

TAMPINES JUNIOR COLLEGE
JC2 PRELIMINARY EXAMINATION



ECONOMICS

Paper 1

9757/01

Friday, 25 Aug 2017

2 hours 15 minutes

Additional Materials: Writing Paper

READ THESE INSTRUCTIONS FIRST

Write in dark blue or black pen.

You may use a soft pencil for any diagrams, graphs or rough working.

Do not use paper clips, highlighters, glue or correction fluid.

Paper 1 (Case Study) [40%]

Answer **ALL** questions

Submit each Case Study separately.

The number of marks is given in brackets [] at the end of each question or part question.

Answer **all** questions.

Begin **each case study** on a **fresh sheet of paper**. Case study questions 1 and 2 are to be submitted **separately**.

Question 1 Private Hire Transport in Singapore

The taxi industry, made up of firms such as ComfortDelGro and Trans-cab, has been shaken by the entry of new private hire car services. Private hire services occur when a passenger books transport through a private hire car booking service operator such as Uber, which communicates the passenger's booking to a private hire car driver who carries out the transport booked. The number of rental cars has been on the rise as private hire service operators have been utilising more of these vehicles. As such, traditional taxi companies have been losing the bulk of their customers to them.

Table 1: Motor Vehicle Population by Vehicle Type in Singapore

	2010	2011	2012	2013	2014	2015	2016
Taxis	26,073	27,051	28,210	27,695	28,736	28,259	27,534
Rental Cars	13,347	13,919	14,862	16,396	18,847	29,369	51,336

Source: *Land Transport Authority*, accessed on 21 July 2017

Extract 1: ComfortDelGro introduces incentives

In order to compete with the private car hire services, ComfortDelGro is dangling double the reward points to lure commuters to hop onto its cabs within 24 hours of alighting from a bus or train ride. The points earned can be used to redeem a variety of rewards, including taxi vouchers or free transfers to the airport via its CabRewards website. For example, a S\$10 cab ride, which would typically earn commuters 10 Cabpoints under the CabRewards Programme, will translate into 20 Cabpoints under the initiative, called CabRewards, which was launched on Wednesday. For every 83 Cabpoints, commuters can get an instant discount of 50 cents off their cab fare, up to a maximum discount of S\$10.

When asked if its latest move is aimed at beating competition from the likes of ride-hailing firms Grab and Uber, Mr Ang, the CEO of ComfortDelGro Taxi Business said: "Competition is everywhere, and we have to come up with a unique value proposition ... that will benefit our commuters."

ComfortDelGro has also started offering its flat taxi-fare option, which costs slightly less in general compared with metered trips or those booked on ride-hailing apps, whether during off-peak hours in the afternoon or the evening peak period. Taxi drivers with the company said that the new option would help them get more rides, adding that passengers would stand to gain since they do not have to pay more during jams, and the surcharges that come with cashless payments.

However, ComfortDelGro also needs to consider its ability to continually keep the price of its taxi services low, in light of the costs it needs to bear such as the recently introduced volume-based tax of S\$0.10 per litre on automotive diesel, which is needed for ComfortDelGro's

diesel-run vehicles. In order to keep costs manageable, ComfortDelGro has reduced their taxi fleet to 15,863, which is a significant fall from 16,281 in December 2016.

Source: *Various*

Extract 2: Price war between Uber and Grab

Competition is also occurring between the private hire operators themselves. The fight between Grab and Uber has been a long and sustained one, buttressed by the fact that both private ride-hailing companies are financially capable of dragging one out. The war strategy utilised by Grab and Uber is one of predatory pricing. Through this, the companies keep the price of rides for passengers down, all with the singular goal of eliminating the competition. Once that has been achieved, the victor gets a hold of the entire market demand.

Uber, owing to its presence worldwide has been successful in operating in loss-making markets. The losses incurred in these countries are supported by the gains they make in other markets where they have a stronger hold. Secondly, even though Uber has constantly been reporting losses and a burning through of their war chest, the company continues to raise money. In June 2016, Uber raised \$3.5 billion from Saudi Arabia and the very next month, another \$1.15 billion. As such they have a massive war chest with which to compete, thus allowing them to cover any losses they might be making in countries where their market penetration rate is low.

Adapted from: *AsiaOne*, 25 February 2017

Extract 3: Can Uber ever make money?

Uber's challenge now will be to shift its model from one that has been very successful at revenue growth, to one that is more financially sustainable and, eventually, profitable. Some economists say there is no obvious way to do that. "There is no clear pathway I can see for Uber to go from a high-revenue growth company to a profitable company," says Aswath Damodaran, a Professor of Finance at the Stern School of Business. "Normally the story for start-ups is that as revenues grow economies of scale will kick in, but that story is tough to tell with Uber."

Uber has between \$6.5 billion and \$7 billion of unrestricted cash in the bank, with a further \$2.3bn untapped line of credit. This could cover the company's cash needs for roughly three more years. Uber's path to sustainability will depend on controlling the company's two main costs: the subsidies for drivers, and general costs such as engineering and research and development. These general costs benefit from economies of scale — as Uber grows, the overhead becomes less expensive on a per-ride basis.

The fact that switching costs are so low between one service and the other — riders can easily flip between the apps — means that it can be hard for Uber to defend its market dominance. Uber has been experimenting with a different revenue model through subscriptions — offering a monthly membership "pack" to frequent riders (one example might be a \$20 monthly fee that buys the rider 20 shared rides for \$2 each). "Subscription models are always very beneficial," says Santosh Rao, Head of Research at Manhattan Venture Partners. "There is visibility, and it is a nice recurring revenue model."

On the other hand, Grab is planning to introduce new features such as more sophisticated technology, like telematics for monitoring speeding, braking, and swerving, which are intended to encourage safer driving behaviour. This was in response to recent rise in numbers of accidents that involved ride-hailing services.

Adapted from: *Financial Times*, 23 June 2017

Questions:

- (a) Compare the changes in the motor vehicle population between taxis and rental cars from 2010 to 2016. [2]
- (b) With reference to Extract 3,
- (i) Deduce the value of the cross elasticity of demand between Uber and Grab. [2]
- (ii) Explain how Grab's plan to introduce new features may change the value of the cross elasticity of demand between Uber and Grab. [2]
- (c) With the aid of a diagram, explain if ComfortDelGro or its consumers will bear more of the burden that arises from the introduction of the diesel tax. [3]
- (d) Explain how inefficiency is worsened if Uber is successful in "eliminating the competition". [3]
- (e) Discuss whether the entry of Uber will necessarily lower ComfortDelGro's profits. [8]
- (f) Discuss the factors that Uber would consider when deciding on its strategies to compete with its rivals. [10]

[Total: 30]

Question 2**Generation NEET***

[NEET* refers to a young person who is Not in Education, Employment or Training.]

Extract 4: Why is unemployment so high?

The latest euro-area unemployment figures show that the overall unemployment rate has crept down to 11.1% from its peak of 12.1% in April 2013. Despite the good news, another problem in the form of long-term unemployment (generally defined as being out of work for over 12 months) has emerged in the nineteen-member currency union. Of the 19 million jobless Europeans, more than half have not worked for the last year. And over 15% have not had a job for more than four years.

Unsurprisingly, the problem is most severe in southern Europe where a protracted crisis pushed up overall unemployment, and with it long-term joblessness. So why is it so tough for Europeans to get back to work?

Part of the reason lies in labour mobility. A mere 2.8% of Europeans have moved to a different country in the EU for work. Language barriers, cultural differences and non-transferable qualifications make it much harder for them to find a new job. Generous unemployment benefits in Europe also tie would-be workers to one place and make getting work less urgent. In the UK jobless workers qualify for only 24 weeks of unemployment benefits and only if they are actively searching for a job. Many euro-area countries support the unemployed for more than a year.

One cause of the differing joblessness rate is actually a symptom of a healthier labour market in Europe. Another reason for falling unemployment is partly because discouraged workers are dropping out of the labour force. In Europe the opposite is true: the workforce has actually grown, which pushes up unemployment rates.

Adapted from: *The Economist*, 2015

Extract 5: Rusty skills and stagnant growth

The effects of youth unemployment can persist for years. Those who begin their careers without work are more likely to have lower wages and suffer joblessness again later in life. The economic losses can be substantial, too, and not just in the form of higher welfare payments. Part of these losses may be due to missing out on training and experience accumulation that typically occurs with young workers. But younger workers typically change jobs at much higher rates than their older counterparts, and these job switches are responsible for most of a worker's wage growth early in a career. Workers forced into bad matches or no matches end up on a productivity trajectory well below what they might otherwise have expected. One estimate suggests that the total economic loss from youth unemployment was equivalent to 1.2% of GDP in Europe in 2011.

But all this bodes ill for single currency. Long-term unemployment can be self-sustaining: the longer someone is out of work the harder it is to get back in, hence discouraged workers will drop out of labour force. Other difficulties arise too. Fertility rates, already falling in Europe, tend to drop off and life expectancy can decline when joblessness rates are high. The problem is not universal though.

Denmark and Germany have kept both long-term and overall unemployment low through job training programmes, flexible labour laws and education. Apprenticeships in Britain have increased in recent years, for example. There is evidence too that companies are investing more in the young and revamping their training programmes. New technology is providing educational opportunities to people who might otherwise remain outside the job market.

Adapted from: *The Economist*, 2015

Extract 6: The EU unwisely slides towards protectionism

The forces of protection within the EU have been growing in strength, and it was the recent conversion of Germany to the cause that will probably tip the balance. The new EU policy on antidumping and anti-subsidy duties is a bleak foreshadowing of a Europe in which the defenders of free trade are either switching sides, like Germany, or leaving the field, like the UK. It may bring some short-term political relief to governments whose voters are complaining about globalisation leading to the loss of jobs. In the longer term, though, it will do nothing to build the kind of modern, profitable sectors that will lead European economic growth.

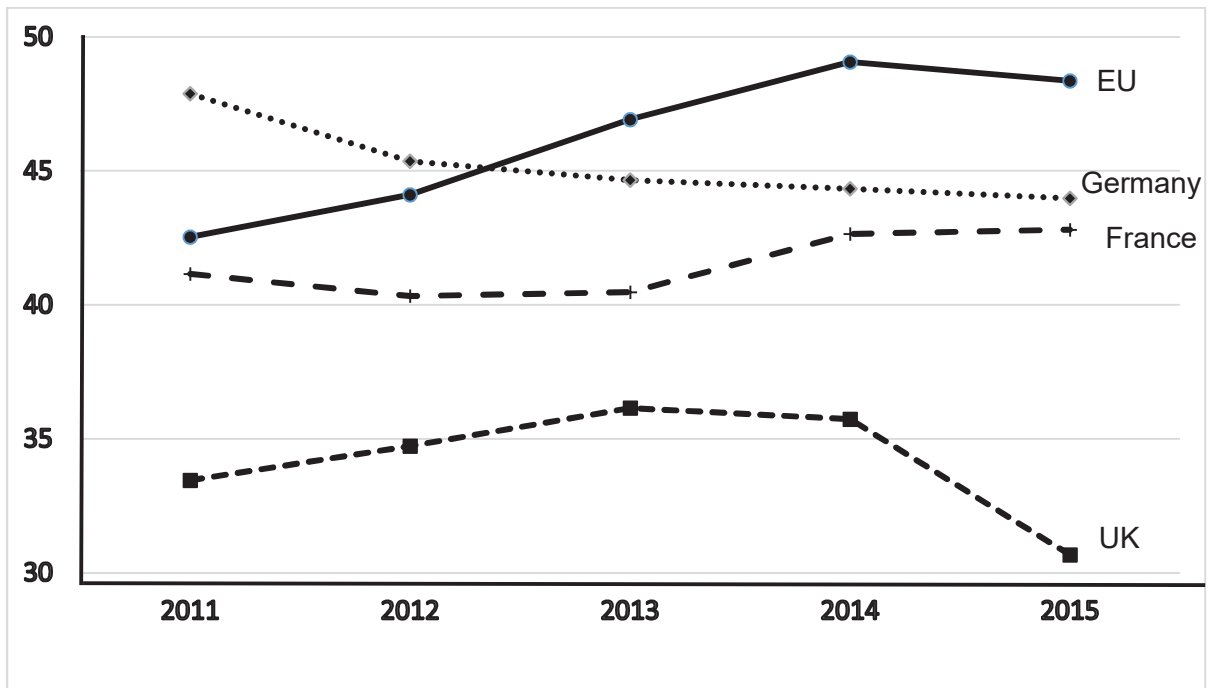
Adapted from: *The Financial Times*, Nov 2016

Extract 7: France reviews its 35-hours working week

France is reforming its 35-hour working week in a move that could sound the death knell of two-hour lunches and early departures for weekend breaks. The short working week was introduced in the 1990s with the aim of spurring job creation. But many employers say it has escalated labour costs and handicapped French companies struggling to compete in global markets. Companies currently have to pay between 10 and 50 per cent extra per hour if they want employees to work more than 35 hours a week, but they are now to be given the right to renegotiate longer hours and lower overtime pay with staff. The changes are fiercely opposed by trade unions which cherish the short working week as a sacrosanct right and view any move to tamper with it as undermining one of the foundations of France's social model. The progressive and business-friendly economy minister, Emmanuel Macron, 37, a former Rothschild banker, wants the government to go further and scrap a current legal requirement to pay overtime of at least 10 per cent more than the standard pay rate. That would be tantamount to abolishing the short week altogether, a course Mr Macron indicated he favoured at the Davos summit last week in order to put French companies on more of a level footing with their foreign competitors.

Adapted from: *The Telegraph*, January 2016

Figure 1: Long-term unemployment in Europe Union and selected member states (as % of unemployment rate)



Source: *OECD Data*, Accessed on 21 July 2017

Table 2: Fiscal positions of selected countries (as % of GDP)

Country	2011	2012	2013	2014	2015
France	-5.10	-4.81	-4.04	-3.93	-3.59
Germany	-0.96	-0.03	-0.19	0.29	0.69
UK	-7.52	-8.24	-5.57	-5.65	-4.35

Table 3: Unemployment rates of selected countries (as % of labour force)

Country	2011	2012	2013	2014	2015
EU	9.60	10.42	10.81	10.21	9.39
France	8.81	9.40	9.92	10.30	10.36
Germany	5.83	5.38	5.23	4.98	4.62
UK	8.04	7.89	7.53	6.11	5.30

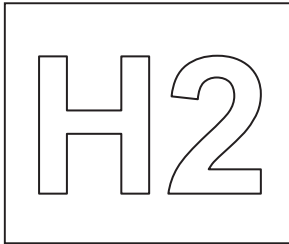
Source: *OECD Data*, Accessed on 21 July 2017

Questions:

- (a) (i) With reference to Figure 1, compare the trends in long-term unemployment rates between EU and UK. [2]
- (ii) Account for the differences in trends observed above. [4]
- (b) Explain, with the aid of diagram(s), the impacts of long-term unemployment in the UK on: [6]
- (i) its labour market.
- (ii) its economy.
- (c) Using relevant case materials, discuss the considerations of a government in their decision to address unemployment. [8]
- (d) Discuss why the EU has decided to implement a different policy from that of the UK and French government to resolve unemployment, and consider which approach is likely to be more effective. [10]

[Total: 30]

END OF PAPER



**TAMPINES JUNIOR COLLEGE
JC2 PRELIMINARY EXAMINATION**



ECONOMICS

Paper 2

9757/02

Tuesday, 12 Sept 2017

2 hours 15 minutes

Additional Materials: Writing Paper

READ THESE INSTRUCTIONS FIRST

Write in dark blue or black pen.

You may use a soft pencil for any diagrams, graphs or rough working.

Do not use paper clips, highlighters, glue or correction fluid.

Paper 2 (Essay) [60%]

Answer **THREE** questions in total, of which **one** must be from Section A, **one** from Section B and **one** from **either** Section A or Section B.

Submit each section separately.

The number of marks is given in brackets [] at the end of each question or part question.

Answer **three** questions in total.

Begin **each question** on a **fresh sheet of paper**. Section A and B are to be submitted **separately**.

Section A

One or two of your three chosen questions must be from this section.

1. Water is a necessity. Across the globe, countries are working to supply drinking water to its people, through taps or subsidising bottled water. However, there are increasing calls for government to tax bottled water instead, since these plastics are not biodegradable and cause pollution.

Brand of Natural Mineral Water (500 ML)	Retailer/Country	Price (SGD)
Volvic	NTUC/Singapore	\$1.50
Evian	Giant/Singapore	\$1.75
Suisai no mori	Epermarket/China	\$3.05
Volvic	Tesco/UK	\$0.89

Accessed on: Various websites, 10 July 2017

Discuss the possible reasons why prices of bottled water differ across firms and countries. [25]

2. “Lemon laws” are laws protecting consumers against defective goods that fail to conform to contract, or meet satisfactory quality or performance standards at the time of purchase, colloquially known as “lemons”.

Source: <http://sbr.com.sg>

- (a) Explain, with supporting examples, how information failure might lead to market failure. [10]
- (b) Evaluate the policies currently used by the Singapore government to correct information failure in different types of products. [15]
3. Globalisation has brought about both opportunities and challenges. Some firms have capitalised on this phenomenon to expand overseas. Netflix, an over-the-top (OTT) video streaming service from America which provides on-demand video content over the Internet, has begun its foray into international markets since 2011.

Source: The Business Times, January 21, 2017

- (a) Explain possible factors affecting Netflix’s decision to enter the Singapore’s OTT market. [10]
- (b) In the light of globalisation, discuss whether it is beneficial when firms increase in size. [15]

Section B

One or two of your three chosen questions must be from this section.

4. Japan has repeatedly pursued government intervention in the hope of revitalising its economy weakened by deflation, debt and ageing demographics. Japanese Prime Minister Shinzo Abe's three-pronged approach combines fiscal expansion, quantitative easing, and structural reform to boost economic growth while raising inflation to 2 percent.

Source: Council on Foreign Relations, 10 February 2017

- (a) Explain the reasons why governments aim to achieve sustained economic growth, a healthy balance of payments and a low rate of inflation. [10]
- (b) Discuss whether conflict in macroeconomic objectives is the most important reason that underlies Japan's three-pronged approach to achieve her macroeconomic objectives. [15]

5. The economic environment of Singapore has been challenging, with the world economy yet to fully recover from the financial crisis while a clear growth driver has yet to emerge as major powers like the United States and China continue to grapple with reform and recovery. All these have had a dampening effect on global trade, and by extension, Singapore's small and open economy.

Adapted from The Straits Times, 2016

Discuss the extent to which Singapore has control over her economic performance. [25]

6. The withdrawal of United States from the Trans-Pacific Partnership (TPP) and Britain's Brexit are outcomes powered by anti-globalisation sentiments. Some countries have adopted anti-globalisation measures such as imposing higher tariffs on imported goods, higher taxes on domestic firms moving abroad and implementing anti-immigration laws to address the challenges of globalisation.

Source: Adapted from MTI, 6 Feb 2017 & The Guardian, 9 November 2016

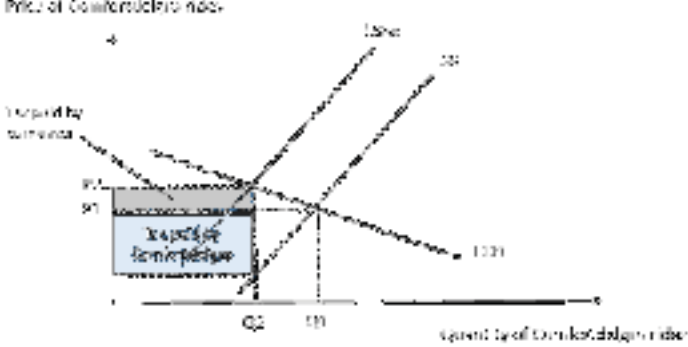
- (a) Explain the underlying reasons why some countries are embracing the move towards anti-globalisation. [10]
- (b) Discuss whether countries should adopt anti-globalisation policies to address the challenges of globalisation. [15]

END OF PAPER

H2 P1 CSQ 1

Suggested Answers

(a)	Compare the changes in the motor vehicle population between taxis and rental cars from 2010 to 2016.	[2]
	<p>Similarity: The motor vehicle population for both taxis and rental cars increased from 2010 to 2016.</p> <p>Difference: The motor vehicle population for rental cars increased at a faster rate as compared to that of taxis.</p>	
	With reference to Extract 3,	
(b) (i)	Deduce the value of the cross elasticity of demand between Uber and Grab.	[2]
	<p>Extract 3 states that “riders can easily flip between the apps”, indicating that they are close substitutes. Therefore the value of the cross elasticity of demand between Uber and Grab is positive and of a high magnitude ($EAB > 1$) due to the high degree of substitutability between the ride-hailing services that the 2 firms offer. If the price of Grab rides rise, the demand for Uber rides would rise more than proportionately.</p>	
(b) (ii)	Explain how Grab’s plan to introduce new features may change the value of the cross elasticity of demand between Uber and Grab.	[2]
	<p>Extract 3 states that Grab is “planning to introduce new features...which are intended to encourage safer driving behaviour.”</p> <p>Grab’s new features would cause the degree of substitutability between Grab and Uber to be reduced as consumers see Grab as a safer option as compared to Uber.</p> <p>This would cause the value of the cross elasticity of demand between Uber and Grab to be reduced but still be a positive value.</p>	
(c)	With the aid of a diagram, explain whether ComfortDelGro or its consumers will bear more of the burden that arises from the introduction of the diesel tax.	[3]

	 <p>The introduction of the diesel tax will increase the cost of production for Comfortdelgro, reducing profit levels and causing supply curve to shift leftwards from SS to SStax.</p> <p>Demand for Comfortdelgro rides is relatively more price elastic compared to that of supply due to the availability of substitutes such as Uber services.</p> <p>Comfortdelgro has to bear a greater tax burden. (as shown by the larger area showing tax paid by Comfortdelgro)</p>	
(d)	<p>Explain how inefficiency is worsened if Uber is successful in “eliminating the competition”.</p>	[3]
	<p>If Uber is successful in “eliminating the competition”, this will increase its share of the market and increase its market power, bringing about greater market dominance, and causing a worsening of allocative inefficiency.</p> <p>With greater market power, Uber will be able to charge prices much higher than MC. Price will be more than marginal cost to a greater extent than before the competition was eliminated.</p> <p>There would be a rise in allocative inefficiency.</p>	
(e)	<p>Discuss whether the entry of Uber will necessarily lower ComfortDelgro’s profits.</p>	[8]
	<p>Introduction</p> <p>Profits consists of total revenue minus total cost. Therefore how ComfortDelgro’s profits are affected will depend on the effect of Uber’s entry on ComfortDelgro’s cost and revenue.</p> <p>Thesis: The entry of Uber would lower Comfortdegro’s profits</p>	

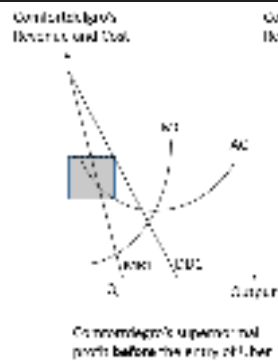


Figure 1

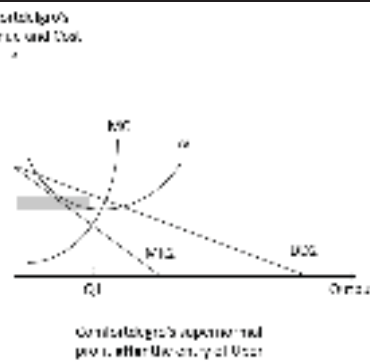


Figure 2

Due to Uber's entry, demand for Comfortdelgro's services becomes more price elastic due to an increase in the availability of substitutes that consumers have when deciding on which transport provider to use.

The slope of the demand curve changes from DD1 to DD2. Assuming that cost conditions for Comfortdelgro remains the same, supernormal profits have fallen as shown by the smaller shaded area as seen in Figure 2.

Antithesis: The entry of Uber would not necessarily lower Comfortdelgro's profits.

[students are expected to write any 2 anti thesis points]

As seen in extract 1, Comfortdelgro has taken steps to address the competition from Uber.

Comfortdelgro has introduced CabRewards, where points earned can be used to redeem a variety of rewards, such as taxi vouchers or free transfers to the airport. This could change the preferences of consumers to choose Comfortdelgro and lead to an increase in demand for their services. Total revenue would increase.

Comfortdelgro also started its flat taxi-fare option, "which costs slightly less in general compared with metered trips or those booked on ride-hailing apps." This would effectively be a fall in price of Comfortdelgro rides if consumers use this option. With demand being price elastic due to high availability of substitutes, the fall in price would lead to a more than proportionate rise in quantity demanded. Total revenue would rise.

Furthermore, a reduction in Comfortdelgro's fleet will also reduce its cost of production. For example, there would be less cost incurred due to vehicle maintenance and fuel.

A rise in total revenue and a fall in cost of production due to Comfortdelgro's strategies could indicate that the entry of Uber will not necessarily lower ComfortDelgro's profits.

Conclusion

The extent to which Uber’s entry affects ComfortDelgro’s profits will depend on several factors such as the time period. If Uber is unable to continue offering incentives to consumers if its funds are used up in the long run, ComfortDelgro may then be able to gain back market share and increase revenue and profit.

Mark Scheme

Level	Descriptor	Marks
L2	For a response that addresses both how profit may or may not be affected.	4-6
L1	For a one-sided response For a response that lacks rigour	1-3
E	For a stand with justification	1-2

(f) Discuss the factors that Uber would consider when deciding on its strategies to compete with its rivals. [10]

[students need to explain at least 3 factors]

Introduction

There are several factors that a firm would consider when deciding on its strategies to compete with its rivals. The strategies would involve pricing and non-price behaviour.

Factors that Uber would consider:

1. Amount of funds available [constraint]

If a firm has a large amount of funds, it will be better able to make use of strategies such as engaging in a price war. The objective would be to compete via price competition in order to drive out its competitor from the market. Thereafter the firm would gain a larger market share and would be able to charge higher prices. Having more funds than the competitor would allow it to sustain the price war for a longer period as losses would be expected in the short run. Extract 3 states that Uber has between \$6.5bn and \$7bn of unrestricted cash in the bank. This availability of these funds would allow Uber to decide on whether or not to engage in a price war, which it did as shown in Extract 2.

2. The objectives of the firm

There can be various objectives of a firm. For example, Extract 2 mentions that Uber is a “high-revenue growth company” which may indicate that its objective is to maximise revenue, rather than profit. Since their objective is to maximise revenue, they would produce up to the point where $MR=0$. This would mean that their pricing would be

lower than if their objective was profit maximisation where $MC=MR$ and price would then be set higher.

3. The cost considerations

One of the factors that the firm would consider when deciding its strategy is how the strategy would affect its costs. For example, the firm would be willing to engage in a price war in order to gain market share as this would give it a larger output and thus help the firm achieve internal economies of scale, lowering average cost of production. Extract 2 states that “as revenues grow economies of scale will kick in”. Thus they would be more willing to engage in a price war even though it results in losses in the short run. Examples of internal EOS include managerial EOS, where specialists can be employed to manage the firm. In other words, division of labour can be introduced into tasks of management. Different experts can be employed to take charge of planning, accounting, sales promotion and personnel management. Extract 3 states that “as Uber grows, the overhead becomes less expensive on a per-ride basis.”

Evaluation: However the extract also states that “that story is tough to tell with Uber” which may indicate that the firm is not able to gain the economies of scale that it expects. One other outcome could be that instead of gaining EOS, Uber has diseconomies of scale instead.

4. Actions of competitors

Uber needs to consider the actions of its competitors such as Grab or ComfortDelgro. In such an oligopolistic market, firms such as Uber and Grab and highly rival conscious and mutually interdependent. Extract 3 states that Grab is planning to introduce new features such as more sophisticated technology to improve safety. In order to remain competitive, Uber would also therefore need to respond by engaging in research and development in order to improve the quality of its services.

Conclusion

Uber has to consider the various factors in order to decide on its strategies. As there could be a limit to the amount of funds Uber has as well as a limit to how much EOS can be gained, the best way that Uber can compete against its rivals would then be to focus on research and development so as to increasingly differentiate its services and therefore be less vulnerable to the actions of competitors.

Mark Scheme

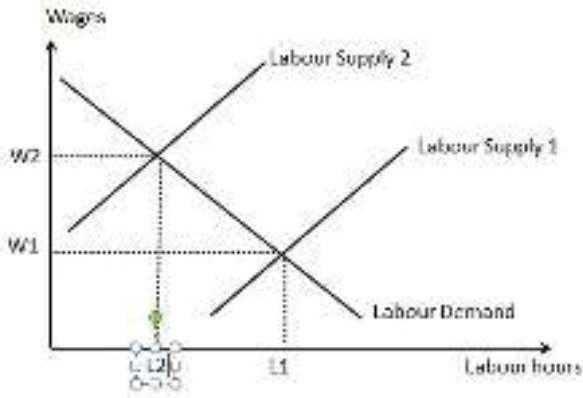
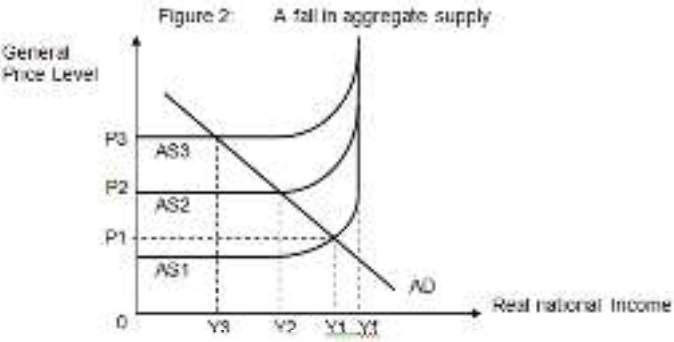
Level	Descriptor	Marks
L2	For a range of factors that are well developed	5-7
L1	Limited number of factors considered Factors not fully explained	1-4
E	For a reasoned judgement	1-3

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H2 P1 CSQ 2

Suggested Answers

a)	i)	With reference to the data, compare the trends in long-term unemployment rates between UK and Europe.	[2]
		Difference: UK's long term unemployment rate is consistently lower than that of EU. Difference: UK's long-term unemployment rate is falling while that of EU is rising <i>1 mark each</i>	
	ii)	Account for the differences in trends as observed from above.	[4]
		Reason for higher unemployment in EU: From Extract 4: EU has been experiencing increase in labour force. Assuming labour demand is constant, a rise in labour supply will lead to a higher unemployment rate. OR From Extract 4: EU faces geographical immobility. There are language, cultural differences and qualifications are not transferable across countries Reason for rising unemployment rates in EU: From Extract 4: EU offers more welfare benefits than UK. Reduces incentive for EU unemployed to seek employment.	

b)	<p>Explain, with the aid of diagram(s), the impacts of long-term unemployment in UK on:</p> <p>i) its labour market. ii) its economy.</p>	[6]
	<p>i) Long-term unemployment erodes confidence and skills of labour.</p> <ul style="list-style-type: none"> - Discouraged workers will cease to seek employment actively. - This reduces labour supply and results in an increase in wages from W1 to W2.  <p>The diagram shows a labour market with 'Wages' on the vertical axis and 'Labour hours' on the horizontal axis. A downward-sloping 'Labour Demand' curve is intersected by two upward-sloping 'Labour Supply' curves. The initial equilibrium is at the intersection of 'Labour Supply 1' and 'Labour Demand', corresponding to wage W1 and labour hours L1. A leftward shift to 'Labour Supply 2' moves the equilibrium to wage W2 and labour hours L2, where L2 < L1.</p> <p>ii) With the increase in wages, there will be an increase in costs of production. This erodes profit margins and incentive to produce. SRAS falls resulting in an increase in general price level from P1 to P2 and a fall in real output from Y1 to Y2.</p>  <p>Figure 2: A fall in aggregate supply</p> <p>The diagram shows 'General Price Level' on the vertical axis and 'Real national Income' on the horizontal axis. A downward-sloping 'AD' curve is intersected by three upward-sloping 'AS' curves (AS1, AS2, AS3). The initial equilibrium is at the intersection of AS1 and AD, corresponding to price level P1 and real output Y1. A leftward shift to AS2 moves the equilibrium to price level P2 and real output Y2, where Y2 < Y1. A further shift to AS3 would result in price level P3 and real output Y3.</p>	
c)	<p>Using case materials, discuss the considerations a government made in their decision to address unemployment.</p>	[8]
	<p>Government has to consider the potential benefits and costs of the policy</p> <p><u>Benefits:</u> <u>Improves fiscal positions in long run</u> From Table 2 and 3, fiscal deficits correspond with high unemployment for the European government. With high unemployment, tax revenues collected by governments will fall as tax bases fall. Similarly, transfer payments in the form of unemployment benefits rise as the number of</p>	

	<p>unemployed increase (from Extract 5). Hence, fiscal position tends to worsen to a deficit. Thus, addressing unemployment would reverse the trend of worsening fiscal position.</p> <p><u>Improves standard of living for households</u> Attempts to lower unemployment will generate higher general household income levels within the countries. This will lead to an improvement in material standard of living as the households will be able to afford more units of goods and services. From Extract 5, being employed will allow labour to undergo trainings and accumulation of experiences which enhance non-material standard of living. Furthermore, higher employment rates have a correlation to higher birth rates and better life expectancies. These suggest that with employment, households are able to better afford healthcare services as well, which improves non-material standard of living into the long run.</p> <p><u>Improves productivities for firms</u> From Extract 5, prolonged unemployment erodes skillset and productivity, which would lower production for firms. Lower output will erode profits for firms. Similarly, firms may face the problem of hiring labours with the right skills, and hence resort to offering higher wages to source for these labour. Likewise, this will translate to higher costs and therefore lower profits for firms.</p> <p><u>Improves outlook on economy</u> A higher employment improves outlook on economy. With a high employment rate, households are typically better equipped to consume goods and services. This will allow the firms to better plan expansion to their productions and contribute towards the accelerator effect. With a better outlook, the economy will be able to attract foreign direct investments as well. All of these will lead to increase in C and I and therefore AD and NY. Assuming investment to include capital accumulation, there will be improvement to productive capacity and increases to LRAS. Collectively these will generate sustained growth for the economy.</p> <p><u>Costs:</u> <u>Worsens fiscal position in short run</u> Policies to address unemployment such as trainings and job fairs incur costs and will worsen fiscal position. This is largely undesirable particularly with the fiscal deficits that are plaguing the countries from Table 2. Worsening fiscal positions tend to worsen outlook on economy, especially with the belief that taxes will rise in the near future to correct the deficits.</p> <p><u>Worsens allocation of resources to other areas</u> High unemployment leads to excessive expenditure on transfer payments which represent an opportunity costs as resources are diverted from other areas of concern eg: provision of public goods, merit goods, pension for retirees.</p> <p><u>Worsens productive capacity</u> Prolonged unemployment shrinks labour force as these workers lose their confidence and stop to seek employment actively. This represents fall in productive capacity and restricts growth of the economy.</p> <p><u>Stance:</u></p>	
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	<p>Governments have to consider short and long run implications. Generally, policy will be implemented so long as there is net benefit to society in the long run. In this case, the net benefits of addressing unemployment outweighs the costs of implementing policies for lowering unemployment. Alternatively, government can consider adopting market-oriented policies to address unemployment as it incurs less expenditure. Although, market-oriented policies may not ascertain as effectiveness an outcome as interventionist policies.</p> <p>Mark Scheme</p> <table border="1" data-bbox="339 528 1315 875"> <thead> <tr> <th data-bbox="339 528 517 600">Level of response</th> <th data-bbox="517 528 1198 600">Descriptor</th> <th data-bbox="1198 528 1315 600">Marks</th> </tr> </thead> <tbody> <tr> <td data-bbox="339 600 517 701">L2</td> <td data-bbox="517 600 1198 701">Balanced analysis on costs and benefits of addressing unemployment, with considerations to different stakeholders of the economy/time period.</td> <td data-bbox="1198 600 1315 701">4-6</td> </tr> <tr> <td data-bbox="339 701 517 772">L1</td> <td data-bbox="517 701 1198 772">One-sided analysis, with under-developed explanations.</td> <td data-bbox="1198 701 1315 772">1-3</td> </tr> <tr> <td colspan="3" data-bbox="339 772 1315 804">Evaluation</td> </tr> <tr> <td data-bbox="339 804 517 875">E</td> <td data-bbox="517 804 1198 875">Rationalised overall stance and judgment on government's priorities.</td> <td data-bbox="1198 804 1315 875">1-2</td> </tr> </tbody> </table>	Level of response	Descriptor	Marks	L2	Balanced analysis on costs and benefits of addressing unemployment, with considerations to different stakeholders of the economy/time period.	4-6	L1	One-sided analysis, with under-developed explanations.	1-3	Evaluation			E	Rationalised overall stance and judgment on government's priorities.	1-2	
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d)	<p>Discuss why EU has decided to implement a different policy from that of the UK and French government, and consider which approach is more likely to be effective.</p>	[10]															
	<p>1. Explain why EU has decided to implement protectionist measures to <u>resolve unemployment</u> (i.e explain how the policies work)</p> <p>From Extract 6, EU is leaning towards protectionist measures like anti-dumping and anti-subsidy duties on imported goods. These duties and tariffs will increase the price of imported goods and cause domestically produced goods (assume that they are close substitutes to imports) to be relatively cheaper. Hence, domestic consumers will switch their import expenditure over to that of domestic consumption. Hence, import expenditure may fall and domestic consumption may increase. This will serve to stimulate AD (through an increase in C and increase in (X-M)) and through multiplier process, generates increases in real output. With the increase in AD, there will be a decline in demand deficient unemployment.</p> <p>2. Explain why the UK and French government has decided to implement supply side policies (interventionist and market oriented policies respectively) to resolve unemployment.</p> <p><u>UK</u> The UK government have implemented supply-side policies like increasing expenditure on training programmes and apprenticeship to equip labour force with the necessary skills to remain employable and to improve labour mobility. This would aid in reducing structural unemployment (unemployment due to the mismatch of skills) as workers are now better equipped with relevant skills to move from one industry to another.</p> <p><u>France</u></p>																

The French government are reviewing the wage policies to consider the abolishment of the 35 hour work week and reforming the over time pay scheme (renegotiate lower over time pay for staff). This market oriented policy is implemented in a bid to lower the labour cost of firms as labour costs and higher productivity allow “handicapped French companies to compete better in global markets” since goods exported and produced locally in France can be sold at a more competitive price and this could increase net exports and potentially reduce demand deficient unemployment. Also, with lower labour costs, this could also encourage the inflow of FDI to set up their operations in France and this will provide more job opportunities for the locals and reduces unemployment.

3. Consider which approach is more effective

a) Depends on the root cause of the unemployment

While it appears both measures will reduce unemployment, it is important to consider the root cause and likely reactions to the policies. For EU, the root cause of unemployment appears to be a mixture of increasing labour force, overly generous welfare packages that reduced the incentive for the unemployed to seek jobs and external factors (emergence of low cost competitors due to globalisation). Although protectionism serves to stimulate demand for domestic labour, it is crucial to note that it is a double-edge sword that tends to draw retaliation from trade partners. This may results in trade partners imposing higher tariffs on EU causing a fall in AD through net export revenue instead. The fall in AD will lead to greater demand-deficient unemployment.

For the UK, the unemployment rate is generally lower than that of EU and falling. This suggests that the apprenticeship has proven to be effective in lowering unemployment. However, it is important to note that the funding of these programmes could have contributed to the fiscal deficits UK is suffering from. France is suffering from a higher and rising unemployment and long-term unemployment. This is detrimental to the French economy alongside with its fiscal deficit. The move to review its 35 hour work week may cause unhappiness amongst its labour, but prove to delight the firms, as longer working hours generally translate to higher output and therefore revenues.

2. Dependent on the time period and whether there is a need for more immediate solutions which depends on the urgency of the problem

Hence, it appears that the EU should instead consider incorporating the supply-side policies adopted by France and UK as it seems to be a less detrimental measure than protectionism. However, as supply-side policies generally require long gestation time period, the protectionism measure may be adopted only to address the high unemployment in the short run especially if immediate solutions are necessary to solve perennial high unemployment situation.

Lastly, it is important to note that EU is a body that governs the well-beings of members of the union. The protectionist stance it is considering is meant to complement the policies adopted by the respective European governments so that there will be a more effective outcome in resolving unemployment within the EU. Furthermore, protectionism has often been used a short run tool to buy time or to mitigate short run costs while supply side policies take effect.

Mark Scheme		
Level of response	Descriptor	Marks
L2	Balanced analysis on costs and benefits of addressing unemployment, with considerations the different countries/regions' unemployment problems.	5-7
L1	One-sided analysis, with under-developed explanation.	1-4
Evaluation		
E	<p>Unjustified stand on the preferred choice of policy.(1 mark)</p> <p>Rationalised overall stance and judgment on government's priorities and criteria for selecting the most appropriate policy to reduce unemployment.</p> <p>Consideration of a combination of policies to tackle the multiple causes of unemployment.</p>	1-3

Water is a necessity. Across the globe, countries are working to supply drinking water to its people, through taps or subsidising bottled water. However, there are increasing calls for government to tax bottled water instead, since these plastics are not biodegradable and cause pollution.

Brand of Natural Mineral Water (500 ML)	Retailer/Country	Price (SGD)
Volvic	NTUC/Singapore	\$1.50
Evian	Giant/Singapore	\$1.75
Suisai no mori	Epermarket/China	\$3.05
Volvic	Tesco/UK	\$0.89

Accessed on: Various websites, 10 July 2017

Discuss the possible reasons why prices of bottled water differ across firms and countries. [25]

Suggested Answer

Reasons why prices differ across firms

Demand and supply

- Differing DD
 - o differences in number of consumers
 - o caters to different taste and preferences → Differences in composition → mineral, alkalinity, oxygenation, bubbles
 - o future expectations → possibility of hurricanes, war etc, may lead to households hoarding bottled water
- Differing SS → differences in costs of production
 - o Differences in costs of advertising/packaging
 - o Differences in state of technology eg: desalination vs filtration
 - o Differences in government intervention: subsidy vs taxation
- Competitive demand → water required for irrigation or other forms of industrial needs eg: agriculture
- Differing Ep
 - o Firms facing price elastic demand are likely to lower prices to earn higher total revenue as quantity demanded increases more than proportionately eg: supermarkets which face extensive competition from other retailers
 - o Firms facing price inelastic demand are likely to raise prices to earn higher total revenue as quantity demanded falls less than proportionately. Eg: 24 hours convenient stores which face less competition after nightfall

- Differing Es
 - o Availability of factor inputs/stocks. With a price inelastic supply, any shift in demand will bring about a more than proportionate change in prices compared to changes to quantity.

Possible market structures firms are operating under

- Retailers like supermarkets → Oligopolies → Able to harness internal EOS → lower unit costs as scale of production increases, therefore able to pass on costs savings to consumers through lowering of prices
- Oligopolies may display price rigidity due to mutual interdependency, hence there might be evidences where prices of water are sold within a similar price range.
- Firms may attempt to increase their respective market shares through pricing competition, thus resulting in differing prices.
- Firms choose to pursue sales revenue maximization in the short run, and set production at $MR=0$, and charge a lower price.
- Possibility of government intervention where firms charges MC/AC pricing
- Cafes/Restaurants → MPCs → unable to harness internal EOS → higher unit costs which may translate to higher prices
- MPCs generally set prices independently, hence prices set by MPCs may differ vastly.
- Possibility of firms conducting price discrimination
 - o 2nd degree PD: 1-for-1 promotion will lower the average price of bottled water
 - o 3rd degree PD: Elderly/low-income concession may apply in certain countries where bottled water could be sold at a discounted rate.

Water as a merit good/necessity/equity concern

- subsidy to water → fall in costs of production → increase in SS → lower prices

Plastic bottles as a source of negative externality

- Taxation → $tax=MEC@Q_{soc}$ → raises MPC to same level as MSC → higher prices

Reasons why prices differ across countries

Differing/fluctuating exchange rates

- Bottled water which are imported may be subjected to volatility of the exchange rates, and thus resulting in prices which may deviate greatly from the price found in the country of origin

Differing tax rates

- Countries may have different tax rates. Eg: GST in SG is 7% while VAT in UK is 20%. Higher taxes will translate to higher costs of production resulting in differences in prices

Differing tariffs/Presence of FTA/Protectionism

- Imports are subjected to tariffs which may lead to higher prices of bottled water
- Should there be an existing FTA, the countries involved will charge a preferential tariff to each other and therefore different prices of bottled water

- For a country that is exporting bottled water, the government may apply protectionism to safeguard interests of the home industry. Therefore prices of bottled water may be higher

Possibility of inflation

- Costs-push inflation: wage-push inflation, rising wages leading to rising costs of production within the country. SRAS falls, GPL rises.
- Import price-push inflation: depreciation/devaluation of currency which makes import more costly, prices of imported water will increase
- Demand-pull inflation: Country experiencing rapid growth as AD shifts into intermediate/classical range of AS → increases in GPL along with increases to real NY. → increases in GPL will lead to higher prices of bottled water

Factors affecting Patterns of Trade

- Taste and preference for imported mineral water
 - o Consumers in China may have a preference for imported bottled water due to reports on their domestic sources being contaminated.
- Differences in factor endowment/Lack of portable water
 - o Countries which face water shortage will be importing water from other countries

Conclusion

- Depends on government's/country's perception of water
- And whether country has a ready supply of portable water
- Ultimately, water is a scarce resource. There has to be efforts to conserve it, otherwise with increasing scarcity prices of water will only increase.
- Penalty should be levied on water pollution/contamination → worsens the scarcity of water
- R&D efforts should be directed to supplying portable water to households in an efficient manner rather than developing a bio-degradable material for bottles.

Level of response	Descriptor	Marks
L3	Response with rigorous analysis of factors resulting in both firms and countries having differing prices for bottled water with points spanning both micro and macro L3-16m: For a scripts with a total of 5 points/only micro or macro considerations.	15-20
L2	Response citing factors for differing prices of bottled water, lacking scope or only consider firms or countries. L2-10m: requires at least 3 factors for both firms and countries.	9-14
L1	Response that listed factors with some errors in analysis.	1-8

H2 Economics Prelim

Essay 1

E3	Insightful comments pertaining to the 3 stakeholders and how they may be affected.	4-5
E2	Comments on possible development on prices of bottled water.	2-3
E1	Unsubstantiated judgment	1

2. “Lemon laws” are laws protecting consumers against defective goods that fail to conform to contract, or meet satisfactory quality or performance standards at the time of purchase, colloquially known as “lemons”.

Source: <http://sbr.com.sg>

- (a) Explain, with supporting examples, how information failure might lead to market failure. [10]
- (b) Evaluate the policies currently used by the Singapore government to correct information failure in different types of products. [15]

Suggested answer for (a)

Introduction:

Define market failure → Market failure describes the circumstances in which distortions prevent the price mechanism from allocating resources efficiently, resulting in welfare loss.

Define Information failure → Individuals or firms lack information that is required for them to make economic decisions. In perfectly competitive markets, consumers and firms have perfect information, i.e. perfect knowledge about prices, costs and benefits of goods and services. However, in the real world, there is a great deal of ignorance and uncertainty. As a result, economic agents are unable to equate marginal benefit with marginal cost, such that they are unable to produce and consume at the allocative efficient price and output level.

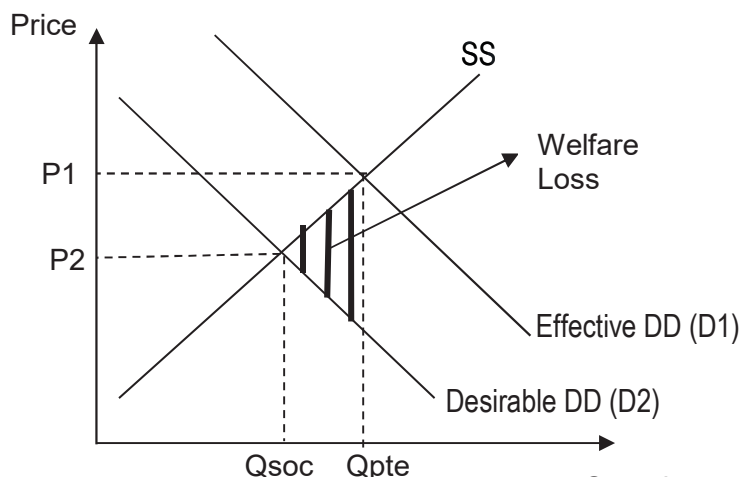
Information failure can be caused by:

- Imperfect information
- Asymmetric information, which in turn leads to the problems of
 1. Adverse selection, and
 2. Moral hazard

Body/Essay Development:

Imperfect information - Underestimation of the true costs / benefits

Using the context of cigarettes, the lack of knowledge of the true costs of cigarette smoking results in overconsumption of cigarettes, as some consumers are not aware of the harmful health effects of cigarette smoking on their bodies, hence they tend to underestimate the true private costs of demerit goods. For example, smokers may not be fully aware of the health risks of smoking or may underestimate the chances of contracting smoking-related illnesses.



As consumers do not fully realise the true harmful effects of the product, demand is registered at D1. Private consumers will consume at Q_{pte} . However, the government feels that because of the undesirable qualities of demerit goods, less should be consumed. The desired level ('correct' level) of demand, as perceived by society, should be at D2. Q_{soc} is the socially efficient level of output. Due to the underestimation of the true private costs, there is an overconsumption of the demerit good resulting in misallocation of resources and hence leading to market failure.

Asymmetric information - Adverse Selection

Adverse selection occurs when a product or service is predominantly demanded by a certain group of economic agents who could offer the lowest level of return for other economic agents.

Using the context of the 2nd hand car market, used car dealers often have more information regarding the condition of the used cars being sold than potential buyers have. For instance, dealers would probably have knowledge of the true mileage of the car, whether the car has met with any road accidents, and if so, how many and to what extent, as well as whether the car has any defects that are unnoticeable by the naked eye. In order to profit from the sale of used cars, used car dealers might have the incentive to hide some of the information that they have about the condition of used cars from potential buyers.

If buyers have the information to distinguish between lemon (low quality car) and gem (high quality car), they could strike fair trades with the respective sellers – the gem-owner receives a high price for the good quality car while the lemon-owner receives a low price for the lower quality car. However, in the real world, there is asymmetric information. As explained above, used car sellers have more information about the condition of their secondhand car as compared to potential buyers. Since buyers cannot spot the quality difference, there will only be one market for all used cars, and buyers will only be willing to pay the average of the prices of lemons and gems. Note that the average price is **below** the minimum that a gem-owner will require, so gem-owners will exit the market as they are unwilling to offer their good quality cars for sale. This will result in a situation where only lower quality cars (lemons) are being sold.

Asymmetric information thus results in the used car market adversely selecting against higher quality used cars, in favour of used cars of a lower quality. This is a distortion of incentives, hence resulting in an inefficient market outcome, where there is a "missing market" leading to market failure – gems are pushed out of the market, leaving only lemons.

Asymmetric information – Moral Hazard

Moral hazard is a situation in which economic agents take greater risks than they normally would, because the costs that result would not be borne by the economic agents themselves. Here, the information asymmetry is due to the fact that the buyer knows more about his/her intended actions than the seller.

Using the context of health insurance, if an individual is not insured, the he/she is more likely to take care of his/her own health, for instance, by exercising, taking health supplements or even going for annual health check and visiting the hospital less frequently. However, if the individual was to insure himself/herself with health insurance at full value by adding on rider payment, he/she would be fully covered, and will not lose out in the event of hospitalization, as he/she will not be required to pay both the deductible and the co-payment. As a result, the individual will have less incentive to take care of his/her health and visiting the hospital over minor ailments. They may even have an incentive to seek more expensive and even riskier services that they would otherwise not require. There is hence moral hazard in that,

because the individual, because of the availability of the health insurance, may be less inclined to take care of himself/herself, since the payment from an insurance company lessens the burden on the individual in the case of an admission to the hospital.

Conclusion:

Justification for government intervention → Government intervention is therefore necessary to solve the market failure caused by information failure so as to improve resource allocation so as to increase welfare of the society. (link to part (b))

Knowledge, Application, Understanding and Analysis		
L3	Good, clear, rigorous explanation of 3 types of information failure as a source of market failure with diagram analysis. Showing clear understanding and application with supporting examples.	7-10
L2	An explanation and illustration of how presence of information failure might lead to market failure. Undeveloped answer that is weak in economic analysis or is lacking in examples. Answer lacks scope in that only 1 of the 2 types of information failure was covered.	5-6
L1	An answer showing some knowledge of the source of market failure (information failure). But analysis is weak and erroneous, showing little / no understanding of how the different form of information failure leads to market failure. No examples at all or examples are irrelevant or inappropriate	1-4

Suggested answer for (b)

Introduction:

Government intervention in the case of information failure aims to improve information flow between consumers and producers, or to help both buyers and sellers value the actual cost and/or benefit of a good or service.

The various policies currently used by the Singapore government to correct information failure in different types of products are:

- Imperfect Information → Education or Campaigns
- Adverse Selection → Legislation – Lemon Law
- Morale Hazard → Co-payment

Body/Essay Development:

Imperfect information – Education & Campaign

To reduce the information failure on merit / demerit goods, the government can through the use of education or campaigns, help the consumers to be more informed of the true costs and benefits of the products they are purchasing so as to allow them to make informed choices. Some examples include education fairs, education on preventive healthcare in schools, and anti-smoking campaigns. Educational campaigns could be held by the government or non-profit organisations to educate people of the negative effects smoking has on oneself. The government could also educate the child while they are in school on the harmful effects of smoking through classroom lessons and educational videos in hope of deterring them from forming the habit since young.

For example, Singapore began her massive anti-smoking campaigns in 2007 such as the “I Quit” campaigns which started in 2011, in which smokers pledged to quit smoking. They would receive daily tips and encouragement via SMS and social media, as well as calls from Health Promotion Board (HPB) counsellors, to monitor their progress. HPB also organise a month-long smoking control campaign annually to focus attention on smoking. Such campaign would aim to coincide with WHO’s annual “World No-Tobacco Day” on 31 May. Singapore has implement ongoing public education on smoking control throughout the years and targets all sectors of society, with emphasis on preventing youths from starting to smoke. Over the years, public education has conveyed a variety of messages. These included information about harmful effects of smoking, passive smoking and the addictive nature of smoking, encouraging youths to stay smoke-free using role models (eg popular TV stars, sportsmen), promoting the benefits of a healthier smoke-free lifestyle and encouraging non-smokers to help a friend or someone close to stop smoking.

However, such educational approach and campaigns are not enforceable by law and mainly serves as an encouragement and its effectiveness is dependent on the receptivity of the recipients coupled with the reinforcement of the message from the family. People may not heed the advice due to ingrained habits that are hard to change, e.g. cigarette addiction. Moreover, financing education and campaigns may be costly and it takes time for campaigns to take effect, so this method does not offer immediate solutions to more pressing, urgent problems.

Asymmetric information: Adverse Selection - Legislation

In the case of complex products such as electronic devices or cars, legislations are imposed to force firms to provide more information to consumers, or to prohibit or restrict false or misleading advertising. This creates a legal incentive to facilitate the flow of information between economic agents between the buyers and sellers.

For example, In Singapore, there is the Consumer Protection (Fair Trading) Act, also known as the lemon law. Lemon Law was imposed to protect consumers against defective goods - for consumers to get their money's worth when purchasing a product. It strengthens upon the existing Consumer Protection and Hire Purchase Acts and helps consumers to receive a standardised solution when they have unintentionally bought a defective product colloquially known as 'lemons'. The new Lemon Law provides a transparent and legal framework for both buyers and sellers when faced with return claims. Under the law, consumers can report a defective item within a period of six months from delivery. Under a two-stage recourse framework, the retailer has an obligation to prove that the reported defect did not exist at time of delivery. The Lemon Law can be applied in two stages. For the first stage, the consumer can request repair for reported problem or parts replacement within a specified time frame. The second stage takes effect if the fault is not fixable, the problem persists even after repair or the repair is not satisfactory. In this scenario, you can request for a price reduction - while keeping the product or returning for a full refund. If the seller does not comply, the issue can be brought up to the Consumers Association of Singapore (CASE), which is a non-profit, non-governmental organisation whose aim is to protect the interest and welfare of consumers.

Lemon Law benefits consumers whom have unintentionally bought a defective or 'lemon' product including second hand cars, and would like a repair, refund or replacement from the seller. Singapore has often been perceived as a shopper's paradise and thus, such a law will assure consumers that products they purchase here are of good quality. This in turn improves the image of the retail industry in Singapore.

However, the use of legislation requires firms to provide more information to consumers will raise their costs of production. They may in turn pass on the higher costs to consumers in the form of higher prices, or compromise on the quality of their services. There is also difficulty in enforcement and ensuring compliance. There are also high administrative costs involved in legislation where high costs are incurred in sending government officials to check and monitor that laws are being followed. Furthermore, reporting a case of a defective good to CASE may incur a transaction cost such as the cost of time and the cost of transport. If the value of the good is low relative to the transaction cost, the buyer may be reluctant to file a report even if the good is found to be defective. Therefore, they may decide to not purchase the good.

Asymmetric information: Moral Hazard – Co-payment

In the case of insurance markets involving moral hazard, it is possible to create insurable risks through the use of co-payment. In such cases, the insured patient will be required to pay an excess before claiming the insurance pay-out so that individuals will still prefer to take care of his/her health to avoid hospitalisation and not seek more expensive and even riskier services that they would otherwise not required, not being hospitalised than the converse but the insurance will still offsets some of the medical bill.

For example, in Singapore, all Singaporeans and Singapore Permanent Residents are covered by MediShield Life from 1 November 2015. MediShield Life is a basic medical expense insurance. It is the national healthcare insurance scheme run by the CPF Board and

can help you with medical expenses from major illnesses and prolonged hospital stays at the Class B2/C level. MediShield Life has claims limits which is the maximum amount you can claim from MediShield Life depends on the claim limit for each type of expense, such as the daily ward charges and the type of treatment or surgery undertaken, and operates on a deductibles and co-insurance basis. Under MediShield Life, the maximum claim limit per policy year is set at \$100,000 with no lifetime limit on claims. The deductible is the fixed amount payable by the insured each policy year (the year following his policy renewal month) before the MediShield Life payout kicks in. It helps to sieve out small claims, which can be paid using Medisave and/or cash, and helps to keep premiums affordable. The deductible is payable only once every policy year. The co-insurance is a percentage of the claimable amount which you have to pay, on top of the deductible. The larger the bill, the lower the co-insurance payable. Under MediShield Life, the co-insurance rate ranges from 10% to 3% as the bill size increases. Such a policy and usage of deductible amounts is an incentive for the insured to cut down on services and to avoid making claims.

However, it must be noted that it is difficult to ascertain the ideal amount of deductible and co-payment to be set in order to prevent moral hazard. As a co-payment clause in an insurance policy will require the insured to pay a proportion of the cost they incur in the event of a claim, it may induce some individuals to be reluctant to buy insurance for their health.

Conclusion:

In conclusion, a range of policies and approaches which seek to bridge the information gap through various platforms is crucial. Consumers will need to be educated on the products prior to purchase and important information regarding the products will need to be explicitly indicated through labelling. Furthermore, consumers can also harness the use of Internet to research and learn more about the products through the official websites and read up on reviews by other consumers who have purchased the products to reduce information failure.

It can be noted that all examples of measures mentioned above to reduce adverse selection and moral hazard can be seen as forms of legislation that are undertaken by Singapore government. Legislation, as compared to other types of policies, ensures certainty of outcomes and this is a major strength of legislation. Mandatory consumption for instance, the MediShield Life, is the best policy as it is able to resolve both moral hazard and adverse selection, with the best certainty in outcome. The success of provision of information to resolve asymmetric information, on the other hand, depends on the ability of firms to collect accurate and updated data. Similarly, despite lemon laws, consumers may not be in the best position to make judgement on the condition of the goods.

Government will also have to consider its budget position when implementing policies to correct information failure especially for education and campaigns which require substantial government funding. For the case of Singapore face with a budget surplus, we have no issue with funding of education and campaign to correct market failure. However, it must also be noted that for a thorough decision-making process, further information will have to be collected on benefits and costs of the next-best alternative use of funds, and will feature as the opportunity cost of introducing the campaigns.

Knowledge, Application, Understanding and Analysis		
L3	Clear and well-developed answer that explains 3 policies (at least 1 policy each for the 3 different types of information failure) that the government can undertake to solve the market failure. Policies explained are thoroughly evaluated with constant use of real world examples applied to the Singapore context.	8 – 10
L2	Good explanation on at least 2 relevant policies that the government can undertake to solve the market failure. Some attempt at evaluation and limited usage of real world examples	5 – 7
L1	Identification of various policies used by the Singapore government. Brief explanation of the given government measures with irrelevancies and errors.	1 – 4
E3	For a well-explained judgement that is supported with economic reasoning.	4 – 5
E2	For an underdeveloped justification of stand made, one that is lacking in economic rigour.	2 – 3
E1	For an unjustified stand/unexplained judgement made. Listing instead of explanation.	1

TPJC JC2 Preliminary Examination 2017
EQ3 – Question and Answers

Question

Globalisation has brought about both opportunities and challenges. Some firms have capitalised on this phenomenon to expand overseas. Netflix, an over-the-top (OTT) video streaming service from America which provides on-demand video content over the Internet, has begun its foray into international markets since 2011.

Source: The Business Times, January 21, 2017

- (a) Explain possible factors affecting Netflix's decision to enter Singapore's OTT market.
[10]
- (b) In the light of globalisation, discuss whether it is beneficial when firms increase in size.
[15]

Suggested Answers

- (a) Explain possible factors affecting Netflix's decision to enter Singapore's OTT market. [10]**

Introduction

The objective of all firms, at least in the long run, is to maximise profits, by maximising total revenue and minimising total costs. In deciding on its strategies, a firm like Netflix needs to consider the impact of its behaviour and decisions on its revenue and costs. It will also need to consider the impact of external circumstances. In the first part of the essay, we will explain possible factors that affect Netflix's decision to enter Singapore's OTT market.

Body (any 3 well-explained factors)

Factor 1: Barriers to entry

One of the factors that Netflix needs to consider in its decision to enter Singapore's OTT market is that of barriers to entry (BTE). BTEs are obstacles, either natural or artificially imposed, to prevent potential entrants from entering the industry, thereby restricting competition. One natural BTE that Netflix needs to consider is that of start-up costs. If the start-up costs are high, perhaps due to huge infrastructure outlays and technological investment, then Netflix might not want to enter the industry as it would incur substantial costs. If the costs turn out to be too high, they would earn subnormal profits. However, in this context, Netflix is a well-established brand with most of its services already developed and distributed online. As such, start-up costs in terms of infrastructural development are likely to be low, signalling that BTE are low and it is beneficial for Netflix to enter Singapore's OTT market, since it does not incur significant entry costs.

Factor 2: Impact on revenue

Another possible factor that influences Netflix's decision to enter Singapore's OTT market is the impact of Netflix's entry on their revenue.

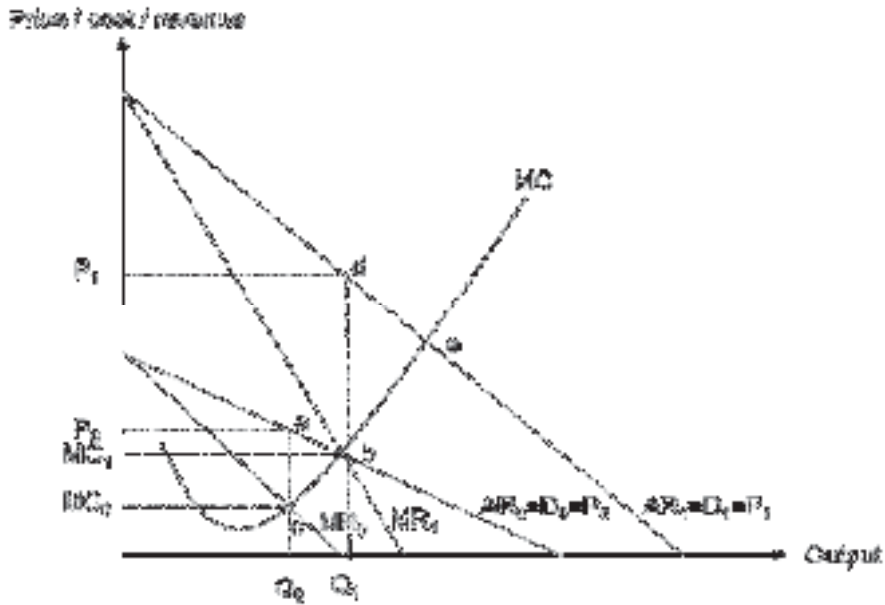
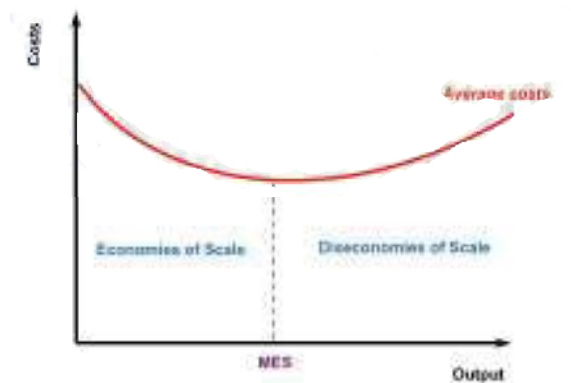


Figure 1: Increase in TR from Netflix's international foray

Netflix is a firm originating from the USA. By tapping into international markets such as Singapore, Netflix's market share will increase, thereby increasing its total revenue. With a greater customer base, the higher market share means an increase in demand for Netflix's services. Originally, Netflix produced at the profit maximising output level Q_0 , where the marginal cost (MC) curve intersects the marginal revenue (MR) curve MR_0 , and corresponding price P_0 . With its international foray, Netflix's demand/average revenue (AR) curve shifts rightwards from AR_0 to AR_1 , with their MR curve following suit. This increases both the profit maximising output and price to Q_1 and P_1 respectively, thus leading to an increase in total revenue from P_0Q_0 to P_1Q_1 . In such a situation, Netflix is likely to enter the OTT market.

It is not definite that entering Singapore's OTT market means an increase in Netflix's revenue. Netflix's revenue might not increase significantly if there is a lack of demand for Netflix's services, for instance, if consumers still prefer to watch live-air TV. However, this is probably not the case in Singapore, as consumer tastes and preferences have changed towards a preference for on-demand content due to busier lifestyles and perhaps an inclination towards instant gratification. Hence, it is likely that Netflix's revenue will increase.

Factor 3: Impact on costs of production



Another factor that affects Netflix's decision to enter the OTT market is the impact of its entry on its costs of production. By entering into international markets, Netflix expands its scale of

production beyond the USA. As long as Netflix is still operating below the minimum efficient scale, it will be able to reap greater internal economies of scale (iEOS), which is defined as the decrease in average cost of production from a greater scale of production. One example of the iEOS it can reap is that of marketing EOS, where Netflix is now able to spread its advertising costs over a large range of output. As advertising costs are fixed costs of production, the larger scale of production beyond USA means that the per unit advertising cost is lower. With lower costs of production, Netflix's profits would increase, ceteris paribus, and Netflix should enter the OTT market in Singapore.

However, keeping the factor of costs in mind, Netflix also needs to consider if its entry into Singapore's OTT market would result in the firm operating beyond the MES and suffering internal diseconomies of scale (iDOS) instead, where an increase in the scale of production would unfortunately lead to higher average costs instead. For instance, costs of production might increase due to a lack of co-ordination between Netflix employees from the different countries, leading to a fall in productivity of workers.

Furthermore, entry into Singapore's OTT market would also directly increase Netflix's costs as it would have to incur start-up expenses to penetrate the market, such as the cost of setting up its office. Ultimately, though, Netflix's decision on whether to enter the market depends on whether the increase in revenue (as explained in the first point) exceeds the increase in cost of production, i.e. if they foresee an increase in profits. If the costs incurred are likely to exceed the increase in revenue, they might decide to stay away instead to avoid a loss in profits.

Factor 4: Economic outlook

A third factor that affects Netflix's decision on whether to enter Singapore's OTT market is the current economic outlook in Singapore. If the economic outlook is positive, it will be more likely that Singaporeans will take to Netflix, since it can be considered a normal good, where higher incomes would lead to higher demand for the normal good. As such, demand for Netflix and hence revenue will be more likely to increase. On the other hand, if the economic outlook in Singapore is negative and economic growth is worsening, then incomes will be falling, and consumers will not be likely to take to Netflix. In such a scenario, Netflix might want to consider delaying its foray into the Singapore OTT market by waiting for a more positive economic outlook, so as to increase the likelihood that its revenue will increase significantly.

Factor 5: Consumers' tastes and preferences

Lastly, another factor that Netflix can consider is consumers' tastes and preferences. In deciding whether to enter a new market, Netflix needs to take into account the characteristics of the consumers it is targeting, as they may be different from that of consumers in the USA. For instance, Netflix needs to consider whether and to what extent consumers in Singapore will demand for the specifics of the services offered by Netflix, including the price plans and the genre of TV shows that are desired by Singaporean consumers. If, say, the majority of Singaporean consumers prefer Asian TV shows as compared to American TV shows, then Netflix might want to decide not to enter Singapore's OTT market, or if it decides to enter the market nevertheless it would need to differentiate its services to ensure that it can cater to the tastes and preferences of Singapore's consumers.

Conclusion

All in all, Netflix will need to consider a variety of factors, including the impact of its entry on costs and revenue, as well as any information it might have about the market in question. Ultimately, Netflix will need to conduct a cost-benefit analysis in order to decide whether to

enter the market or not. If their total revenue exceeds total cost, then Netflix would be earning supernormal profits and thus should enter Singapore's OTT market, and vice versa.

Other possible factors:

- Market contestability (link to revenue)
- Barriers to entry (link to revenue)
- Existence of supernormal profits to be earned
- Ability to withstand competition with existing firms
- Existing supernormal profits (link to ability to engage in strategies to establish position in SG market)

Level	Descriptor	Marks
L3	For a developed and well-explained answer that explains the various factors affecting Netflix's decision, with application to the context laid out in the preamble.	8 – 10
L2	For an underdeveloped explanation of the various factors affecting Netflix's decision.	5 – 7
L1	For a descriptive explanation of the factors affecting Netflix's decision, or for an answer that scratches the surface on the factors but does not directly answer the question requirements.	1 – 4

(b) In the light of globalisation, discuss whether it is beneficial when firms increase in size. [15]

Introduction

As explained in part (a), if Netflix decides to enter Singapore's OTT market, it may be able to benefit from its larger size and market share. Apart from the considerations explained earlier, Netflix also needs to take into account external factors that might affect the impact of its decision – the impacts of globalisation, for instance. Globalisation is the process by which countries become more interconnected through a freer flow of goods and services, labour, capital and ideas/technology. Globalisation has brought about both positive and negative impacts. Thus the next part of the essay aims to discuss whether, in light of globalisation and its impacts, it is beneficial for firms to increase in size, in terms of benefits and costs on consumers, producers and society, as well as the economy.

Thesis: Beneficial when firms increase in size

T1: Benefits from freer flow of goods and services

One of the drivers of globalisation is the freer flow of goods and services. With globalisation, there is greater access to world markets, and firms are able to move beyond their domestic customer base, expanding their market demand beyond the domestic boundaries. It is thus beneficial for firms to increase in size by harnessing the freer flow of goods and services to expand overseas (like Netflix did), as this would give the firm greater ability to reap internal EOS, which involves the lowering of average costs of production as firms increase their scale of production. Furthermore, being able to sell their goods and services in overseas markets would also directly increase total revenue. With higher total revenue and lower costs of production, firms' profits would increase, thus benefitting the firm itself.

From a consumer point of view, the ability to consume goods and services from overseas would mean greater variety, thus improving consumer welfare.

Additionally, these higher supernormal profits earned would increase the ability of the firm to engage in research and development (R&D). This could be via product or process innovation, either to improve on the quality of their products or to lower the cost of production via more efficient production processes respectively. In so doing, the firm could further ensure higher revenue and lower costs, and hence higher profits, in the long run.

From a society point of view, this would also lead to greater dynamic efficiency.

The freer flow of goods and services would undoubtedly have its downsides too – the ability of firms to expand into overseas markets would mean that domestic firms would in general face greater competition and greater threat of competition. In the light of this, it would be beneficial for firms to increase in size as the higher market share and hence supernormal profits earned would give the firm greater ability to compete with overseas firms via various price and non-price strategies. Thus increasing its size enhances the survivability of the firm.

T2: Benefits from freer flow of capital

With globalisation bringing about freer flow of capital, it may be beneficial for firms to increase in size because now they will be able to harness the capital or technology transfer to improve their productivity or efficiency of their production processes. As a result, increasing in size would help them to expand their scale of production and reap iEOS – specifically technical EOS that allows them to spread the costs of their expensive and/or specialist capital

machinery over a larger range of output. This lower cost of production will thus increase firms' profits, *ceteris paribus*.

Also, the freer flow of capital means that firms may be able to enjoy lower costs of production if they can move their capital/machinery and hence production processes where the cost of labour is cheaper. For instance, by increasing in size and expanding its production to low-cost labour countries like Vietnam, firms selling manufactured goods (e.g. apparel firms) would be able to capitalise on the cheaper labour from overseas, as compared to if they did not increase in size and restricted production to within domestic boundaries. With a lower cost of production and yet higher output, this would increase the firm's profits.

T3: Benefits from freer flow of labour

Thirdly, the freer flow of labour brought about by globalisation would mean that labour can flow more efficiently towards where it is needed the most. Thus as firms increase in size, they can employ additional workers more easily now. In other words, workers are free to move to other countries with better job opportunities. This improves workers' material and non-material standard of living, as employment brings with it income, and hence a greater ability to consume goods and services. They can use the higher income to improve their non-material standard of living as well, for instance, via spending on healthcare or education.

From an economy point of view, the freer movement of labour would mean that if firms increase in size and bring in workers from other countries, the home country would enjoy an increase in the quantity (and sometimes quality) of resources, thus increasing the economy's productive capacity, achieving potential growth.

Anti-Thesis: Not beneficial when firms increase in size

AT1: Costs from freer flow of goods and services

However, there are also costs when firms increase in size. As explained earlier, the freer flow of goods and services makes it possible for firms to expand into overseas markets, thus increasing their profits through higher revenue and lower costs of production. However, as firms grow bigger, their greater market share will enable the firm to set higher prices and restrict output. Graphically, the increase in market share corresponds to an increase in demand for the firm's goods and services, resulting in a rightward shift in the MR and AR curves as in Figure 1 back in part (a). With higher market share, the gap between price and marginal cost has increased ($P_0 - MC_0 < P_1 - MC_1$) and the deadweight loss has increased significantly from area abc to area deb in Figure 1. This means that allocative inefficiency is worsened, harming society's welfare.

Furthermore, consumers would suffer from the higher prices charged ($P_1 > P_0$), thus eroding consumer surplus and welfare.

AT2: Costs from freer flow of capital

Although the freer flow of capital benefits firms by lowering their cost of production and increasing profits, it also brings about costs to households and the economy. With freer flow of capital and the transfer of technology from other countries, there is the possibility of capital-labour substitution, where technology and capital takes over the work of labourers. As the structure of the economy has changed towards a more capital-intensive one, workers find themselves displaced and lacking the skills for jobs in new industries. As such, they become structurally unemployed.

As workers become unemployed, the loss of income would directly worsen material standard of living, and the erosion of skills and inability to find work would also lead to worsened non-material standard of living because of demoralisation and social problems.

AT3: Costs from freer flow of labour

When firms increase in size to capitalise on the freer flow of labour, it could lead to workers migrating from one country to another. Although this benefits firms in terms of being able to utilise lower cost methods of production, the economy would lose out. If high-skilled workers migrate out of the country in search of better job opportunities overseas, this would lead to brain drain, where the average quality of workers in the country now decreases, thus reducing the country's productive capacity. As a result, this limits the country's potential for sustained economic growth.

AT4: Merits of firms remaining small in size

In the first place, it could be beneficial for certain firms to remain small in size. Some firms operate in industries where the minimum efficient scale is attained at a rather low level of output. As such, even if the firm tries to harness the benefits of globalisation by growing in size, it could be harmful for the firm in terms of raising costs by more than proportionately, as the firm starts to experience iDOS at a rather low level of output. This applies to small businesses such as corner shops and specialty restaurants. If they increase in size, they would start to earn subnormal profits instead. Hence, there is merit to remaining small.

Furthermore, there are some firms that would benefit from remaining small in size because of the personalised services they offer, and the customer loyalty they enjoy. For example, hairdressers and beauty parlours enjoy the advantage of geographical niche and customer loyalty, because of where they are located and the special services they can offer to their customers. As such, demand for these firms' services are already price inelastic, providing some degree of monopoly power. If these firms become too large, they may not be able to continue to provide such personalised services to consumers, resulting in lower revenue and hence profits.

Note: Accept other relevant points on both sides.

Evaluative Conclusion

Ultimately, whether it is beneficial for firms to increase in size in the light of globalisation depends largely on the nature of the firm, and whether the benefits of doing so outweighs the costs. Firms operating in a monopolistically competitive (mpc) industry may find themselves better off remaining small, as they get to enjoy their certain degree of monopoly power from geographical location and customer loyalty, whereas larger firms from oligopolistic and monopolistic industries may find themselves enjoying iEOS and hence higher profits when they increase in size. Firms will thus need to conduct cost-benefit analyses with the data they can gather in order to predict whether they will gain from becoming larger.

However, firms do not take into account the impacts of their becoming large on other stakeholders, i.e. consumers, society and the macroeconomy. As a result, government intervention may be necessary to keep a check on how far firms increase in size to harness the benefits of being large – for instance, competition watchdogs are tasked to consistently check if consumers and societies indeed benefit, or if firms becoming large would lead to exploitation of consumers and worsening of consumer welfare.

Specifically for consumers and society, whether it is beneficial when firms increase in size would also depend on firms' decisions – for instance, whether they decide to pass on cost savings from higher iEOS in the form of lower prices, or if they choose to retain their profits. Also, whether they choose to use their supernormal profits to engage in R&D to improve dynamic efficiency, or if they just retain their profits.

Lastly, whether it is beneficial for firms to increase in size would also depend on the nature of the economy. In the case of a small and open economy like Singapore, with a rather small domestic consumer base, the additional revenue gained from opening up to overseas markets is very likely to outweigh the increase in costs from having to enter these foreign markets, at least in the long run. On the other hand, for large economies that have a sizeable domestic sector, it may not necessarily be beneficial for firms to increase in size, depending on whether the benefits outweigh the costs, or vice versa.

Level	Descriptor	Marks
L3	For a well-developed and rigorous discussion on the benefits and costs of firms increasing in size, in the light of globalisation and its impacts.	8 – 10
L2	For an underdeveloped, two-sided answer that discusses the benefits and costs of firms increasing in size, in the light of globalisation.	5 – 7
L1	For a one-sided answer that only explains why it is beneficial or harmful for firms to increase in size. OR For an undeveloped/descriptive two-sided answer that lists out why firms should and should not increase in size. OR For an undeveloped answer that does not address the question requirement of considering globalisation and its impacts on firms' decision whether to increase in size.	1 – 4
E3	For a well-explained judgement that is supported with economic reasoning.	4 – 5
E2	For an underdeveloped justification of stand made, one that is lacking in economic rigour.	2 – 3
E1	For an unjustified stand/unexplained judgement made.	1

Q4 Japan has repeatedly pursued government interventions in the hope of revitalizing its economy weakened by deflation, debt and ageing demographics. Japanese Prime Minister Shinzo Abe's three-pronged approach, combines fiscal expansion, quantitative easing, and structural reform to boost economic growth while raising inflation to 2 percent.

Council on Foreign Relations, 10 February 2017

- a) Explain the reasons why governments want to achieve sustained economic growth, a healthy balance of payments and a low rate of inflation. [10]**
- b) Discuss whether conflict in macroeconomic objectives is the most important reason that underlies Japan's three-pronged approach to achieve her macroeconomic objectives. [15]**

Suggested Answer for (a)

Reasons why governments want to achieve sustained economic growth

Economic growth can be defined as:

- an increase in the real output of a country (actual economic growth)
- an increase in an economy's capacity to produce goods and services (potential economic growth).

There must be a combination of actual growth (led by increase in AD) and potential growth (increase in productive capacity marked by an increase in LRAS) for economic growth to be sustained in the long run.

- "Positive" → indicates increase in amount of g/s produced for an economy → more g/s available for consumption → improve material standard of living (mSOL)
- "Positive" → also means rising household incomes → greater purchasing power to satisfy material needs → improve mSOL
- "Positive" → non-material standard of living (nmSOL) also increase in the presence of economic growth due to improvement in lifestyle. For example, there will be greater demand for cars and holidays to foreign lands. People become more conscious of the quality of living.
- "Sustained" → actual and potential growth in tandem → continued consumption levels over time
- May have some impact on nmSOL too → if greater tax revenue collected and channelled towards sectors like education and healthcare. + lower amount of social problems such as crime.

Positive impact on other macroeconomic indicators

- Reduces demand-deficient unemployment with actual growth: "positive" → increase in the derived demand for labour since there is greater income and hence output in the economy → falling unemployment due to increase number of jobs in the economy.
- Reduces demand-pull inflation with potential growth
- Sustained economic growth may lead to a rise in investor confidence as future prospects improve, leading to an increase in investment activities within the country, further enhancing actual and potential growth in the economy.

Reasons why governments want to achieve a healthy BOP

The Balance of Payment is a statement of all transactions between one country and the rest of the world. It is usually reported on an annual basis. The transactions included are merchandise trade, exchange of services and transfers of capital in both directions.

- “Healthy” → indication of external stability (long-term goal) + avoid the problems of large and persistent BOP deficit (example)
- “Healthy” → large and persistent BOP deficits may be financed by drawing on reserves → less resources for other sectors such as education and healthcare → affect nmSOL OR financed by borrowing → burden on the society in terms of debt servicing → future generations may suffer from a lower SOL

Positive impact on other macroeconomic indicators

- Improves investor confidence → further stimulate actual and potential growth (through FDI, I, AD) and unemployment

Reasons why governments want to achieve low rate of inflation

Price stability is reflected by the inflation rate which measures the change in the country's general price level. It is important to keep the inflation rate low in order to maintain confidence and stability in the country.

Related to SOL

- “Low” → income more likely to rise faster than price levels → increase in real GDP (per capita) → value of money is maintained → able to enjoy more g/s

Positive impact on other macroeconomic indicators

- “Low” → reduces uncertainty in decision making → firms can make investment plans more accurately → investor confidence → further stimulate actual and potential growth (through FDI, I, AD) and unemployment
- When the rate of inflation is low in the country, the country's exports become more price-competitive, leading to a rise in export earnings and improvement in the current account of the BOP. FDIs will also be attracted as confidence in the economy improves the rate of returns and profits for the investors, leading to an improvement in the capital account of the BOP.

Countries like Japan also wants to avoid deflation and attain a low rate of inflation because of the following problems:

- Deflation can lead to a vicious cycle of decreased spending and increased unemployment. People wait as prices fall, for goods to get cheaper before buying. Prices therefore fall further, leading to more job losses and an economic recession.
- Deflation also causes a reduction in investment spending because businesses lose confidence in the economy and invest less as prices of their goods and services fall, and profit margins are reduced.
- Deflation is harder to tackle than inflation. Unlike inflation, which can be combated with a rise in interest rates, there is a limit to how far interest rates can be cut when tackling deflation. Moreover, due to deflation, the real interest rate remains high no matter how low interest rates are cut. High real interest rates discourage capital expenditure and investment by companies.

L3	Well-developed and detailed explanation of the meaning and advantages of achieving the key policy objectives of sustained economic growth, healthy balance of payments and low rate of inflation.	8-10
L2	Under-developed explanation of the meaning and advantages of achieving the key policy objectives of sustained economic growth, healthy balance of payments and low rate of inflation.	5-7
L1	An answer that merely stated or defined the key policy objectives without or with little explanation of the reasons for the objectives	1-4

Suggested Answer for (b)

Introduction:

Governments have to make decisions about which economic policy to use, such as fiscal, monetary, or supply-side policies, in order to achieve sustained economic growth, a healthy balance of payments and a low rate of inflation. It is unlikely that these aims can all be achieved by any one policy concurrently, as the use of one policy may result in trade-offs between macroeconomic objectives. Therefore, Japanese Prime Minister Shinzo Abe would have to consider the trade-offs involved in his decision to employ the three-pronged approach. There may also be other factors that determine his policy decisions, and these include: current economic conditions and the nature of the economy/current problems faced by Japan.

Thesis: Conflict in macroeconomic objectives is a factor that underlies Japanese Prime Minister Shinzo Abe's three-pronged approach

Thesis 1:

In June 2014, Abe announced a broad structural reform package, including corporate tax cuts, agriculture liberalization, labor market reform, and initiatives to overhaul regulation of the energy, environment, and health-care sectors.

- ⇒ For example, labor market reform → providing training and education for workers e.g. support relearning of individuals, such as by enabling women, who once take child-rearing leave, to receive recurrent education for skill improvement and re-employment + attract foreign high skilled labour to boost labour productivity → increase LRAS → LRAS shifts to the right → NY increases, GPL falls. Hence the need to complement with fiscal expansionary and monetary easing policies to boost AD to increase GPL to bring Japan out of deflation to achieve low inflation.

[Additional info: Fiscal stimulus began in 2013 with economic recovery measures totalling 20.2 trillion yen (\$210 billion), of which 10.3 trillion (\$116 billion) was direct government spending. It was focused on building critical-infrastructure projects, such as bridges, tunnels, and earthquake-resistant roads.]

Thesis 2:

The BOJ has simultaneously implemented quantitative easing and injected liquidity into the economy and pushed interest rates into negative territory to spur lending and investment.

- ⇒ With the increase in government expenditure + increase in I due to monetary easing → increase in AD → AD shifts to the right → increase in real NY. As more and more

resources are employed, the Japan economy will get out of deflation and face demand pull inflation without a corresponding increase in LRAS.

- ⇒ A high inflation may worsen the balance of trade. When inflation in Japan is relatively high, Japan produced goods will become more expensive and less competitive internationally. Exports will be relatively more expensive, thus foreigners will reduce the quantity demanded of exports. If $PED_x > 1$, the rise in price of exports will lead to a more than proportionate fall in quantity demanded. Total export revenue (X) will fall. When Japan goods become more expensive, Japan residents will buy more imports assuming imports and Japan produced goods are close substitutes. Demand for imports increases and import expenditure increases → fall in net exports → worsen BOT and hence current account for Japan.
- ⇒ Hence, the need to complement quantitative easing with structural reforms (e.g. policies to improve country's productivity and export competitiveness) to increase LRAS and improve current account to achieve sustained economic growth at low inflationary pressure and a healthy BOP.

Thesis 3:

- ⇒ If fiscal expansion and quantitative easing are successful and lead to economic growth in Japan, this may increase demand for foreign imports which have a positive income elasticity of demand resulting in an increase in import expenditure and hence worsening of current account. Furthermore, with monetary easing and lower interest rates (assuming interest rates in other countries remain constant), financial assets of the country becomes less attractive to financial speculators and this results in an outflow of hot money. Hence, demand for the country's currency fall and this causes Yen to depreciate. A depreciation of Yen, assuming Marshall Lerner condition holds can increase net exports and hence improve current account. However, a weaker Yen also drives up the price of imports. Hence, while the weak yen is helping export-oriented companies (e.g. Toyota Motor), it is adversely affecting companies that have to import a large amount of raw materials (e.g. steel makers who imported iron ore and coal and major power companies who rely on imported fuel). This will negatively impact employment in some sectors, thus causing economic stagnations.
- ⇒ Hence, the need for structural reforms to increase government spending on R&D to support Japanese companies → lower cost of production → reduce price and improve quality of exports and domestic goods → increase export revenue and help companies that have to import a large amount of raw materials to reduce cost of production.
- ⇒ A weaker yen also leads to higher cost of living with higher imported prices of gasoline, wheat flour and edible oil. → Hence, the need for structural reforms → labor market reforms to put pressure on companies to increase wages + cut corporate taxes to increase worker wages and pay increases → improve consumers' confidence → increase C → increase AD → to boost growth and achieve its inflation target.

Thesis 4:

Japan has spent trillions of dollars for the fiscal stimulus to lift the economy.

- ⇒ In the process it has accumulated a large public debt.
[Additional infor: There is also worry about Japan's national debt, which, at over one quadrillion yen (\$11 trillion), has surpassed 245 percent of its GDP. The International Monetary Fund (IMF) has repeatedly warned [PDF] that these debt levels are unsustainable. That's why Abe has attempted to reduce the deficit by raising tax. A 2014 increase in the national consumption tax from 5 to 8 percent further depressed consumer's confidence and hence spending and is likely to cause recession.]

- ⇒ While good for immediate growth, this decision arguably undermines the goal of fiscal sustainability → Japan government may need to rein in social security spending through cut on spending on wasteful infrastructure projects, labor market reforms like increasing retirement age and boosting growth through structural reforms to reduce public debt in the long run.

Thesis 5:

The Japanese economy is going to receive money supply injections through a stimulus package, which the Japanese Government wants to finance with an increase in tax receipts, instead of issuing Government denominated bonds. It is against this background that the sales tax hike came.

- ⇒ With households already impacted by rising costs of living, the net effect of the sales tax hike has been a contraction in the economy. It is clear that the government wants corporations to start increasing investment by giving them access to cheap capital. However, this assumes that the new capital will be able to find profitable opportunities to invest in. If the economy contracts as a result of consumers becoming more cautious in spending as a result of prohibitive taxes, corporations might shy away from investing in the economy, thereby reinforcing the same cycle.
- ⇒ Hence, the need for fiscal expansion to combat the contractionary effects on the economy by the increase in sales tax hike.
- ⇒ Hence, the need for structural reforms → labor market reforms to put pressure on companies to increase wages + cut corporate taxes to increase worker wages and pay increases / increase minimum wage to improve consumers' confidence level → boost consumption to increase AD.
- ⇒ Hence, the need for structural reforms → make Japan for attractive for investment → boost investment to increase AD.

Anti-thesis 1: The constraints faced by the Japan government is another factor that underlies Japanese Prime Minister Shinzo Abe's three-pronged approach.

- ⇒ Japanese Prime Minister's three-pronged approach are designed to overcome the constraints faced by the Japan Government.
- ⇒ As Japan has low interest rates for decades, it is caught in a liquidity trap. Hence, Prime Minister Shinzo Abe adopted the non-conventional monetary policy approach of quantitative easing where BoJ print money to buy bonds. This money increases the size of bank reserves in the economy/increases the overall amount of useable funds in the financial system and helps stimulate the economy by encouraging banks to make more loans to businesses and individuals. Furthermore, if BoJ convinces markets that they are serious about fighting deflation, then it can also boost economic activity by raising confidence.
- ⇒ Japan is a rapidly aging society → Japan's total population is falling and the labor force has been shrinking. In an aging society, consumption is underpinned more by savings than current earnings → fall in C → fall in AD
- ⇒ Fall in labour force → fall in LRAS
- ⇒ Hence, the need for labour structural reforms such as increasing labour-force participation – especially among women + lower barriers to entry for migrants + increase investment in capital-intensive technologies and machinery in order to boost productivity → allow the workforce to maintain or even increase levels of production even as the labour force shrinks
- ⇒ Currently, in terms of trade openness – sum of exports and imports of goods and services compared to GDP – Japan ranks relatively low to other countries. *[Additional*

infor: Japan is relatively low in terms of inward investment, R&D by foreign MNC in Japan accounts for only 5% and foreigners only comprise 1% of the total population.]

- ⇒ Fiscal stimulus focused on building critical-infrastructure projects/public works investment, such as bridges, tunnels, and earthquake-resistant roads → increase connectivity + improve productivity/ Fiscal stimulus to improve the investment environment and create a structure for investment support + improve the living environment → attract more inward FDI/increase public investment to compensate for the low inward investment (*public infrastructure projects have been suggested to increase public investment by 100 to 200 trillion yen over the next 10 years*) + structural reforms to open its economy, attract more inward FDI (e.g. tax incentives or subsidies for foreign companies with regional or global headquarters in Japan), improving regulations and administrative procedures concerning investment, internalisation of innovation, and improve openness to labor, particularly high skilled foreign workers. **Evaluation:** With structural reforms, it could lead to economic restructuring and structural unemployment, hence the need to ensure sound labor market and training policies at an early stage to prepare the economy for the transition and minimise structural unemployment.

Anti-thesis 2: Japan's current economic condition/economic problem is another factor that underlies Japanese Prime Minister Shinzo Abe's three-pronged approach.

- ⇒ Japanese economy has been stagnant and facing deflation for more than two decades. Hence, Japanese Prime Minister Shinzo Abe launched the three-pronged approach to jolt Japan's stagnating economy out of its deflation. Its immediate goal was to boost GDP growth while rising inflation to 2 percent. It was determined that the long period of the stagnant economy and deflation justifies a massive fiscal stimulus despite Japan's public debt. While the expansionary fiscal policy may result in conflicts in objectives as mentioned earlier, it is likely that in this case, the immediate economic concern of Japan's Prime Minister was to boost GDP growth while rising inflation. Japan's Prime Minister's decision to unleash a massive programme of quantitative easing aims to double the country's money supply in a drastic bid to restore the economy to health and combat the deflation that has dogged the country for more than a decade. The aim is to rekindle demand to push up prices and wages. Persistent deflation tends to encourage households to hoard their cash, as they wait for prices to fall further. Monetary expansion will also lead depreciation of the yen, boosting exports and increasing investment and employment which will fuel consumption. As a result, AD will grow, while expectations of inflation will prompt further investment and consumption. Hence, the need for fiscal expansion and quantitative easing to combat deflation, improve confidence in the economy to create a virtuous cycle to boost GDP growth while rising inflation to 2 percent. **Structural reforms** are necessary to boost long-run growth to achieve sustainable growth with low inflation as well as achieve healthy BOP as explained above.

Conclusion:

- The criteria used to judge which factor is the most important in determining policy decisions would be how relevant the factor is to the Prime Minister Shinzo Abe in deciding on the three-pronged approach.
- In this context, it seems that Japan's current economic condition of stagnating economy and deflation is the most important factor in determining the three-pronged approach. This is because the main objective of Abenomics is to boost Japan's economic growth while rising inflation to 2%. Of course, the conflicts of macroeconomic

objectives will be the next factor to consider to ensure that the three policies complement one another to achieve sustained economic growth with low inflation and a healthy BOP.

- In reality, very little progress has been made in the area of Abenomics third arrow on structural reforms. This could mean that the current nature of Japan's problems is not the main factor of consideration in Japan Prime Minister's formulation of the three-pronged approach. There is a need for the Japanese government to advance full-fledged structural reforms, lest another valuable opportunity for economic revival be wasted. With limited capacity for more fiscal and monetary stimulus, it is increasingly apparent that maximum attention and effort needs to be directed to structural economic reforms. To achieve all macroeconomic goals concurrently, Japan's Prime Minister must address the problems created by an aging and shrinking workforce and population, lack of inward FDI, low openness to trade and the growing public debt. On fiscal stability, Japan's Prime Minister needs to take drastic measures to cut the budget deficit as tax base shrinks due to Japan's aging population.

Level (Marks)	Descriptors
L3 (8 – 10)	Well-balanced discussion that explain how conflict in macroeconomic objectives and how other factors affect Japanese Government's decision-making process to undertake a three-pronged approach to achieve her macroeconomic objective. Strong application to the context of Japan economy with reference to the preamble.
L2 (5 – 7)	Detailed explanation of how conflict in macroeconomic objectives affect Japanese Government's decision-making process to undertake a three-pronged approach to achieve her macroeconomic objective. OR Detailed explanation of a few factors that affect Japanese Government's decision-making process to undertake a three-pronged approach to achieve her macroeconomic objective. Some application to the context of Japan economy with some reference to the preamble.
L1 (1 – 4)	Weak and incomplete explanation. Poor application to the context of Japan economy. Mere listing of points without explanation.
Evaluation	
E3 (4-5)	For a rational conclusion and an evaluative assessment that is based on economic analysis (that is, a well-explained evaluation).
E2 (2-3)	For an undeveloped rational conclusion that is based on economic analysis.
E1 (1)	Judgment without elaboration (State a stand without justification).

The economic environment of Singapore has been challenging for a while with the world economy yet to fully recover from the financial crisis while a clear growth driver has yet to emerge as major powers like the United States and China continue to grapple with reform and recovery. All these have had a dampening effect on global trade and by extension, Singapore's small, open economy.

Adapted from the Straits Times, 2016

5. Discuss the extent to which Singapore has control over her economic performance. [25]

Introduction:

Meaning of economic performance: Sustained and inclusive growth, low unemployment, low inflation, healthy balance of payments.

- The economic performance of a country could be a result of economic policies or exogenous factors outside the control of economic agents

Thesis: Singapore has control over her economic performance

(Any **3** policies which links to at least 2 different measurements of economic performances)

In the thesis argument, students are expected to show how Singapore has control over her economic performance with the use of suitable policies to boost a sustainable and inclusive economic growth (or to mitigate a recession), maintain price stability (or curb inflation), maintain a low unemployment rate (or reduce unemployment) and ensure a healthy balance of payments.

1. In context of economic recession: Sg can implement an expansionary fiscal policy (EFP) to alleviate the fall in actual growth and reduce demand deficient unemployment, hence gaining control over her economic performance.

(a) Singapore government can attempt to cut direct taxes (personal income taxes and/or corporate taxes) and/or raise government spending (G) (for example, increase spending on public infrastructure) to boost aggregate demand (AD) and achieve actual growth.

With a cut in personal income tax, this has the effect of raising household's disposable income and stimulating consumption (C). With a cut in corporate tax, this has the effect of raising the after-tax profits of the firms thus stimulating investments (I) since there is now more incentive to increase investment expenditure in Singapore. With the rise in C, I and G, AD is raised, (Explain the multiplier (k) effect), which results in a multiple increase in national income and hence, this could help stimulate actual growth (and mitigate the effects of a recession) and reduce demand deficient unemployment as a result of a recession.

In the long run, with the increase in I → increase in capital stock accumulation → increase in productive capacity → achieves potential growth.

(Illustrate the effects on actual and potential growth with the AD-AS diagram)

However, the effectiveness of the policy depends on:

1) The size of the multiplier. The smaller the multiplier, the smaller will be the increases in national income which may deem the policy ineffective.

2) The budget position of the government. If the government is currently experiencing a fiscal deficit, it may be difficult to expand the expenditure and this could reduce the effectiveness of the expansionary effects on the economy.

(b) In addition, increases in government expenditure can also help to promote a more inclusive economic growth.

Real world examples

The government can increase the expenditure through income redistribution. Under the Wage Credit Scheme, the Government will co-fund 40% of wage increases given to Singapore Citizen employees earning a gross monthly wage of \$4,000 and below in 2013 – 2015. Only Employers are eligible for the co-funding.

Wage Credit Scheme launched in 2013, which has seen more than \$2.2 billion handed out to help local businesses subsidise wage increases for low-income workers. This helps to maintain employment as there is greater incentive to work with wage increases and companies will also have more incentive to increase the wages of workers.

This prevents the increase in income gap between low income workers and high income workers, hence ensuring a more inclusive growth.

(c) Unlike a conventional fiscal policy where the government simply reduces taxes without differentiating the income group, a more inclusive growth can be achieved with the implementation of a progressive tax system in Singapore.

Progressive Tax System

Singapore's personal income tax rates for resident taxpayers are progressive. This means higher income earners pay a proportionately higher tax, with the current highest personal income tax rate at 22%. Tax revenue generated are redistributed as subsidies to make healthcare, education and housing affordable to all. Income gap between the higher income and lower income is then narrowed

One limitation for a more progressive tax system is that it creates a disincentive to work and deter foreign talent, this might lower the quality of labour, which may reduce potential growth.

Evaluation

Hence, the government has to ensure that the tax rates implemented is managed wisely and does not distort the incentive to work.

2. In the context of a fall in external demand: Singapore can control its economic performance with the use of exchange rate policy via a depreciation (or zero appreciation stance) of the SGD to promote export competitiveness, increase AD and revive actual growth and reduce demand deficient unemployment.

MAS can pursue a zero-appreciation of SGD exchange rate policy to allow a weakening of the strength of the SGD → fall in P_x in foreign currency terms, rise in P_m in domestic currency terms, which leads to an increase in quantity demanded for exports and decrease in quantity demanded for imports → assuming Marshall – Lerner condition (MLC) is satisfied such that $E_{px} + E_{pm} > 1$ → net exports ($X-M$) increases → increase AD → k effect → multiple increase in national income, output and employment → raises actual growth and reduce demand deficient unemployment in the short run.

Balance of payments may also improve with the increase in net exports via the current account. Hence, in this aspect, SG can control falls in external demand with a suitable usage of the exchange rate policy. This meant that the government may need to decide when to allow the currency to appreciate and when to adopt a zero appreciation stance.

3. In the context of a high inflation present in Singapore, the use of the exchange rate policy via an appreciation stance can help to control inflation and hence Singapore's economic performance.

Singapore is a small and open economy which is export-led and import-reliant. Hence, external factors are significant contributors to inflation in the economy.

- In recent years, the more significant causes of inflation in Singapore are mainly due to external factors of rising global and oil prices.
- Thus, one of the policies that Singapore has implemented to cope with inflation in the economy is to adopt a strong S\$ exchange rate policy so as to cope with changes in the external economy.

How it works? (Explain using the economic concepts)

1. Curbing import price push inflation (Direct transmission mechanism)

- By allowing S\$ to appreciate when there is import-price-push inflation, imports become relatively cheaper in terms of domestic currency.
- Most of Singapore's imports are raw materials and necessities and Singapore being a resource scarce country, demand for imports is expected to be relatively price-inelastic (quantity demanded increases LTP when prices fall). Hence, import expenditure on raw materials and necessities will fall and this translates to lower COP for firms. This increases SRAS and helps to reduce inflationary pressures. (Fig 1) and general price level will fall.
- As necessities become cheaper in terms of domestic currency → lower GPL as price of final goods and services are lower.

Impact on other macroeconomic indicators

In addition, since many exports in Singapore are produced with high import content (contains a significant proportion of imported inputs), the fall in the prices of inputs can lower the cost of production of exports and hence improve export competitiveness where SG exports can be sold at a lower price. The fall in price of exports can then translate to a more than proportionate increase in quantity demanded for exports (assume that demand for SG's export is price elastic). This will result in an increase in export revenue and increases in net exports, c.p which might also improve the balance of payments and bring about actual economic growth and full employment in the short run.

Evaluation on the exchange rate policy

The monetary policy centred on the exchange rate in Singapore focuses on achieving price stability. Achieving low inflation, however, is not an end in itself. Price stability is seen as prerequisite for sustainable economic growth. [Consider how a low inflation environment encourages saving and investment which add to the productive capacity of the economy, shifting the AS to the right.]

However, the monetary policy per se in Singapore (via exchange rate management) cannot affect the long-term growth capacity of the economy. In the long run, the growth of an economy is determined by supply-side factors such as technological progress, capital accumulation, and the size and quality of the labour force. Some government policies may be able to influence these supply-side factors, but monetary policy generally cannot do so directly

Thus, the Singapore government cannot just rely on exchange rate policy alone for sustained growth. It must be accompanied by other macroeconomic policies in order to ensure that the Singapore economy can continue to grow in the long term.

Limitations of Exchange rate policy

- However, such a policy is inappropriate in times of export slump, as in the current situation with world-wide recession, as resulting in further slowdown in actual growth could lead to significant cyclical unemployment problems.(where further fall in AD could lead to unemployment)

- Moreover, exchange rate policy is unable to tackle inflation caused by internal factors → there is a need to implement supply-side policies to achieve price stability in the economy as well.

3. **Singapore can control its economic performance through the use of supply-side policies to promote actual and potential growth and achieve non-inflationary sustained economic growth (LR)**

Long-term supply-side policies

- Industrial policies to develop dynamic CA

E.g. Singapore government disburses grants and provides tax rebates to attract FDI to promote the development of new growth industries and develop industries with potential CA. E.g. clean energy sector, bio-medical sector, etc.

In the LR, with the CA established in these sectors → promotes export growth → increase export revenue → increase AD → increase real NY more than proportionately through the k effect → raises actual growth.

With increase in FDI in these sectors → increase capital stock accumulation, technology transfer → increase productive capacity → achieves potential growth.

- Manpower policies to increase productivity

Manpower policies in the form of government spending on training of workers to enhance skill sets of workers (e.g. WTS) → raise labour productivity → i) lowers labour cost → increase SRAS, achieves actual growth; ii) increase quality of labour → raises productive capacity → achieves potential growth.

Short-term supply-side policy

- Wage policies to reduce cost of production to firms

Through the tri-partite labour market system, under the NWC platform, annual wage recommendations takes into account the prevailing economic conditions facing Singapore and have been advocated such that wage increases granted have lagged behind productivity growth → reduce unit labour costs → increase SRAS → raises actual growth.

4. Lastly, Singapore can use suitable trade Policy: Free trade agreements (FTAs) to promote exports growth, FDI inflows to increase AD and AS to sustain economic growth in order to control the economic performance.

FTA which is a legally binding agreement to lower or remove trade barriers between two or more countries has been employed by Singapore as a trade policy to promote Singapore's export growth. FTAs allow Singapore to overcome the constraints of her small domestic market and expand its markets for exports. E.g. removal of tariffs against Singapore's exports → lowers price of Singapore's exports → assuming $PED_x > 1$ → more than proportionate increase in Qd for X → increase in X revenue → increase AD → increase real NY by more than proportionate through the k effect → raises actual growth.

FTAs have also allowed Singapore to attract FDI as foreign MNCs see Singapore as an attractive destination for their investment given Singapore's preferential access to key markets. Increase in I → increase AD and AS → sustained economic growth as described above.

Anti-thesis: Singapore may not have control over her economic performance

1. Limitations of the policies above (any 3 policies):

Some of the limitations could have been mentioned as an evaluative point in the thesis argument due to differences in structure.

- EFP: small k for Singapore due to high MPS due to compulsory saving scheme (CPF) and high MPM due lack of natural resources → limits the ability of EFP to increase real NY sufficiently to increase actual economic growth.
- Exchange rate policy: depreciation of SGD would worsen BOT due to the J-curve effect. In the SR, demand for X and M are likely to be price inelastic due to trade contracts as exporters and importers are not able to respond very much to changes in P_x and P_m given the exchange rate changes → fall in net X value → fall in AD → more than proportionate fall in NY due to reverse k effect → fall in actual growth.
- Supply side policies: lack of receptiveness and uncertainty of results → low wage workers may not be receptive to training due to unwillingness to forgo paid employment for training as that would mean losing earned income especially for daily-rated workers. Training of workers may not automatically translate to transference and application of skills gained to the work setting, difficult to increase productivity. On the whole, supply-side policies are LR policies, does not work effectively as a short-run response to sudden and severe economic shocks.
- Trade policy (FTA): Just as FTAs enables Singapore to increase its X growth, it would also mean an increased degree of competition from low cost imports → fall in $(X-M)$ and AD and actual growth. However, this effect is unlikely to be significant in terms of curtailing economic growth due to Singapore's open nature of its economy, where in fact, low cost imports has been viewed positively in curbing imported inflation.

2. External factors (Note: Some of the points below could also be seen as limitations of the policies undertaken by SG)

- **Singapore may be unable to control the economic performance with demand-side shocks that stems from external factors.**

As seen from the preamble, “the environment has been challenging for a while with the world economy yet to fully recover from the financial crisis while a clear growth driver has yet to emerge as major powers like the United States and China continue to grapple with reform and recovery. This has all had a dampening effect on global trade and by extension, Singapore's small, open economy.” → Singapore has relied heavily on exports for economic growth. In fact, net exports make up the largest component of Singapore's GDP (net exports making up at least 2/3 of the AD). Hence, Singapore may have problems controlling the economic performance of the country and this might limit the ability of Singapore to use demand management policies to boost domestic demand and actual growth given its high degree of reliance on external demand for its economic growth.

This could be the reason why Singapore was the one of the first few Asian economies that was hit by the global economic crisis in 2008.

- **Singapore may be unable to control the economic performance with supply-side shocks that stems from external factors.**

Rising prices of imported raw materials → this would put a limit to Singapore's ability to continually appreciate SGD without severely compromising export price competitiveness. For instance, if oil prices were to increase significantly, MAS may not be able to appreciate the SGD extensively to cope with the sudden, sharp increases in oil prices as they need to ensure that the SGD still remains within the S\$NEER band (Singapore dollar nominal effective exchange rate, where Singapore currency is managed against a trade-weighted basket of currencies against her major trading partner). Any sudden increases in the value of the SGD could threaten currency stability and investors' confidence hence MAS may only tweak the policy at a gradual rate.

Thus, this would mean that SG has a limited control over its economic performance when there are sudden changes in the external environment.

- **Competition from foreign countries for investments and exports (No control over rivals' policies).** Just as Singapore can pursue economic policies to improve its export competitiveness, there is nothing to preclude other competing countries to engage in similar policies to compete with Singapore for FDI and exports. This is especially the case given the increasing integrated nature of the global economy.

Other external factors that could impact Singapore's trade position and its vulnerability.

- Also, as if Singapore's trading partners adopt more a more protectionist approach, this could hamper trade flows between Singapore and these countries which are not within the control of Singapore. Singapore has to watch out for ramifications from protectionist politics, which, if widespread, can be harmful for the trade-dependent economy in the long run,

Evaluation:

- Hence, it is crucial for government policies to consistently adapt to these external changes to manage Singapore's economic performance. Following the United States' formal withdrawal from the 12-nation Trans-Pacific Partnership (TPP) which is not within the control of Singapore, the impact could impair the growth if policies are not in place to manage these changes. In lieu of this, Singapore can continue to pursue other avenues of economic cooperation, such as the Regional Comprehensive Economic Partnership (RCEP).

Synthesis:

Economic performance can be controlled as long as policies result in international competitiveness and external conditions are favourable. For a small and open economy, growth is not within her control to the extent that globalisation has led to synchronisation and shortening of business cycles.

Hence, the level of control that the government has over Singapore's economic performance is dependent on a few factors:

1. The extent of the changes in external factors. Globalisation has caused many countries to be interconnected and economies to be mutually interdependent. Hence, a recession in one country though may not affect Singapore immediately, could affect Singapore significantly at a later stage due to the contagion effect. On a separate note, countries with limited trading relations with Singapore may not affect Singapore's economic performance that much as compared to Singapore's major trading partners. Hence, it depends on what changes in external conditions are there and the extent of the impact on Singapore's economic performance.

2. Budget constraints/allocation of the government which could be accordance to the government's priority at the point in time. For instance, if inflation is at its highest and the government may prioritise controlling inflation at the expense of other macroeconomic

objective (i.e. trade-offs between goals). Also, if the government does not have sufficient funds to implement suitable policies, this could also limit the control of Singapore over its economic performance.

Level	Knowledge, Application, Understanding and Analysis	Marks
L3	Balanced arguments, strong analysis and valid application to Singapore's economic performance.	15-20
L2	Balanced arguments, undeveloped explanation or analysis, weak application to SG economy	9-14
L1	Descriptive, conceptual inaccuracies, one-sided or irrelevant responses One sided (only thesis/anti-thesis) No application to Singapore context	1-8
Evaluation		
E1	Unsubstantiated judgment- Merely stated a stand	1
E2	Underdeveloped but substantiated judgment with elaboration of factors to determine whether Singapore has control over its economic performance.	2-3
E3	Well-developed and substantiated judgment to determine if Singapore has control over its economic performance.	4-5

Q6 The withdrawal of United States from the Trans-Pacific Partnership (TPP) and Britain's Brexit are outcomes powered by anti-globalisation sentiments. Some countries have adopted anti-globalisation measures such as imposing higher tariffs on imported goods, higher taxes on domestic firms moving abroad and implementing anti-immigration laws to address the challenges of globalisation.

Source: Adapted from MTI, 6 Feb 2017 & The Guardian, 9 November 2016

- a) Explain the underlying reasons why some countries are embracing the move towards anti-globalisation. [10]**
- b) Discuss whether countries should adopt anti-globalisation policies to address the challenges of globalisation. [15]**

Suggested answers to part (a)

(Students will need to explain 3 points on the disadvantages of globalisation – the 3 points chosen will need to cover the different aspects of globalisation, e.g. trade, capital and labour flows)

Introduction

Anti-globalisation refers to the movement of countries adopting the move to make their countries less open to trade, capital and labour movement. Some countries are adopting this stance as opening the country up to globalisation has resulted in worsening trade balances, inability to grow their infant industries to develop comparative advantage, destabilising exchange rates due to capital movement and the loss of jobs for domestic workers. Countries which adopt anti-globalisation stance view the gains of globalisation to lack inclusiveness across countries.

1. To correct a severe trade deficit

Countries such as U.S are adopting anti-globalisation moves due to the worsening of their trade deficit. In 2016, U.S trade deficit totalled to an amount of USD \$502 billion, which has hindered the U.S economic growth. The trade deficit could be a result of the loss of export competitiveness due to rising low-cost competitors from countries such as China, Thailand and Vietnam. Furthermore, in recent years, U.S has accused China of adopting unfair practices in manipulating and undervaluing their exchange rates to make their exports cheaper, resulting in U.S consumers switching away from domestic products towards cheaper alternatives from China. Hence, in order to correct the severe trade deficit, U.S adopted the stance to engage in protectionist measures to make foreign products relatively more expensive than locally produced products. This will steer U.S consumers to purchase local products instead, improving the U.S trade balance which will in turn improve the U.S economic growth, ceteris paribus.

2. Inability to grow infant industries to gain comparative advantage

This is an argument often put forth by developing countries. Infant industries are industries that have been identified as having the potential to possess comparative advantage in the future. An infant industry needs to grow and gain experience. It may have a potential comparative advantage that can only be developed behind a protective barrier such as tariffs. If the country achieves the comparative advantage, then markets in the world will stand to benefit and consumers will be able to enjoy lower prices and better quality. This will allow the country's long term economic growth goals to be met as well. Hence, countries faced by the pressure of strong competition from foreign companies find it difficult to grow their infant industries and will need to adopt protectionist measures to protect their infant industries in the short run. This is also in view of the need to create a level playing field when many other countries are also giving export subsidies and undervaluing their exchange rates to create artificial comparative advantage for their domestic firms.

3. Capital flows destabilising the exchange rates

The free movement of capital into and out of the country has resulted in the destabilising of the exchange rates. With globalisation, there is reduced barriers on capital flow which resulted in greater ease of the influx and exit of 'hot money'. Due to the nature of 'hot money', it changes its investment destination quickly in search of higher returns. When there are news of uncertainty in a country, these 'hot money' will exit the country in huge amount. For example, the pessimistic news of U.S after the subprime crisis and Brexit have resulted in investors and speculators withdrawing their funds from these countries. This has resulted in a sharp depreciation of these countries' currencies, which is unfavourable in the eyes of the investors, sparking off greater uncertainty due to the volatility of the exchange rates. This forces the countries to consider adopting measures to reduce the capital movement of the 'hot money'.

4. Loss of jobs for domestic workers

With countries opening up due to globalisation, they are now faced with greater level of competition from abroad. Due to the rise of low-cost competitors, countries may find it more challenging to compete and are losing their competitive edge. This has resulted in some loss-making firms to shut down. The shutting down of firms has resulted in a rise in unemployment as there are loss of jobs for the locals. Furthermore, in the attempt to lower their cost of production, more local firms from the developed countries are choosing to outsource jobs which were previously managed by the locals to the workers from developing countries who can get the same job done at a lower wage, worsening the case of unemployment for the locals.

Conclusion

Thus, some countries are adopting the anti-globalisation stance to gain more time to develop new comparative advantage, reduce uncertainties for their economy and protecting the jobs of the locals.

Level	Descriptors	Marks
L3	Well-developed explanation with good use of economic concepts on the disadvantages of globalisation. Coverage of points include trade flows, capital flows as well as labour flows.	8-10
L2	An explanation which discusses the disadvantages of at least 2 aspects of globalisation (trade, capital, labour flows)	5-7
L1	A brief explanation about underlying reasons towards anti-globalisation.	1-4

Suggested answers to part (b)

(Students will need to discuss at least 2 of the policies mentioned in the pre-amble and recommend a more sustainable policy to address the challenges of globalisation.)

Introduction

To address some of the challenges faced by globalisation mentioned in part (a), some countries are adopting the policies of imposing higher tariffs on imported goods, higher taxes on domestic firms moving abroad and implementing anti-immigration laws. While these policies may be able to resolve the challenges of globalisation in the short term, they are not sustainable in resolving the challenges in the long run.

1. Imposition of tariffs on imported goods

The imposition of tariffs lead to higher prices on imported goods and hence is considered an expenditure-switching policy to divert local consumers to purchase more of their domestic products. Assuming *ceteris paribus*, this will in turn lead to an improvement in the country's trade balance.

How the tariff works

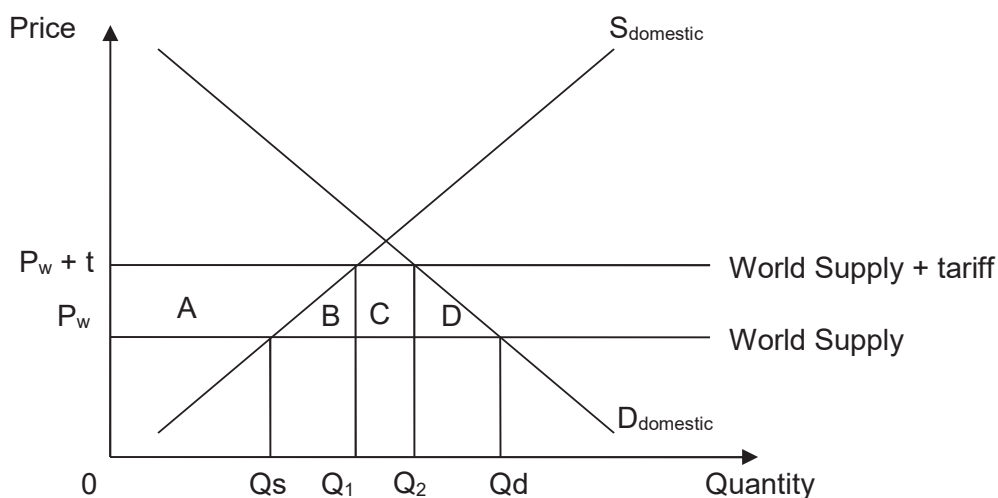
Before the imposition of the tariff

At the world price of P_w , consumption was Q_d , of which $0Q_s$ was of domestic production source and the remaining quantity Q_sQ_d is from imports.

After the imposition of the tariff

The market price rises by the full amount of the tariff to $P_w + t$. At the new price, domestic production increase to $0Q_1$ and imports are reduced to Q_1Q_2 .

Figure 1: Economic Effects of a tariff



Reasons supporting the use of tariffs to correct the challenges of globalisation

- The tariff raises the domestic price and guarantees the domestic producers a bigger market, **domestic sellers** are better off as seen by the gain in **Area A**. With a fall in import expenditure, the imposition of tariffs is able to correct the country's trade deficit.
- The government also gains as the revenue collected by the **government** is shown by **Area C** which could be used to improve aspects of the economy.

Reasons against the use of tariffs to correct the challenges of globalisation

- **Domestic buyers** are worse off because of the higher price which forces them to cut down on the quantity demanded of the good. Furthermore, the variety of goods and services available to the locals will be considerably reduced, lowering the non-material standard of living.
- The restriction in trade can lead to deadweight losses of the **Areas B and D**.

- It is highly likely that other countries may retaliate, adopting similar anti-protectionist policies, against the country which imposes tariffs on their goods. This may result in the benefits mentioned above to be negated leading in a lose-lose situation for the countries involved.

2. Anti-immigration laws to restrict labour flows

Countries imposing the use of anti-immigration laws seek to restrict the labour flow of foreign workers into their countries in order to protect domestic jobs for their locals.

Reasons supporting the use of immigration laws to correct the challenges of globalisation

- Domestic jobs will be better secured for the locals and due to the fall in supply of foreign workers due to the imposition of the anti-immigration law, this will result in a higher wages for the domestic worker, improving their material standard of living.
- At the macro level, due to more locals being employed, the employment rate of the economy will improve.

Reasons against the use of immigration laws to correct the challenges of globalisation

- While more jobs are secured for the locals with the imposition of the immigration laws, this creates challenges for local firms which are trying hard to keep their costs of production low by hiring cheaper labour force from other countries. For example, U.S which recently implemented anti-immigration policies have resulted in some of their biggest tech giants commenting on the appropriateness of such policies in ensuring future growth of U.S companies. By hiring locals who are now commanding a higher wage from the firms, firms will now expect a lower level of profits to be earned and could lead to lower dynamic efficiencies in the future.
- Companies may now also be deemed as less competitive as firms choosing to maintain their profitability may raise their prices. At the global level, the goods will now be less competitive, resulting in a fall in exports revenue which will in turn lead to a fall in AD via the multiplier effect, lowering the country's real national income. Hence, a conflict arises, where the aim of improving domestic employment may result in a worsening economic growth for the country.
- By imposing the immigration law to reduce the hiring of foreign workers, the country is also potentially closing doors to foreign talents who are able to contribute to the nation through specialised skills and knowledge. Some of the current companies have achieved significant growth over the years due to the contributions of foreign talents.

3. Higher taxes on domestic firms moving abroad

Reasons supporting the imposition of taxes on domestic firms moving abroad

In order to ensure more local jobs employment, countries such as U.S have imposed higher taxes on domestic firms moving abroad. The higher taxes will reduce the profitability of the domestic firms moving abroad and redirect them to focus on the domestic market instead, leading to greater employment of the locals.

Reasons against the imposition of taxes on domestic firms moving abroad

However, by restricting domestic firms from moving abroad through higher corporate taxes imposed, this will disincentivise offshoring where companies move abroad in search of opportunities to reduce their costs of production. This will translate to the goods and services produced to be more expensive and losing exports competitiveness if local workers are hired. This will especially be a significant issue faced by the developed countries.

4. Adopt Supply side policies to address the challenges of globalisation

Countries facing the challenges of globalisation should adopt the use of supply side policies rather than anti-globalisation policies due to the possible retaliations by other countries.

Investing in training programmes to upgrade the skillsets of workers

Governments could look into training programmes to enhance and upgrade the skillsets of their workers to provide better productivity which will translate to lower costs of production. By having a pool of productive workers, the improvement in labour productivity will lead to more competitive exports which will improve the trade balance of the country and eventually shifting AD to the right via multiplier process and achieving improvement in economic growth.

Investing in technological advancements to gain competitive edge

Countries should engage in forward planning and invest in technology to gain competitive edge in the years ahead. Singapore, for example, tries to overcome the challenges of globalisation by embarking on the journey towards a Smart Nation initiative and being **one of the first movers in leveraging on cutting technologies integrated into society. This will attract investors who are interested in the prospects the technological advancements into the country. Singapore therefore tries to reposition herself from a value-added country towards an innovator where they value create services to compete with other countries.**

Limitations on the use of supply side policies

In order to ensure an effective implementation of the supply side policies, countries must first have a healthy budget to invest in workers' upgrading and innovation. Countries that are currently facing a severe budget deficit may find it difficult to utilise their current resources into these areas. Furthermore, in order to ensure that the goals are achieved as planned, the country must have a forward looking government

dedicated in ensuring the processes are carefully looked into and strategies effectively carried out as planned.

Conclusion

The use of anti-globalisation policies is mostly justifiable if a country is using it as a short-term strategy to correct immediate issues in the country such as a persistent trade deficit or job insecurity for the locals. The use of these policies will not be sustainable in correcting the issues in the long run as other countries are likely to retaliate such a move and may bring more harm than benefits to the global economy in the long run.

In the long run, countries should instead be adopting supply-side policies to better upgrade their workers and enhance their state of technology or quality of resources to better face the challenges of globalisation. This however is also subjected to the government's ability and budget to finance the implementation of the supply-side policies.

Level (Marks)	Descriptors
L3 (8 – 10)	Answer provides a clear and detailed analysis of the policies to address the challenges of globalisation.
L2 (5 – 7)	Answer provides an undeveloped analysis of the policies to address the challenges of globalisation.
L1 (1 – 4)	Answer shows some knowledge of the policies to address the challenges of globalisation but with irrelevancies and errors.
Evaluation	
E3 (4-5)	For a well-explained judgement that is supported with economic reasoning.
E2 (2-3)	For an underdeveloped justification of stand made, one that is lacking in economic rigour.
E1 (1)	Mainly unexplained judgment based on analysis.

