

## Essay Question 6

**Explain why an economy's comparative advantage might change over time and discuss the benefits and costs brought about by globalisation to the Singapore economy. [25]**

**Suggested answer:**

### First Part

- Based on the theory of Comparative Advantage (CA), a country is able to benefit from trade by specializing in the production of a good which it has a CA, i.e. able to produce at a lower opportunity cost compared to its trading partners
- An economy's CA might change over time due to a multitude of factors such as changes in factor endowments, government policies

### **(i) Changes in the quality of capital and labour due to globalisation**

Globalisation brought about greater flows in capital, particularly FDI

→ Led to sharing of technology and expertise resulting in technological improvements and advancement

➔ Increase in the quality and quantity of capital and labour

For example, Singapore is able to gain comparative advantage in high-tech, high skilled manufactured goods and services such as financial services and bio-medical services

→ Able to produce such goods and services at a lower opportunity cost

→ Singapore should specialize in the production of such high-tech goods and services, and export them

### **(ii) Depletion of natural resources**

A country that used to export goods such as coal or oil could face with a depletion of its natural resources → lead to a loss of CA

For example, Brunei, a highly oil-reliant economy, is facing the prospect of losing its CA in the hydrocarbons industry, as its level of oil reserves is slowly depleting

→ need to develop new areas of CA, for e.g. in the areas of garment-making and construction related industries, such as cement and pre-cast concrete production and tourism to continue to achieve its economic objectives such as economic growth etc

### **(iii) Changes in government policies**

Governments may also play a role in determining the type of comparative advantage the country will have. Governments may encourage the development of new comparative advantages, especially in moving up the production chain, as part of their development strategy. For example, the Singapore government plays an instrumental role in providing the availability of infrastructure and facilities such as Biopolis in developing the Biomedical industry → #Able to attract foreign direct investments and produce such biomedical research services at a lower opportunity cost

## Second part

### Introduction

- Define globalisation—increased integration of economies through greater flows of trade, capital, labour and technology
- Characteristics of the Singapore economy – Small domestic market, Open to capital flows and trade, reliance on imports
- Net benefits from globalisation depends on the availability of policies to mitigate the unexpected and negative consequences of globalisation

### Explain and analyze how globalisation has affected Singapore

#### **Trade**

- With a small domestic market, Singapore cannot depend on C and I to support AD and drive economic growth → Hence, she must be export oriented and globalisation will benefit Singapore to a large extent
- With globalisation, Singapore is able to gain access to more export markets → demand for Singapore's exports rise → rise in AD → real GDP increase → national income rise by multiplier times via multiplier process and employment increase as well
- In addition, as Singapore is a small country, she is not endowed with natural resources → import reliant → With globalisation, Singapore is able to diversify our sources of imports → cushions her from adverse external shocks and increase consumer welfare (can bring a greater variety and cheaper imports)
- On the other hand, being highly globalized will make Singapore very vulnerable to external shocks and bring unexpected consequences → during 2008/09 global recession, Singapore was one of the most seriously affected nations → our exports fell significantly, leading to rapid rise in unemployment
- *The Singapore government has taken measures to reduce our susceptibility to external shocks in future. For instance, we have tried to reduce dependence on our visible trade balance by encouraging SMEs to venture overseas (increase net factor income from abroad that also could contribute to economic growth) and also restructuring towards a higher value added and knowledge based economy.*

#### **Capital & Technology**

- Globalisation will result in higher flows of capital such as FDIs between countries → the influx of FDIs also raises the level of investments as well as demand for goods and services from complementary industries such as banking, logistics and transport → the firms in complementary industries will then expand operations by increasing I to respond to a rising demand for their goods and services → this will lead to a significant rise in AD → real GDP increases → higher employment and multiplied increase in national income via multiplier process
- With higher influx of FDIs, there will be transfers of technologies and knowledge to the domestic economy → increase productivity → rise in productive capacity of the economy → rise in potential growth → increase in AS → sustained economic growth

- For a small country like Singapore with no natural resources, it is extremely challenging for us to expand AS → heavily dependent on FDIs for capacity building → globalisation brings benefits for Singapore to a very large extent
- On the other hand, being more globalized also entails higher competition for our industries → Greater need for constant restructuring and innovation → sectors that cannot compete will either relocate to more cost competitive regions or outsourcing parts of their operations → jobs will be lost as a result → workers displaced may not possess relevant skills and knowledge to take up the opportunities presented in the expanding industries → mismatch of skills and job requirements occurs → occupational immobility rises (structural unemployment)
- *However, the unexpected consequences are mitigated by the Singapore government's supply side policies → Singapore government is committed to help Singaporeans learn and upgrade through life → SkillsFuture was introduced recently to promote constant skills upgrading and retraining of workers → allows workers to always gain updated and relevant skills and knowledge required by firms → reduce occupational immobility and makes workers more employable, throughout their lives → Hence, unexpected consequences of globalisation applies to Singapore only to a small extent*

## Labour

- Globalisation has allowed Singapore to gain access to low wage foreign workers for industries such as construction, healthcare and F&B → allows our firms to lower their COP, making them more competitive and generates economic growth.
- Singapore is also able to attract top foreign talent and professionals → raises productivity → able to attract quality FDIs → our productive capacity will rise
- On the other hand, with an influx of cheap foreign workers, the average wage of the lower skilled local workers will be depressed. To attract top foreign talent, higher wages will have to be offered → results in rising income inequality.
- Globalisation also increases labour mobility → Singapore can suffer from brain drain as well
- *However, the Singapore government has put in place policies like the imposition of Workfare has made income inequality a less serious problem in Singapore. Workfare is a scheme that tops up low income workers' CPF accounts to ensure that essential goods and services such as healthcare and housing are always affordable and accessible. This promotes equity and reduces income inequality.*

## Conclusion

- Despite facing some consequences of globalisation, Singapore has always been able to weather the storms. For instance, during the 2008/09 global recession, Singapore was the first to recover and it validated the effectiveness of her government policies in mitigating the unexpected negative consequences of globalisation
- Economic data over the past few years such as sustained economic growth, low UN and healthy BOP all point to the fact that we have managed to maximize our gains from globalisation while also having in place a set of comprehensive measures to cope with the negative consequences of globalisation.

<b>Level (Marks)</b>	<b>Knowledge, Application, Understanding and Analysis</b>
L3 15 – 21	<ul style="list-style-type: none"> <li>• A well-explanation of the factors which will result in the changing comparative advantage of a country.</li> <li>• A well-developed and balanced answer (benefits and costs of globalisation) that shows strong content knowledge. The answer should have a discussion with respect to all 3 aspects of globalisation.</li> <li>• Analysis is supported with real life examples.</li> </ul>
L2 9 – 14	<ul style="list-style-type: none"> <li>• An underdeveloped explanation of the factors which will result in the changing comparative advantage of a country.</li> <li>• An elaborated one-sided answer (or 2-sided answer but briefly explained) that focuses on either the benefits or costs of globalisation.</li> <li>• Real life examples may not be used.</li> </ul>
L1 1 – 8	<ul style="list-style-type: none"> <li>• An answer that shows a brief explanation of the factors which will result in the changing comparative advantage of a country and/or effects of globalisation.</li> <li>• Some conceptual errors expected</li> </ul>
E2 3 – 4	For an evaluative discussion that is based on economic analysis. Assess whether Singapore has overall benefitted from globalisation and able to make a stand as to whether the costs outweigh the benefits or the benefits outweigh the costs and why
E1 1 – 2	For an unexplained judgement, or one that is not supported by analysis. Merely stating that the benefits outweigh the costs or vice-versa without any clear basis.