectiveness of expansionary fiscal policy to stimulate its economy. In other words, to achieve the intended increase in national income, the government would have to increase G by a much larger amount, which may be an impediment bearing in mind the impact on Singapore's fiscal budget position.

Body Point 4 (optional): Employing a gradual and modest appreciation of the Singapore dollar to overcome the threat of imported inflation and demand-pull inflation (ie. reducing costs of globalisation)

- Modest and gradual appreciation will allow Singapore to better manage its threat of imported inflation. Given that Singapore has poor factor endowment and relies heavily on imports for raw materials and necessities like food, the hike in global prices would contribute to significant inflationary pressures.
- Appreciation will cause prices of imports to be cheaper in domestic currency, and with a price inelastic demand, quantity demanded increases less than proportionately, and import expenditure will fall. Assuming *ceteris paribus*, balance of trade improves as import expenditure falls.
- Also, the decrease in price of imports in domestic currency lowers the costs of imported factors of production, lowering unit costs of production for producers. Firms respond by partially raising output and lowering GPL. □
- SRAS will increase and shift downwards from SRAS1 to SRAS2 in Figure 3, leading to a fall in GPL from P1 to P2, curbing imported inflation.
- Take for example in 2022, the Monetary Authority of Singapore (MAS) re-centred upwards the policy band and further increased its rate of appreciation. This was in view of inflation arising from shocks to global commodity prices and supply chains in the wake of reopening of economies from the Covid-19 pandemic, as well as the Russia-Ukraine war.

Intermediate Evaluation

- However, the appropriateness of the modest and gradual appreciation would in fact be limited by the contractionary effects on Singapore's economic growth.
- Appreciation will cause prices of exports to be more expensive in foreign currencies, negatively affecting export price competitiveness. Assuming demand for exports to be price elastic, as SG does not produce unique (ie. highly substitutable) goods and services, an increase in prices of exports will lead to be more than proportionate fall in quantity demanded, leading to a fall in export revenue (X) and therefore a fall in AD, exacerbated by the fact that X is a major component of AD in the context of our export-driven economy.
- Assuming that Singapore's economy is operating with limited spare capacity, AD cuts AS along the intermediate range. With a fall in AD, via the reverse multiplier process, this results in a multiplied decrease in real national income.

Summative Evaluation

- In conclusion, given the multi-faceted nature of globalisation, a multi-pronged approach implemented by the government would be appropriate in positioning Singapore to maximise its benefits and minimize its challenges. Amidst the backdrop of rising worldwide protectionism sentiment and global recession brought about by Covid-19 and given the nature of Singapore's economy and heavy reliance on trade, trade policies like FTAs are extremely important as they are the *superhighways*- laying the foundation for the economy to connect to other major economies, which will be complemented with other policies.
- In the short run, Singapore can employ the use of fiscal policy with supply-side slant, while depending on gradual and modest appreciation in the medium term and allowing the effects of supply-side policies to come to fruition in the longer term.
- In the short run, supply side policies to improve global competitiveness through boosting productivity might have limited effectiveness. These measures require time for the mind-set of various stakeholders to change. Meanwhile, fiscal policies are effective in the short run to quickly cushion the negative consequences owing to susceptibility to external conditions. Meanwhile, adopting modest and gradual appreciation is important to instill confidence and create a stable environment for businesses to function and investment expenditure to take place, ensuring our attractiveness to investment and global competitiveness, raking in FDI.
- The government also must be cognizant of the ever-changing global economic conditions and assess the appropriateness of the policies based on the current state of the economy (boom or recession) and its immediate government priorities (in the midst of conflicting macroeconomic and/or microeconomic goals).

Mark Scheme

Levels	Descriptors	Marks
L3	Displays full slew of skills across AO1, AO2 and AO3: <ul style="list-style-type: none">• A balanced and well-developed answer	8-10

	<ul style="list-style-type: none"> • Correct application of various policies to tackle both benefits and costs of globalization • Accurate and fully labeled diagrams • Use good examples to support analysis on costs and benefits of protectionism 	
L2	Displays AO1, AO2 and AO3 skills: <ul style="list-style-type: none"> • An under-developed response • Inconsistent of application of of various policies to tackle both benefits and costs of globalization • Incorrect diagrams drawn • No examples given 	5-7
L1	Uneven display of AO1 and AO2 skills: <ul style="list-style-type: none"> • Many conceptual errors • No economic framework in analysis • Superficial explanation • Question requirement is not addressed 	1-4
Evaluation		
E3	Well-reasoned judgements: <ul style="list-style-type: none"> • A well-reasoned judgement about the appropriateness of different policy measures in tackling the consequences of globalisation • Question any unstated assumptions to arrive at this well-reasoned judgement. Good explanation of the limitations of the analysis 	4-5
E2	Largely unexplained judgements: <ul style="list-style-type: none"> • Some attempt to explain their judgement on the different policy measures 	2-3
E1	An unsupported judgement: <ul style="list-style-type: none"> • Mere evaluative statements or judgements that are neither supported nor relevant to any specific context 	1