

H2 Economics Prelims Essays Suggested Answers

- 1 The recent strong economic growth and the advancement in technology have had major impact on the demand for and supply of air travel.

Assess how the markets for low cost carriers and full cost carriers might be affected by the above. [25]

| Low cost carrier | Full cost carrier |
|--|---|
| <ul style="list-style-type: none"> Economic growth – increase in household income – for inferior goods (low cost carrier may be perceived as inferior compared to their full cost counterparts) – DD for air travel decreases | <ul style="list-style-type: none"> Economic growth – increase in household income – for normal goods – DD for air travel increases For normal and necessity goods – higher degree of need for the good – consumers like businessmen would likely face an income inelastic DD curve – for a given increase in income, DD for air travel increases by less than proportionate For normal and luxury goods – lower degree of need for the good – consumers like holiday-goers would likely face an income elastic DD curve – for a given increase in income, DD for air travel increases by more than proportionate |
| <ul style="list-style-type: none"> Advancement in technology – higher productivity – lower AC – SS increases | |
| <p>Inferior goods</p> <ul style="list-style-type: none"> Decrease in DD Increase in SS <p>Impact on the market</p> <ul style="list-style-type: none"> Decrease in eqm p – explained using the price adjustment mechanism The impact on eqm Q depends on the extent of the shift of the 2 curves <ul style="list-style-type: none"> If DD decrease > SS increase → eqm Q decreases If DD decreases < SS increase → eqm Q increases If DD decrease = SS increase → eqm Q remains unchanged | <p>Normal and necessity goods</p> <ul style="list-style-type: none"> Increase in DD (by less than proportionate) Increase in SS <p>Normal and luxury goods</p> <ul style="list-style-type: none"> Increase in DD (by more than proportionate) Increase in SS <p>Impact on the market</p> <ul style="list-style-type: none"> Increase in eqm Q The impact on eqm P depends on the extent of the shift of the 2 curves <ul style="list-style-type: none"> If DD increase > SS increase → eqm P increases If DD increases < SS increase → eqm P decreases If DD increase = SS increase → eqm P remains unchanged |
| <ul style="list-style-type: none"> Diagrams drawn to illustrate the impact on P and Q on the different types of goods | |

Note:

- Technology can also affect the DD (and not just the SS)
- XED can be used to explain the extent of the shift of the curve
- Can accept a range of answers, as long as the concepts are accurately applied

- 2 (a) Explain how barriers to entry determine a firm's pricing and output decisions. [10]

Define barriers to entry

Barriers to entry refer to any impediments that prevent new firms from entering an industry and limit the competition faced by existing firms.

Explain how high barriers to entry determine a firm's pricing and output decisions

- Industry with high barriers to entry, may only have a few large firms dominating the market (oligopolies) or it may only have 1 firm in the market (monopoly)
- Firms in the industry will therefore have strong market power and can have control over the market price. Each firm will have the market power to set its own price or quantity to be sold but not both at the same time. If the firm decides to set the price in the market, then it would have to leave the resulting quantity demanded & sold to the market to determine. If the firm decides to raise its price, quantity demanded will fall. Alternatively, the firm can restrict output in order to raise the price. This implies that the demand curve (AR curve) that the firm faces is downward sloping.
- The higher the BTEs, the more price inelastic is the demand curve and the lower the BTEs, the more price elastic the demand curve.
- Each firm's MR curve is below the AR curve as price needs to be reduced if firm wants to sell an additional unit of the product.
- If the firm aims to maximise profits, the firm will produce at a level where the extra revenue earned from selling the last unit is just equal to the extra cost of producing that last unit, i.e. where $MR = MC$.
Reason: When $MR > MC$, an additional unit produced adds more to the revenue than to the cost and hence profits can still increase by producing the extra unit. When $MR < MC$, an additional unit produced adds more to the cost than to the revenue, hence reducing the firm's profit and thus the firm will not produce the extra unit.
- At this output level, where $MR = MC$, $P > MC$, since $AR (AR = P)$ is above MR.

Explain how the absence of barriers to entry determine the price and output decisions

- In a perfectly competitive market where there are no barriers to entry, new firms can easily enter the industry. There will be many firms in the industry.
- Each firm will only contribute an insignificant proportion of the total market supply and so has no power to influence the market price. The firm is a price taker, selling its product at the market-determined price which is determined by the total demand and supply in the market.
- The demand curve of each firm is perfectly price elastic. $AR = MR$
- The profit-maximising firm will produce the output level where $MR = MC$. Since $MR = AR = P$, the firm produces where $P = MC$

Conclusion

Barriers to entry determine the shape of a firm's AR/DD curve and this influences the firm's pricing and output decisions.

- (b) **Discuss the likely benefits to society if the barriers to entry were removed.** [15]

Introduction

Removal of barriers to entry leads to increased competition in the market. Both consumers and producers can benefit from this.

Development

Benefits from removing barriers

- Increase in number of firms operating in the industry → firms produce at or near $P=MC$ → remove or reduce the extent of allocative inefficiency caused by market dominance
- Since P is equal to or closer to MC , consumer surplus is maximised or the extent to which producers rob consumers of their surplus is reduced
- New firms enter the industry → each firm's demand fall → AR curve of each firm shifts to the left → p and q falls → TR falls and supernormal profits are competed away → all firms earn supernormal profits → there is a more equitable distribution of income in society as there is no sustained redistribution of income to the producers
- With an increase in competition, X-inefficiency is also avoided – as the firm is kept on its toes and would not face a lack of motivation from staff, lax cost controls and undertake unnecessary spending

Costs of removing barriers

- With an increase in the number of firms – incumbent's supernormal profits are eroded – limits their ability to conduct R&D to discover cost-efficient methods of production, or to innovate – dynamic efficiency is reduced
- In the case of a natural monopoly which faces a falling AC and MC over a large range of output, removing barriers may lead to them making losses as their TR cannot cover their TC – this is because the firm has to produce on a large scale in order to reap substantial EOS -- once the natural monopoly is prevented from doing so, it shuts down, and consumers are deprived of the good

Conclusion

- There may be costs to society when BTE is removed but it also makes sense if government comes in to intervene to ensure the benefits to society is maximised

3 (a) Explain why markets fail in the case of public goods and in the consumption of alcohol. [10]

Explain why market fails in the case of public goods

- State that public goods are goods that exhibit 2 characteristics:
 - Non excludable
 - Non rivalrous in consumption
- Explain the implication of each characteristics.

| | Non-excludability | Non-rivalrous in consumption |
|-------------|--|--|
| Definition | A good is non-excludable when it is impossible or very costly to exclude non-payers from consuming it. | A good is non-rivalrous in consumption when the consumption of the good by one person does not reduce the amount of satisfaction of the next person consuming the same good. |
| Implication | Non-payers can also enjoy the good or service, leading to the free ridership problem . Consumers will not reveal their preferences and there will be no effective demand . | To provide the good for an additional consumer, no additional resources are needed. Thus, the marginal cost of producing an additional unit of good for the next person is zero. As society aims to be allocative efficient, price equals marginal cost, and since the marginal cost is zero, $P=0$. There is no incentive for producers to supply the good at all. |
| As a result | There will be no price signal and the good or service will not be provided by the free market. There is no resources are allocated to the provision of public goods. | |

- Explain that in the case of public goods, there is complete market failure. As there is no signal of effective demand and supply in the market, no resources will be allocated to the production of the good in the free market. Hence there is complete market failure.

Explain why market fails in the case of consumption of alcohol

- State that alcohol is considered as a demerit good because the government deems consumption of alcohol as undesirable.
- State also that there is a tendency for overconsumption of alcohol as consumers are not fully aware of the cost of consuming alcohol and that consuming alcohol generates large amount of negative externalities.
- Explain the possible negative externalities generated from the consumption of alcohol.
 - In consumption of alcohol, there are negative spill-over effects such as accidents caused by drunk driving, ruckus caused by highly intoxicated people.
- Explain how the presence of negative externalities lead to market failure.
 - The presence of negative externalities leads to the divergence between MSC and MPC as MEC on third parties not accounted for.
 - Explain that the private optimal consumption level > social optimal level, therefore over allocation of resources to the consumption of

alcohol. [Illustrate with diagram]

- State the welfare loss, hence there is market failure.

Alternative explanation

Explain how due to presence of imperfect information, consumers are unaware of the full extent of the costs of consuming alcohol, thus undervalues the MPC, leading to over allocation of resources for the consumption.

(b) Evaluate the policies that the Singapore government can adopt to correct these causes of market failure. [15]

Introduction

- State that as market fails in the case of public goods and in the consumption of alcohol, there is a need for government intervention to correct the market failure.

Development

- Policy adopted to correct market failure in the case of public goods:
 - Direct provision by the government
 - When there exists complete market failure, as in the case of public goods, there is a need for direct provision.
 - Since goods/services like national defence and law enforcement are non-excludable and non-rivalrous in consumption, there exists a missing market and no producer will be willing to produce the good/service even though provision of the good/service benefits the society.
 - Thus in order to ensure efficient allocation of resources the government directly provides for the good.
 - However, it is difficult for government to have complete knowledge of the right amount of the good to be provided. (information failure)
 - In addition, such policy puts a strain on government's budget which can be used to develop other sectors, which are important to aid economic growth in the country
- Policies adopted to correct market failure in the consumption of alcohol:
 - Legislation to discourage consumption of alcohol
 - Legislative Acts such as ban of the sales of alcoholic drinks after 10.30pm.
 - This policy reduces supply of alcohol after 10.30pm, thus the quantity available for consumption falls. Hence curbing the over consumption problem.
 - Such Acts may also increase the cost of getting access to alcohol. Thus increasing the MPC of consuming alcohol. As MPC rises, the quantity consumed by consumers to maximised their net private benefit will fall, Hence solving the over consumption problem.
 - This policy is simple to implement, relatively easy to administer. And any sellers who break the law will be heavily punished.
 - However, there will be high enforcement cost, such as the high cost involved in getting law enforcers to conduct regulatory checks.

- Taxation
 - Imposing taxes equivalent to the marginal external cost at the socially optimal level of output increases MPC to MSC, reduces consumption of alcohol (illustrate and explain using diagram the shift of MPC curve to MSC curve)
 - However, due to complexity and inaccurate information, it is hard to measure and quantify the amount of negative externalities given off due to consumption of alcohol, hence it's difficult to impose the correct value of tax to fully internalize the different types of negative externalities exhibited.
 - In addition, if the consumers are alcohol addicts, their demand for alcohol will be highly price inelastic. Thus, it will require a very high amount of tax to reduce alcohol consumption.
- Campaigns to increase the awareness of costs of consuming alcohol
 - Educating people on the costs of consuming alcohol to increase their awareness and thus closing the gap of imperfect information.
 - As consumers have more knowledge of the costs of alcohol consumption, their MPC will increase and as such the quantity they consumed will fall. Problem of over-consumption is thus solved.
 - However, it is difficult to change the mindset of people, some people may think that precaution measures are not necessary.
 - Nonetheless, such policy is needed for long term impact.

Conclusion

- Effectiveness of intervention in these markets depend on the severity of market failure and the appropriateness of intervention.
- If extent of market failure is small, less intervention is required, for e.g if MEC is small, perhaps some efforts to raise awareness is sufficient, as opposed to large taxes which might unnecessarily distort the workings of the free market.
- Even in the case of public goods, effectiveness of direct provision cannot exist alone as strict regulation and monitoring are also required in order for resources to be efficiently allocated. i.e. army and police force are given sufficient funds for operation and not for resources to be unnecessarily wasted.
- Presence of good governance would prevent government failure and ensure a greater success of the implementation of the policies.

- 4 Explain the conflicts that exist between the major macroeconomic objectives and discuss the extent to which exchange rate policy alone can be effective in achieving these macroeconomic objectives in Singapore. [25]

Introduction

- Explain the 4 macroeconomic objectives
- The 4 macroeconomic objectives can be achieved by demand management policies and/or supply-side policies. Use of demand management and supply-side can sometimes lead to conflicts in achieving the macroeconomic objectives.

Development

1. Use of expansionary demand management policies such as EFP can lead to conflict between macroeconomic goals <use graph to illustrate>.

Conflict 1: When the government tries to achieve actual growth (and full employment), it will lead to demand-pull inflation

AD rises along upward sloping portion of AS curve (actual growth) → economy has little excess resources → competition for resources by producers bid up factor prices → translates into higher COP is then passed on to consumers through higher consumers prices + exports become less price competitive.

→ Employment goals achieved at the expense of higher inflation and possibly worsening BOT.

2. Use of supply-side policy can lead to conflict between macroeconomic goals.

Conflict 2: When the government tries to achieve potential growth, it will lead to structural unemployment

Successful supply-side measures increase quantity and improve quality of factors of production → potential output increases → productivity ↑, COP ↓, GPL ↓ and export competitiveness (price and product) ↑, possibly improving BOT.

→ ↑productivity through automation and labour-saving innovations increases structural unemployment.

Note: Other conflicts are also acceptable

3. Exchange rate policy can be effective in achieving macroeconomic objectives in Singapore.

Singapore is a small and open economy. Small size and lack of resources → need to import resources and final goods and services from overseas → Increasing import prices is one main source of inflation.

Appreciation of SGD: P_m of final goods and services ↓ in SGD → GPL ↓ directly

P_m of intermediate goods and raw materials ↓ in SGD → COP ↓ → GPL ↓ → helps to curb **imported inflation** in Singapore

Moreover, Singapore's exports have high import content → Improved price competitiveness of SG's exports, BOT improves → net exports ↑, AD ↑, Y ↑ by multiples (**actual growth**). With improvement in BOT, it will also **improve the current account**.

SG's ERP stance of stable, appreciating currency reduces exchange rate risks and is conducive for international trade and investment → attracts FDI (**improves capital and financial account**) → benefits: capital accumulation, skills and technology transfer → LRAS shifts right (potential output increases), makes **sustained growth** possible.

4. Exchange rate policy alone may not be effective in achieving macroeconomic objectives in Singapore

- Appreciation of SGD lowers import prices only through the currency effect. The effects of an external shock such as a sharp increase in oil prices may not be fully mitigated by currency appreciation and can translate into higher COP, threatening export competitiveness.
- Stable, long-term appreciation alone is not sufficient to attract FDIs. Other factors such as political stability, good industrial relations, availability of supporting infrastructure, are also very important.

- Inflationary pressures from domestic sources such as higher wages from a tight labour market, wealth effect from appreciating asset prices causing increase in domestic consumption cannot be addressed through appreciating the SGD.
- Structural unemployment cannot be solved by ERP as the root cause of the problem is the mismatch of skills due to the changing structure of the economy. As such, it is more appropriate to use supply-side policies to tackle the problem.
- Demand for SG's export and direct investment into SG depend on world income levels as well as the level of optimism in the world economy. These factors are external and cannot be influenced by domestic policies.
- In addition to capital accumulation, which may be encouraged through ERP, SG also needs to develop her workforce through **other supply-side measures** such as education, training and re-training, to achieve sustained growth. ERP alone is insufficient.

Conclusion

In the case of Singapore, because of the characteristics of Singapore economy, ERP has proven to be effective in achieving our macroeconomic aims and it is our main policy to stable prices. With price stability, our macroeconomic objectives can be achieved. However, ERP alone is definitely not effective enough because it is important to look at the root cause of the problems before using the appropriate policies to achieve the macroeconomic aims.

5 Economists are concerned that the Chinese economy is too dependent on exports and investments for growth.

- (a) Using the circular flow of income, explain how an increase in exports and investments can affect China's national income. [10]**

Requirements:

- Circular flow of income – identify that exports and investments are J
- Process to bring national income back into equilibrium
- Multiplier process

In a circular flow of income, the national income equilibrium is determined when total planned injections equal to total planned withdrawals. Injections include investment, government spending and exports revenue while withdrawals consist of savings, taxes and imports expenditure. When injections do not equal to withdrawals, a state of disequilibrium will exist. This will kick in a process to bring the economy back into equilibrium.

An increase in exports and investments will increase the total injections. As $J > W$, there will be unplanned running down on stocks. Firms then step up production and increase the demand for factors of production. As firms hire more resources, they also pay out more factor income. As national income and purchasing power starts to increase, it will induce more consumption. **Since one person's spending becomes another person's income, national income will increase by multiples assuming that value of MPC is between 0 and 1.** Furthermore, households will not only spend more on domestic goods, they will tend to save more, pay more taxes or buy more imports, thus increasing the amount of withdrawals. Withdrawals will continue to rise until it is equal to injections. The equilibrium is thus achieved at a higher national income.

- (b) Discuss whether a country's high rate of economic growth achieved by depending heavily on exports and investments is desirable. [15]**

Requirements:

- Balanced discussion with a good scope of analysis:
- Advantages of economic growth
- Disadvantages of
 - o Too heavily dependent on external factors for growth
 - o **High** growth rates
- Evaluation/judgement

It is desirable for a country to achieve high rate of economic growth by depending on exports and investments

- Able to tap on international market that enables the demand for domestically-produced goods to expand → volume of trade increases → firms can now operate on large scale and enjoy economies of scale → lower cost of production
- FDI allows for transfer of technological knowledge and skills from foreign firms to domestic firms, thereby improving productivity
- Increase in X and I increases AD and LRAS, thus achieving actual and potential growth, and increasing employment level
- Higher national income → higher purchasing power → higher material SOL
- This is especially desirable for an economy with relatively small domestic market. Eg. Singapore relies on trade and investment for growth → X revenue is a significant component of AD → enables it to depend on increase in X revenue (rather than C) to achieve high growth rate. There is also a need for FDIs to invest in this small domestic economy to help promote sustained growth in the economy

However, there are situations where it may be undesirable for a country to achieve high rate of economic growth through exports and investments

- Vulnerable to external shocks - If country Z's trading partners faced a recession → their NY falls → demand less imports from other countries → translates to less X revenue and I spending in country Z → AD falls → RNY falls by multiples & higher unemployment level → undesirable as country Z's growth is dependent on the state of other countries
- If most goods and services produced in the country are exported, left very little for domestic consumption → undesirable as material SOL is compromised
- With more investments entering the economy, there may be a changing structure of the economy as it changes from labour intensive to capital intensive industries. Structural unemployment may result if the workers' skill level did not keep pace with the advancement of technology/ if there is a displacement of low-skilled workers through automation and improvement in quality of technology → labour not used fully → undesirable because there will loss of potential output and income
- Not sustainable to maintain such high growth rates → Rapid depletion of non-renewable resources → may compromise growth in the future
- Deterioration of the environment (higher pollution and waste level) → lower SOL

Evaluation

An investment or export-driven economy such as China has to depend on the state of the global economy and foreign demand for its products. If consumption cannot increase to play a much larger role in aggregate demand, then this rapid growth will slow down or even stop at some time in the future. With prospects for export growth weakening, such economy needs to rebalance its growth away from potentially volatile net exports toward a more sustainable path driven by domestic demand.

- 6 (a) Explain how the concept of opportunity cost can be used in explaining why countries trade with each other. [10]

Introduction

- Countries trade with each other because there are benefits to trading. The gains from trade can be partially explained by the principle of comparative advantage, which allows a country to specialise in producing goods at a lower opportunity cost, given its labour, natural resources and technology.
- World output will increase due to specialisation and countries can now trade in their exports with their trade partners to obtain imports which they would have to incur a higher opportunity cost if they were to produce the goods themselves. Thus, when countries are able to exploit the differences in opportunity cost of production, they can consume beyond their production possibility curve and enjoy a higher standard of living.

Development

1. Production gains can be achieved through specialising production in goods which the country can produce at lower opportunity cost.
 - A country has comparative advantage (CA) over another country in the production of a good if it can produce it at a lower opportunity cost, i.e. if it has to forego less of other goods in order to produce it.
 - Differences in opportunity costs arise, e.g. as countries have different endowments of factors of production and different level of technology, the ability to produce goods differ between countries. What this means is that the opportunity cost of producing goods that requires different factors of production varies from country to country. Example of Singapore's CA in production of goods requiring high-skill labour and advanced technology.
 - Differences in opportunity cost would lead to specialisation, i.e. due to differences in factor endowments and therefore differences in opportunity cost, a country should specialise in producing and exporting the goods in which it has a comparative advantage in because the opportunity cost of producing them is lower.
 - <Use a simple example to illustrate>
 - Suppose a two country, two good model, and the two countries (China and Singapore) spend equal amount of resources into producing both cloth and hard disk within the country :

| Country | Cloth (m) | | Hard Disks (units) |
|--------------|-----------|-----|--------------------|
| China | 500 | and | 250 |
| Singapore | 400 | and | 800 |
| Total output | 900 | and | 1050 |

In this case, to produce 1 unit of cloth, China gives up producing 0.5 unit of hard disk. For Singapore, to produce 1 unit of cloth, the country has to give up producing 2 units of hard disk. China therefore incurs lower opportunity cost in producing cloth, and Singapore would incur a lower opportunity cost in producing hard disks. Suppose the two countries completely specialise their resources in producing the good whereby they have a comparative advantage:

| Country | Cloth (m) | | Hard Disks (units) |
|--------------|-----------|-----|--------------------|
| China | 1000 | and | 0 |
| Singapore | 0 | and | 1600 |
| Total output | 1000 | and | 1600 |

In this case, the output of cloth would increase by 100 units and output of hard disk increase by 550 units.

2. Countries can benefit from the exchange of goods at a mutually beneficial trade price that was set in between the opportunity cost of production of the two goods in the two countries.
- Subsequently, Singapore and China can engage in trade to exchange their outputs. To do that, countries would have to agree on a mutually beneficial exchange ratio (i.e. terms of trade). The terms of trade is defined as the rate at which two goods will be exchanged in trade, i.e. the amount of a good or service that must be given up (opportunity cost) to buy a unit of another good or service.
 - A mutually beneficial exchange ratio is one where each country will now be able to import the goods in which it does not have a CA in, at a lower opportunity cost (as compared to if it tries to produce the good itself).

In this case, the TOT for 1 unit of cloth must be set between 0.5 and 2 units of hard disk. Suppose the TOT is fixed at 1 unit of cloth for 1 unit of hard disk and China exports 450 cloth in exchange for 450 units of hard disk:

| Country | Cloth (m) | | Hard Disks (units) |
|--------------|-----------|-----|--------------------|
| China | 550 | and | 450 |
| Singapore | 450 | and | 1050 |
| Total output | 1000 | and | 1600 |

Singapore will enjoy an additional 50 units of cloth and 200 units of hard disk compared to the pre-specialisation and trade, and China enjoys an additional 50 units of cloth and 250 units of hard disk.

- As a result, both countries get to consume beyond what they can produce for themselves if they do not trade, allowing the two countries to enjoy a higher standard of living.

Conclusion

In conclusion, countries trade because they can benefit from the exchange, and this was made possible due to differences in opportunity costs of producing the two goods within the two countries.

(b) To what extent does this concept explain the pattern of trade between Singapore and the rest of the world? [15]

Introduction

- Examining Singapore's pattern of trade requires one to consider Singapore's trade partners as well as the volume and composition of goods and services that Singapore imports and exports.
- Singapore's top export destinations in order of trade value are Hong Kong, China, Malaysia, Indonesia and Other Asia. The top import origins are China, Malaysia, the United States, Other Asia and South Korea.
- The concept of opportunity cost can be useful in understanding the composition of goods and services that Singapore imports and exports.

Development

1. Singapore's pattern of trade can be explained through the concept of opportunity cost.

- The openness of Singapore implies that it has a high degree of exchange in capital, particularly in FDI. Such FDI has brought about significant technological progress through the capital goods used by foreign firms. Singapore also has a highly skilled labour force (both foreign talents and an educated domestic workforce).
- The congregation of technology, as well as highly productive physical and human capital meant that Singapore tends to incur a lower opportunity cost and hence exports high-technology and skills-intensive goods and services. In terms of visible trade,

Singapore is a net exporter of chemical products, machinery, and transport equipment. In terms of invisible trade, Singapore exports high-skilled-labour intensive services such as in the areas of Bio-Medical Research & Development, as well as financial services.

- In particular, Singapore has a large oil refining industry. Singapore imports crude oil to refine into oil-based products like diesel and petroleum. While much of the products are exported, some are for domestic use, which is why Singapore is a net importer. While Singapore does not have any oil resources, it still has a comparative advantage in capital-intensive, high-tech, and high-skilled oil refining. Therefore, it would seem that the concept of opportunity cost does explain Singapore's export pattern.
- At the same time, Singapore incurs higher opportunity cost in producing land- and low-skilled-labour-intensive products. Hence, the lack of specialisation in these areas explains why Singapore is a net importer of non-oil products like food, beverages and tobacco and animal and vegetable oils.

2. Singapore's pattern of trade can also be explained by other factors besides the concept of opportunity cost.

Demand-side reasons

- Intra-industry trade (trade in the same industry) may also take place despite similar opportunity costs in production due to differences in taste and preferences. There are differences in taste and preferences due to different lifestyles, technological innovations and improved product design. This means that there will be trade between Singapore with other countries in goods and services in the same industry. E.g. Singapore export banking services (e.g. DBS, OCBC, UOB) to other countries but we also import banking services from other countries (e.g. HSBC, Citibank).

Historical/Geographical Reasons

- As Singapore is a transshipments hub as well as a famous hub for entrepot trade, much of its imports are re-exported out of Singapore. Often Singapore is only a temporary destination for goods meant for re-export. Such transshipment trade is not related to comparative advantage and hence the concept of opportunity cost, but are more due to Singapore's locational or geographical, positional advantage along major shipping routes.

Conclusion

<candidates should take a stand and provide reasons>

- The concept of opportunity cost does explain many aspects of Singapore's trade pattern. While the openness of the economy as well as the government's supply-side policies have been fairly successful in shaping Singapore's comparative advantage (lower opportunity cost) in producing technology, physical and human capital, and knowledge-intensive products and services, Singapore government's strategy of always anticipating and preparing its productive capability for the emerging products and services have also been fairly important in influencing the pace of change in its comparative advantage (changes in opportunity cost) and hence in the changes in Singapore's trade pattern.
- Furthermore, as the pace of countries' exchange through the Trans Pacific Partnership quickens, trade barriers are increasingly reduced or eliminated. As such, Singapore will increasingly import from countries which can produce the good or service at lower opportunity costs and export to countries that incurs higher opportunity costs in production. This should further open up the Singapore economy to many other export and import markets which should further affect Singapore's trade patterns through changes in opportunity costs.