

Question 2: Challenges and Promises of Globalisation

Extract 6: The purpose of EU

The original objectives of the European Economic Community were the development of a common market, subsequently becoming a single market, and a customs union between its member states. The single market involves the free circulation of goods, capital, people, and services within the EU, and the customs union involves the application of a common external tariff on all goods entering the market. Once goods have been admitted into the market they cannot be subjected to customs duties, discriminatory taxes or import quotas, as they travel internally. Free movement of capital is intended to permit movement of investments such as property purchases and buying of shares between countries. The free movement of persons means that EU citizens can move freely between member states to live, work, study or retire in another country.

Wikipedia, 26 July 2016

Extract 7: Brexit and its impact

The people of Britain voted for a British exit, or Brexit, from the EU in a historic referendum on Thursday 23 June 2016. The outcome has prompted jubilant celebrations among Euro sceptics around Europe and sent shockwaves through the global economy. The Brexit victory sent economic shockwaves through global markets and UK stocks had their worst drop since the financial crisis. Emergency steps are now being taken to calm the economic turmoil after the pound fell to its lowest level since 1985 against a loss of international competitiveness in recent years. Britain has lost its top AAA credit rating. There is ongoing uncertainty over what will happen when Britain leaves the EU because it has to make new trade agreements with the rest of the world.

Bank of England Governor Mark Carney said: "Some market and economic volatility can be expected as this process unfolds. But we are well prepared for this." Supporters of Brexit argue that EU countries have every incentive keep trading with the UK, which is a large importer of goods and services. But Europhiles worry that foreign companies will be less likely to invest here and could relocate as seen in recent years. Neil Woodford, head of investment at Woodford Investment Management, said could see to an extent why the Brexit vote had been seen as an "existential shock" to the economy. But he said: "The reality is very different in my view. I don't think there's going to be a recession in the UK." He has also said the Brexit vote is good news for exporters who have struggled with the high value of the pound.

Adapted from Express, Alice Foster, 22 July 2016

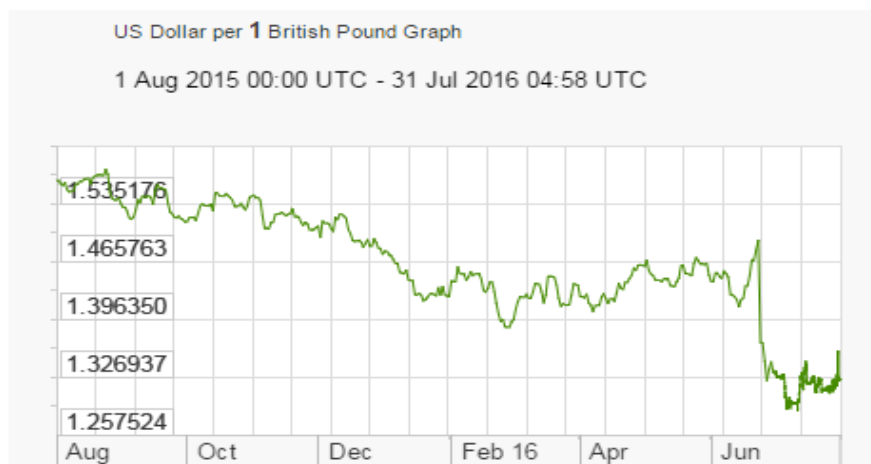


Figure 1: British Pound Exchange rates www.x-rates.com, 31 July 2016

Extract 8: Pattern of Trade between USA and China since China's accession to WTO

An examination of trade data from 2000 to 2011 demonstrates the following patterns in U.S.-China trade that have taken place in the decade since China's accession to the WTO:

1. U.S. exports to China have more than quintupled in value but are dwarfed by the surge of Chinese imports into the United States, resulting in a steadily growing bilateral trade deficit;
2. A dramatic rise in the levels of non-manufactured goods (particularly agricultural products, raw materials, and mined natural resource products) exported by U.S. producers to China, to the extent that there is now a U.S. trade surplus with China in non-manufactured goods;
3. A dramatic rise in imports of Chinese-made manufactured goods into the United States, and a significant decrease in U.S. exports of manufactured goods to China as a share of total exports; Most of the computers and electronic products exported from China to the United States are still relatively low-tech items, such as notebook computers, telephones, televisions and video games.
4. A steady move up the value chain for Chinese imports into the United States – most noticeably in computers and consumer electronics. However, in this latter category China often serves as an assembly and export platform for multinational corporations of components manufactured elsewhere in world, a fact that may not be clearly reflected in trade statistics.

U.S.-China Economic and Security Review Commission Staff Research Report, November 2012

Extract 9: U.S. hikes duties on Chinese steel to more than 500%

A trade spat between the U.S. and China boiled over on Wednesday, with Beijing demanding the removal of a new 500% duty on some of its steel products. The escalation follows a ruling by the U.S. Department of Commerce on Tuesday that dramatically increases duties on Chinese cold-rolled steel, which is used to make appliances, cars and electric motors.

Trade tensions between the U.S. and China have risen considerably this year -- especially over steel. Last month, U.S. Steel accused dozens of Chinese producers of breaking trade rules, and asked the U.S. International Trade Commission to investigate. China produces half of the world's steel, more than the U.S., European Union, Russia and Japan combined. Other countries affected by China's export of steel has even resorted to international pressure on clamping down the steel mills mostly based in Tangshan through claims of extreme pollution readings and inhumane living conditions for labour. But as the country's massive economy slows, internal demand for steel is dropping. Beijing now stands accused of dumping its unwanted metal on other markets, forcing rivals to close their plants and killing thousands of jobs, especially in the US, leaving many Americans jobless with no relevant skills suitable for other industries.

CNN Money Internationals, 18 May 2016

Extract 10: Singaporean workers and firms face challenges from globalisation

Globalisation and technological advances are disrupting industries and displacing workers, and these are challenges that Singapore workers and companies will have to face, said Prime Minister Lee Mr Lee said

that Singapore also faces competition from both developing and developed economies. He noted that in Japan, for instance, the starting salaries for graduates is lower than for those in Singapore.

"Every economy is going to be disrupted and especially Singapore, a small country with the most open economy in the world. We depend heavily on foreign investments, we depend heavily on trade," said Mr Lee. "And so much of what we produce, we cannot consume ourselves," he added. "We make petrochemicals - we sell it to the whole world. We want smartphones, we can't make our own smartphones - we buy them from the world."

Mr Lee warned that Singapore will have to be prepared for a slowdown and possibly even a downturn. While the country is gearing up for such challenges, Mr Lee said it will take time for new jobs to be created and for new skills to be learned, and that it is not always easy for workers, especially older ones, to change jobs and industries.

Mr Lee said that the state still has a role to play in preparing the country to face future challenges. Besides creating the basic conditions for the markets to operate properly, Mr Lee said that the state should also aim to "mitigate the excesses and negative effects of a market system" and give Singaporeans better protection in a less stable economic environment. To this end, the Government has rolled out the Progressive Wage Model to help upgrade the skills and wages of low-income workers like security guards and cleaners, and other initiatives like Medishield Life and Silver Support are also in the works.

Channel News Asia 26 Oct 2015

- a(i) From Figure 1, describe the trend observed of the British pound from August 2015 till July 2016. 2m
- a(ii) Using demand and supply analysis and with reference to the extracts, explain your observation. 4m
- a(iii) How far do you agree that the Brexit vote is good news for British exporters as mentioned in extract 6. 3m
- (b) Using concepts of opportunity cost, account for the patterns of trade as seen in extract 7 between US and China. 6m
- c(i) Explain how the use of tariff on steel from China will resolve unemployment issues in USA. 4m
- c(ii) Explain briefly possible unintended consequences on the other industries in USA as a result of the tariff on steel from China. 3m
- (d) The complexity of economic relationships that can occur as globalisation gathers pace can be clearly seen in the extracts – in this case between USA and China, Britain and the EU. Discuss whether Singapore should follow the footsteps of Britain and USA in order to prevent the challenges from globalization. 8m

(a)(i) From Figure 1, describe the trend observed of the British pound from August 2015 till July 2016. [2m]

The British Pound generally depreciated over the period.

There was sharp dip in its value in June 2016.

(a)(ii) Using demand and supply analysis and with reference to the extracts, explain your observation. [4m]

Any 2 relevant explanations with clear link to observations:

Explanation of general trend:

Demand Side

In extract 7, Britain export competitiveness has been going down which translated to a fall in demand of British exports of goods and services. This would mean a fall in the demand of British pounds in the foreign exchange market, leading to depreciation of the British Pound. [2m]

Supply Side

Extract 7 mentioned that British firms will relocate. The disinvestment from Britain to other parts of the world would see the selling of British pounds for other foreign currencies which increased the supply of British pounds in the foreign exchange market, further reinforcing the weakening of the British pound. [2m]

Explanation of the sudden dip:

Demand side:

The sudden dip in its value in the FOREX in June 2016 is likely to be linked to the Brexit vote and the resultant loss in confidence in its economy. This would lead to a reactive drastic fall in the demand of British pounds as all potential investors are likely to seek safer destinations elsewhere and hence a significant drop in its value. [2m]

(a)(iii) How far do you agree that the Brexit vote is good news for British exporters as mentioned in extract 7. [3m]

Explain why it is 'good news'

A direct impact of the Brexit vote is a weaker pound. This is beneficial for British exporters as **it** increases export competitiveness since exports are cheaper in foreign currency. This increases export revenue.

Address 'how far'

However a weaker pound may also mean more expensive imports. If these imports are raw materials, this would translate to higher unit cost of production, this would partially erode the price advantage gained from the weaker pound.

(b) Using concepts of opportunity cost, account for the patterns of trade as seen in extract 4 between US and China. [6m]

Use OC to explain why there is an increase in volume of trade (3m)

Pattern of Trade: Refers to volume, composition and direction of trade in goods and services

Pattern of international trade is largely determined by differences in opportunity costs or **CA**. Based on the theory of CA, countries would gain from trade if they specialize in the production of goods that they have comparative advantage in (produce at a lower opp costs) and export it for goods it does not have CA in producing provided the terms of trade lies within the domestic opp costs of the 2 countries. The quantity and quality of factor endowments a country has will influence the opp costs in production and hence determine the comparative advantage in production

The theory of CA predicts that countries will gain from trade if they specialize in producing an exporting gds in which they incur lower OC. The desire of countries to reap gains from trade leads to the increase in volume of trade as opined in the case materials. Hence OC explains the pattern of trade in terms of why there is an increase in the volume of trade.

Use OC to explain the types of goods USA/China exports & imports (3)

- **Composition of Trade [What is traded]:** Each country will export the types of good that they have comparative advantage in production and import the types good that they do not have comparative advantage in production.
- As seen in the extract, it seems that China has lower OC (comparative advantage) in the production of goods that require intensive low skilled labour, a factor endowment in which China possess. It also seemed that China is seeing a shift in comparative advantage from low end manufactured goods to higher end manufactured goods, this could be due to a change in its quality of labour showcasing the fact that comparative advantage is dynamic.
- As for US, the lower OC (comparative advantage) lies in the production of agricultural products and natural resources, this is likely due to its factor endowment in land and also superior technology engaged in such farming and mining industries

[Must cite evidence to support analysis]

[Max 6m]

(c)(i) Explain how the use of tariff on steel from China will resolve unemployment issues in US. 4m

A tariff is a tax on imported steel and has the impact of raising the unit cost of production hence reducing the supply and raising the equilibrium price of the imported steel. The quantity demanded of imported steel falls.

Since domestic goods and imported steel are substitutes, the demand for domestic steel will increase. Output level of domestic steel will increase and since the demand for steel labour is a derived demand for steel, and increase in output would mean an increase in the demand for steel workers, and this would cushion the unemployment created due to the influx of cheap steel from China.

The impact on employment depends on the size of the tariff and the PES of the domestic supply. The bigger the tariff, the larger the increase in output of domestic steel and the bigger the increase in employment.

(c) (ii) Explain the possible unintended consequences on the other related industries in USA as a result of the tariff on steel from China. [3m]

Imposition of a 500% tariff leads to increase in price of steel in USA. Domestic industries that require steel for production will have to turn to domestic steel industries. This would naturally mean an increase in the cost of production as compared to prior the tariff.

Such industries include the construction industries, shipbuilding, automobiles, defence technology sector which would experience an increase in unit cost of production, leading to a fall in supply of these goods and translating to higher prices.

These effects would lead to fall in international competitiveness of these exports from USA reducing exports of these products.

There would also be a fall in demand of labour in these various industries & unemployment may actually worsen.

- (d) **The complexity of economic relationships that can occur as globalisation gathers pace can be clearly seen in the extracts – in this case between USA and China, Britain and the EU. Discuss whether Singapore should follow the footsteps of Britain and USA in order to manage the challenges from globalization. [8m]**

Define Globalisation:

Globalisation refers to the integration of the world's economy into a single international market. It refers to trade in goods and services, technology, labour and capital flows.

Identify the policy approaches of Britain and USA: Brexit & tariff

Thesis: Benefits of following Britain in exiting EU and US in imposing tariff (3m)

These are basically challenges that arose due to globalization

- 1) Structural Unemployment as seen in USA with regards to the steel workers (Ext 9) and also in Singapore (as mentioned in Extract 10) due to the loss of comparative advantage or increase in opportunity cost.

Globalisation results in heightened competition from abroad and increased the rate of change in the structure of an economy. The fall in demand for low end manufacturing export from Singapore leads to a fall the demand for factors of production used in these industries including labour as firms downsize. The most inefficient firms will be forced to exit the industry. There could be structural unemployment as retrenched workers are unable to get new jobs due to a lack of necessary skills.

This has been an acute problem for Singapore during the last few years when the emergence of new super-competitive economies like China and India have made many types of skills redundant in Singapore as many local and foreign companies relocated or downsized their operations. Singaporeans who were displaced from their existing industries often suffer prolonged periods of unemployment and hardship. Therefore the possibility of using some form of protectionist measures to offset the structural unemployment issues.

Wage differential is greater and the income gaps widen. The income gap also widen as there will be people who became unemployed because of structural changes.

Anti Thesis: Singapore should not follow the footsteps of Britain and USA and continue to pursue globalization [3m]

- 1) **Raising living standards:**

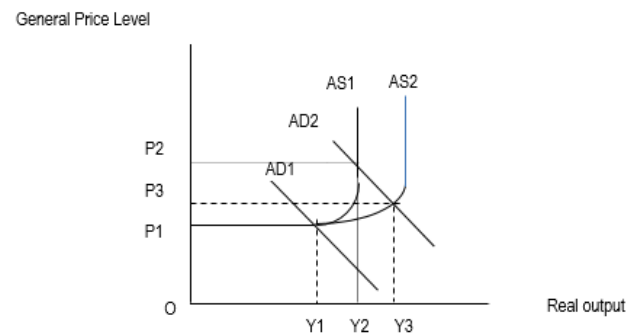
Promotes economic growth

(i) Actual economic growth

E.g. In Singapore, physical size and lack of natural resources have become less of a constraint due to globalization as it has helped opened up new markets for our exports. In the past years, there has been rising foreign demand for Singapore-made goods and services such as education and health, boosting economic growth. With reference to figure 1, the resulting increase in net export shifts the AD1 to AD2 and causes real output to increase from Y1 to Y2.

This can be seen in extract 1 where the integration of various countries in EU allows the various countries to gain access into various new markets for their exports. This is extremely important for a country like Singapore which has an extremely small domestic market. This again is echoed by PM Lee who mentioned in extract 6 that the domestic market in Singapore is not able to consume all products produced. The Singapore economy needs to depend on external demand to grow.

The extent of increase in real output depends on the country's dependence on external demand. For example, due to a large population, USA's domestic demand is large enough to drive the country's economic growth. In USA, domestic consumption (C_d) takes up a larger proportion of AD, leading to a lesser need for the country to depend on net exports to drive economic growth. Therefore USA could enact protectionist measures and not be as concerned about the impact as Singapore.



(ii) Potential economic growth

Globalisation helps to enhance the capacity of an economy to grow in a number of ways. E.g. It allows the transfer of skills and technology. FDI (Foreign direct investments) and international movement of labour allow the transfer of skills and technology from the (Developed countries) DCs to LDCs (Developing countries), shifting the latter's LRAS rightwards. Increased economic productivity due to more advanced technology contributes to potential economic growth. FDI into Singapore is an important source for technological advancement in the economy. This can be seen in extract 1 which mentioned the benefits of a country in EU where such technology can move freely.

As shown in figure above, globalisation not only results in an increase in net export ($X-M$), shifting her AD curve from AD1 to AD2. it can also increase the transfer of skills and technology to the country hence shifting her long-run aggregate supply curve outward from AS1 to AS2. This increases the capacity of the country to produce and increases potential economic growth. The rightward shift of the LRAS has an added advantage of reducing inflationary pressures and lowering of the general price level for P2 to P3. Together with actual growth, sustained economic growth will be achieved. This means that there can be continued growth without the economy overheating.

Conclusion: Synthesis

While there are costs and consequences to globalization, the Singapore government has rolled out various measures to tackle them, for example to this end, the Government has rolled out the Progressive Wage Model to help upgrade the skills and wages of low-income workers. An example of skills upgrading measure is the Workfare Training Support Scheme, in which the Singapore government subsidizes employers up to 95% of fees incurred in sending

low income earners for approved upgrading courses. Workers are also provided cash incentives for completing upgrading courses.