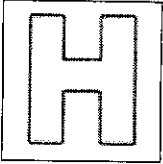


Full name : _____

Economics subject class : _____



NATIONAL JUNIOR COLLEGE
SH2 Preliminary Examination for
General Certificate of Education Advanced Level
Higher 2

ECONOMICS

Paper 2

9570/02**2 hours 30 minutes**

No Additional Materials are required.

READ THESE INSTRUCTIONS FIRST

An answer booklet will be provided with this question paper. You should follow the instructions on the front cover of the answer booklet. If you need additional answer paper ask the invigilator for a continuation booklet.

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.

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

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NATIONAL JUNIOR COLLEGE
Economics Department

Section A

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

- 1** Lithium currently plays a significant role in the production of lithium batteries widely used in electric vehicles (EVs), but recent research into alternatives such as sodium-ion batteries could also enable their use in EVs. To encourage more consumers to purchase EVs in a push for environmental sustainability, some governments have introduced direct subsidies on EVs. Others are exploring to increase taxes on internal combustion engine vehicles (ICEVs).
- (a) With the aid of a diagram, explain a likely impact of a rise in the price of lithium on the overall consumer expenditure on EVs. [10]
- (b) Discuss whether government policies or advancements in battery technologies will have a greater impact on the market for EVs in the long run. [15]
- 2** A firm's decisions and strategies are largely determined by the objectives of the firm.
- (a) Explain how a firm's price and output decision might change if its objective changes from maximising profit to maximising its revenue. [10]
- (b) Discuss whether price discrimination is the best strategy for a firm to increase its revenue. [15]
- 3** Two possible reasons why markets may fail are public goods and positive externalities.
- (a) Explain **two** characteristics of public goods, and why markets might be allocative inefficient in the case of public goods. [10]
- (b) Discuss whether government policies used to correct market failure due to positive externalities will always create unintended consequences. [15]

Section B

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

- 4** The Covid-19 pandemic and rapid digital transformation have triggered massive job cuts in Malaysia, leaving many out of work. At the same time, businesses are struggling to find workers to bridge a critical skills gap.

Adapted from New Straits Times, 13 March 2021

- (a) In light of the above events, explain the possible causes of unemployment in Malaysia. [10]
- (b) Discuss whether a policy of cutting interest rates is the most effective in solving Malaysia's unemployment problem. [15]
- 5** (a) Explain the possible causes of balance of trade deficit. [10]
- (b) Discuss how far the policy response to address balance of trade deficit is dependent on the cause of the deficit. [15]
- 6** "Cheap consumer products are sold to us as some achievement of globalisation, but they have come at the price of middle-class jobs, craftsmanship and stable communities."

Adapted from Overdressed: The Shockingly High Cost of Cheap Fashion

- (a) Explain how globalisation may worsen the standard of living of a country. [10]
- (b) Discuss whether protectionism is the best way to reduce the negative effects that globalisation may bring about. [15]

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- As EVs and ICEVs might not be considered close substitutes in consumption, given that they have different types of engines and might cater to different types of consumers (e.g. environmentally conscious individuals might only purchase EVs, whereas those who are less environmentally conscious might be more inclined to purchase the cheaper ICEVs instead). Thus, the extent of increase in demand for EVs might not be significant.
- Direct subsidies on EVs might not increase demand for EVs significantly if the amount of subsidy given is insignificant and does not effectively raise purchasing power of consumers much.
- Even with these two stated policies in the preamble, it may be insufficient to resolve the pain points of owning an EV, as it primarily relates to the need for charging it once the battery runs out.

Requirement 2

- Advancements in battery technologies has the effect of reducing the cost of batteries used in powering EVs. As such, the cost of production of EVs is decreased since the cost of batteries are lowered.
- This would have the effect of increasing supply of EVs. An increase in supply for EVs (as reflected by a rightward shift in supply curve from S_0 to S_1) would result in a decrease in equilibrium price (from P_0 to P_1) and an increase in equilibrium quantity (from Q_0 to Q_1).
- In addition, given that there are more alternatives to batteries that are used in powering EVs, supply for EVs can also become more price elastic as a result.
- Since supply for EVs is more price elastic due to the advancements in battery technologies, this means that equilibrium quantity increases by more (i.e. to Q_2 instead of Q_1) and equilibrium price decreases by more (i.e. to P_2 instead of P_1).

Evaluation

- Demand of EVs is likely to be price elastic, as explained in part (a) due to the wide number of available substitutes to EVs, therefore an increase in supply would result in a more than proportionate increase in quantity demanded relative to the decrease in price. This implies that equilibrium quantity of EVs increases quite significantly, whilst equilibrium price falls more marginally in comparison.

Conclusion

- Government policies primarily seek to increase the demand for EVs, whilst advancements in battery technologies would primarily increase the supply of EVs. As such, equilibrium quantity of EVs would definitely increase and quite significantly. The impact on equilibrium price is indeterminate since it depends on the extent of shifts in demand and supply curves. Thus, we need to consider which has a greater impact in the long run.

Essay Question 2

A firm's decisions and strategies are largely determined by the objectives of the firm.

- (a) Explain how a firm's price and output decision might change if its objective changes from maximising profit to maximising its revenue. [10]
- (b) Discuss whether price discrimination is the best strategy for a firm to increase its revenue. [15]

Part (a)

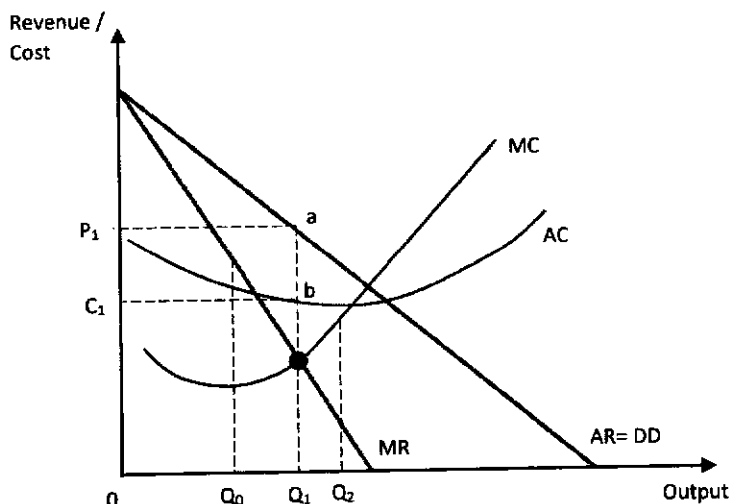
- (a) Explain how a firm's price and output decision might change if its objective changes from maximising profit to maximising its revenue. [10]

Introduction

- A basic assumption in economic theory is that firms seek to maximise profit.
- However, in reality, there could be other objectives a firm may have. In this essay, we shall examine how the objective of maximising revenue could change the price and output decision of a firm.

Requirement 1

- A firm whose objective is to maximise profit will decide on its price and output based on $MR=MC$
- If $MR>MC$, the firm's profit will increase by producing an additional unit of output. Hence the firm will continue to increase output as long as $MR>MC$. This is shown as Q_0 in Figure 1.
- At $MR<MC$, if the firm reduces its output by one unit, its profit to increase. Hence, the firm will reduce its output as long as $MR<MC$. This is shown by Q_2 in Figure 1.
- Hence, the firm will maximise its profit at the output where $MR=MC$ ie. at Q_1 in Figure 1. At the output Q_1 , the firm will set its price at P_1 .
- The profit-maximising firm will therefore decide to produce at output Q_1 and set price at P_1 .
- The profit of the firm is given by the area C_1P_1ab in Figure 1.



Requirement 2

Figure 1 – Profit-maximising firm

- In some cases, the firm may seek to maximise its revenue instead of profit.
- If the firm's objective is to maximise revenue, then its price and output are decided based on the criterion that $MR=0$.
- This is because as long as $MR>0$, the firm's revenue is not maximised and it will continue to increase its output until $MR=0$, when its revenue will not increase any further. Hence its revenue will be maximised at the output where $MR=0$. This is shown by Q_3 in Figure 2.
- At output Q_3 , the firm will set its price at P_2 which is determined by the AR curve. The profit is now C_2P_2ef . However, at Q_3 , the MC is greater than MR, which means that total cost has risen

by more than total revenue, and thus the profit would have fallen. Hence the profit C_2P_2ef , is lower than the profit at Q_1 where $MC=MR$.

- The objective of maximising revenue thus results in a lower price P_2 and a higher output Q_3 compared to the price P_1 and output Q_1 of a profit-maximising firm.

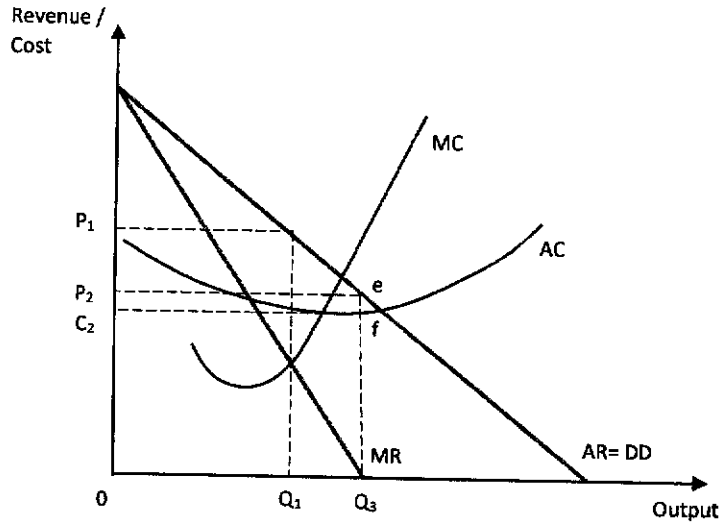


Figure 2 -- Revenue-maximising firm

Conclusion

Therefore, when the objective of a firm changes from profit-maximisation to revenue-maximisation, the basis of its price-output decision will change from $MR=MC$ to $MR=0$, resulting in a higher output and lower price.

Part (b)

- (b) Discuss whether price discrimination is the best strategy for a firm to increase its revenue. [15]

Introduction

- Price discrimination occurs when a firm sells the same product to different buyers (or different segments of a market) at two or more different prices for reasons not associated with differences in costs.
- This essay will examine whether third degree price discrimination is the best strategy to increase a firm's revenue.

Requirement 1

- Price discrimination is one of the strategies a firm can adopt to increase its revenue.
- For third degree price discrimination to be feasible, the following conditions must be met:
 - The seller must be able to set its price.
 - The seller must be able to separate the market.
 - The seller faces different price elasticities of demand (PED) from separate groups of buyers (or market segments).
- Example: Cinema-goers would generally prefer to watch movies during the weekend when they have more leisure time and watching movies at the cinema is one of their favourite pastimes. During the weekdays, however, they are likely to have less leisure time and are thus less inclined to go to the cinema. The demand for cinema tickets would thus be more price inelastic during the weekend due to their higher degree of necessity to movie lovers, compared to the weekdays when the movie enthusiasts may not have the time to watch movies. Hence cinema operators charge a higher price for weekend cinema tickets and a lower price for weekday tickets.
- Suppose the 2 groups of buyers are Market A and Market B. Market A has a price inelastic demand (eg. weekend cinema tickets) while Market B has a price elastic demand (eg. weekday cinema tickets). Suppose the firm initially charges the same price in both markets. With price discrimination, the firm (cinema operator) now charges a higher price in Market A ie for weekend cinema tickets, and a lower price in Market B ie. for weekday cinema tickets.
- Since the demand for weekend cinema tickets (Market A) is price inelastic, the higher price P_1 results an increase in revenue.
- In Market B (weekday cinema tickets), the demand is price-elastic, and so the lower price results in an increase in revenue.
- As the revenue increases in both Markets A and B, the firm's total revenue is increased. Hence the third degree price discrimination results in an overall increase in the firm's revenue.

Evaluation

- In reality, it is difficult to determine the actual PED values and any error in the firm's estimation of the PED value could result in a smaller increase in revenue or even a fall in revenue.

Requirement 2

- A firm may adopt advertising as a strategy to increase the demand for its product by influencing consumers' taste and preference, thus increasing its revenue.
- Example: A restaurant may put up newspaper advertisements or posters with enticing pictures of its food offerings to attract customers. It may also advertise online and post positive comments from its customers to boost its brand image, thus changing consumers' taste and preference towards the restaurant. Such advertisements may also have a salience effect, as the attractive

pictures of its menu items may capture the attention of people and cause them to decide to try out its food. This causes the demand for the restaurant to increase.

- The increase in demand due to the advertising strategy leads to a rightward shift in AR/DD and MR, which results in an increase in revenue.
- At the same time, the advertisements may cause its demand more price-inelastic. This allows the restaurant to raise the prices of its food items without a significant fall in its quantity demanded, thus resulting in an increase in revenue.

Evaluation

- Advertising may not always be effective in changing consumers' taste and preference. The success of advertising is uncertain as it depends on how well and extensive the platform or mode of advertisement is able to reach out to consumers.

Conclusion

- Whether price discrimination or advertising is the best strategy to increase the firm's revenue depends on the cost of the strategy – the relatively high cost of advertising (especially in popular media) means that it may not increase the firm's profit even if it succeeds in increasing revenue. This makes it inferior to price discrimination which does not involve any explicit cost, and so the increase in revenue is more likely to increase the firm's profit as well.

Essay Question 3

Two possible reasons why markets may fail are public goods and positive externalities.

- (a) Explain **two** characteristics of public goods, and why markets might be allocative inefficient in the case of public goods. [10]
- (b) Discuss whether government policies used to correct market failure due to positive externalities will always create unintended consequences. [15]

Suggested Answers

Part (a)

Two possible reasons why markets may fail are public goods and positive externalities.

- (a) Explain **two** characteristics of public goods, and why markets might be allocative inefficient in the case of public goods. [10]

Introduction

There are 3 characteristics of public goods – non-excludability in consumption, non-rivalry in consumption and non-rejectability.

Requirement 1

Non-excludability

- The characteristic of non-excludability means that it is impossible or unfeasible to exclude anyone from the benefits of the good once it is provided.
- Everyone benefits from it regardless of whether they pay for it or not.
- For example, once street lighting is provided for no one can be omitted to benefit from the lighting provided.

Non-rivalry

- The characteristic of non-rivalry means that the consumption of the good by one person does not reduce the benefit of the good available to others.
- In the case of street lighting, the brightness of the lighting will not decrease even if another person will use it. This means that an additional user does not deplete the supply of a public good and the marginal cost (MC) of providing for an additional user is zero.

Requirement 2

- Since non-paying users usually cannot be excluded from enjoying a public good, suppliers of such goods will find it difficult or impossible to collect fees for the benefits they provide.
- In the example of street lighting, once it has been provided, it would be almost impossible to not allow non-payers in the country to enjoy the benefits. It will benefit everyone who is in the area, irrespective of whether the person has paid for it or not.
- Since non-payers would be able to enjoy the benefit of lighting, this would deter people from deciding to pay for it in the first place. It is known as the 'free rider' problem. Hence, this would lead to people not paying for the public good. Public good would not be provided by private producers, thus there is allocative inefficiency.
- With $MC=0$ because of non-rivalry, the price must also be zero for it to be allocative efficient. However, there would be no private firms that are willing to produce at price = 0.

Part (b)

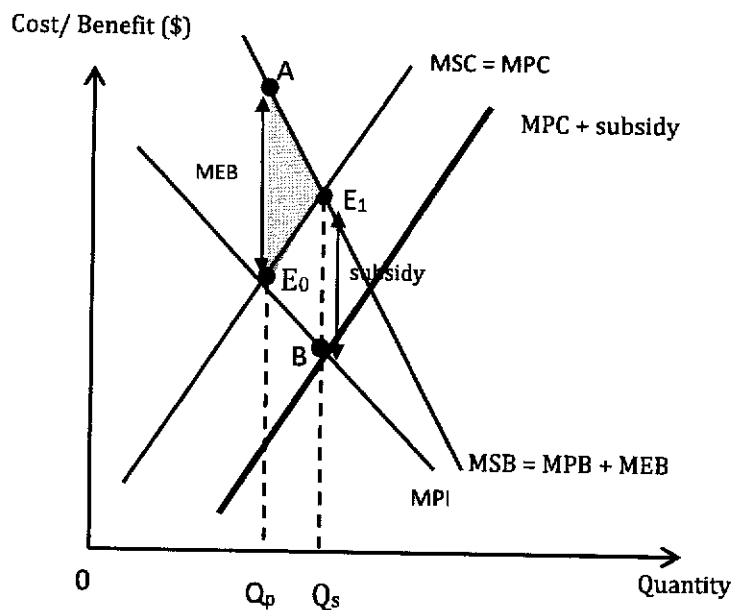
- (b) Discuss whether government policies used to correct market failure due to positive externalities will always create unintended consequences. [15]

Introduction

- Governments may want to intervene in the market with positive externalities because the market would under-produce/consume the good/service.

Requirement 1

- Positive externalities in consumption occurs when the benefits associated with the consumption of a good or service spill over onto third parties for which no compensation is paid.
- Private individuals would consume or produce up to the level where the $MPB = MPC$. However, with a market with positive externalities, there would be MEB .
- Without government intervention, economic agents would consume or produce up to $MPB = MPC$. However, the socially optimal point is where $MSB = MSC$. The socially optimal output level would be higher than the free market output level, thus leading to allocative inefficiency.
- To address the allocative inefficiency in markets with positive externalities, the government can provide subsidies. In Figure 1, a subsidy caused the MPC to shift downwards to $MPC + \text{subsidy}$. As a result, the private economic agents would equate the MPB to the $MPC + \text{subsidy}$ and consume/produce at Q_s .



- One possible unintended consequence that might result in the government providing subsidies to address the positive externality is a budget deficit. As subsidies are part of government's expenditure, an increase in provision of subsidies would increase the expenditure, which results in a budget deficit.

Evaluation

- However, the unintended consequence of a budget deficit would only happen if a country has very low budget surplus or was in a balanced budget. If the country was having very high budget surplus, the increase in spending on the subsidies may not result in a deficit.

Requirement 2

- Another policy the government can implement is to provide for the good with positive externalities.
- The government can either provide it fully ($0Q_s$) or provide partially (Q_pQ_s). An example of this is education. In providing for the good, the government would be financing it through taxes, thus the same unintended consequence of budget deficit may also occur. In addition, given that the government is not a profit motivated entity, there might not be incentive for it to produce in the most efficiency way. There might be wastages and redundancies, or low-quality services.

Evaluation

- However, the unintended consequence of inefficiency in the provision of the good by the government can be eliminated via joint provision. For example, under Land Transport Authority (LTA), the government owns the assets of the train and bus companies and builds the infrastructure while the private firms will bid for the contracts to run the service. This is also known as Private-Public-Partnership (PPP). There is more incentive to be efficient due to competitive pressure and private firms' profit motives.

Conclusion

- In conclusion, it is possible that the policies used to correct market failure due to positive externalities will always create unintended consequences. However, the government can have counter measures to reduce their negative effects.

Essay Question 4

The Covid-19 pandemic and rapid digital transformation have triggered massive job cuts in Malaysia, leaving many out of work. At the same time, businesses are struggling to find workers to bridge a critical skills gap.

Adapted from New Straits Times, 13 March 2021.

- (c) In light of the above events, explain the possible causes of unemployment in Malaysia. [10]
 (d) Discuss whether a policy of cutting interest rates is the most effective in solving Malaysia's unemployment problem. [15]

Suggested Answers

Part (a)

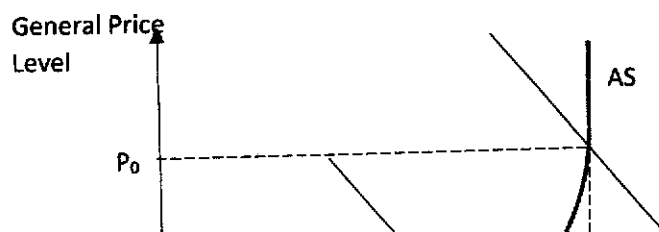
- (a) In light of the above events, explain the possible causes of unemployment in Malaysia. [10]

Introduction

- Unemployment refers to a situation where people who are able and willing to work are unable to get a job.
- In light of the Covid-19 pandemic and digital transformation, there is likely to be demand-deficient unemployment as well as structural unemployment.

Requirement 1

- Due to the Covid-19 pandemic, one possible cause of unemployment in Malaysia is the deficiency of demand.
- During the Covid-19 pandemic, the Malaysian government imposed lockdown measures to control the spread of the disease. Shops and restaurants as well as entertainment outlets had to be closed, and workers had to work from home while students were engaged in home-based learning instead of attending school physically. These resulted in a fall in consumption (C).
- The fall in C results in a fall in AD, triggering a reverse multiplier effect.
- The result is a multiplied decrease in real national output from Y_F to Y_1 as shown in Figure 1.



- The fall in real output results in lower demand for labour results in workers being retrenched, hence resulting in demand-deficient unemployment in Malaysia.

Requirement 2

- As mentioned in the preamble, digital transformation has resulted in massive job cuts, thus causing higher unemployment in Malaysia.
- One reason is that the adoption of digital technology can result in the displacement of labour as certain types of work become replaced by machinery, resulting in workers being made redundant. For example, with the digitalisation of banking eg. use of digital banking apps, many banking transactions can be done online, reducing the need for consumers to visit the bank. This has resulted in a reduction in the number of physical branches of banks, so there is less demand for human bank tellers to serve customers at retail banks. Likewise at supermarkets, with self-checkout counters and e-payments, the need for human cashiers is reduced. Such digital technologies result in reduced demand for labour, leading to redundancies and retrenchment of workers, thus causing technological unemployment.
- Hence, this suggests that there is structural unemployment in Malaysia.

Conclusion

- Due to the Covid-19 pandemic and rapid digital transformation, the main causes of unemployment are demand-deficient unemployment and structural unemployment.

- (b) Discuss whether a policy of cutting interest rates is the most effective in solving Malaysia's unemployment problem. [15]

Introduction

- As explained in (a), the unemployment problem in Malaysia may be due to both demand-deficient unemployment and structural unemployment.

Requirement 1

- Malaysia can solve its unemployment problem by adopting an expansionary monetary policy of cutting interest rates.
- The Malaysia Central Bank may cut the interest rate it charges on commercial banks, causing the commercial banks to cut their interest rates as well. This fall in interest rate from R_0 to R_1 would stimulate an increase in investment from I_0 to I_1 as shown by the downward sloping Marginal Efficiency of Investment (MEI).
- Moreover, the lower interest rate encourages households to spend on credit especially for big-ticket items such as cars and home renovations or property purchases. This results in an increase in consumption expenditure.
- The increase in investment and consumption results in a rightward shift of the AD from AD_0 to AD_1 . In this case, the autonomous increase in AD will lead to an eventual multiplied increase in national income.

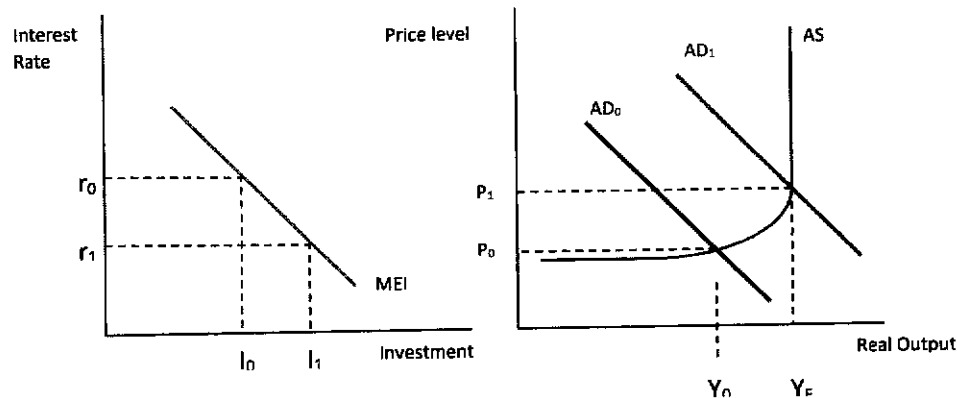


Figure 2

- As shown in Figure 2, the increase in AD results in an increase in real output from Y_0 to Y_F . The increase in output creates more jobs and causing a fall in unemployment, and hence the demand-deficient unemployment is resolved.

Evaluation

- The effectiveness of the cut in interest rates depends on the responsiveness of investment and consumption to the lower borrowing costs.

Requirement 2

- Malaysia is faced with structural unemployment due to the rapid digital transformation. Hence supply-side policies are more appropriate.
- While the rapid digital transformation has caused job losses and retrenchment of workers, it also creates new jobs that require higher skills such as computer programmers, data analysts, software engineers, IT technicians etc. As the unemployed workers do not have the right skills to take up such jobs, they remain structurally unemployed
- Supply-side policies such as skill training can help to resolve the skills mismatch and thus reduce structural unemployment.
- Such skills training or skills upgrading programmes will help the unemployed workers to acquire the relevant skills that are needed to take up the available jobs created by the digital transformation, thus bridging the skills gap faced by businesses.

Evaluation

- The effectiveness of the skills training programmes depends on the receptiveness of workers to take up the training courses. The unemployed workers, especially those who are more senior in age, may be resistant to attending training courses.
- .

Conclusion

- In the final analysis, whichever policy is the most effective in solving a country's unemployment problem depends largely on the root cause of the unemployment.

Essay Question 5

- (e) Explain the possible causes of balance of trade deficit. [10]
- (f) Discuss how far the policy response to address balance of trade deficit is dependent on the cause of the deficit. [15]

Suggested Answers

Part (a)

- (a) Explain the possible causes of balance of trade deficit. [10]

Introduction

- BOT deficit is defined as when M is higher than X , or when BOT is negative.

Requirement 1

- One possible cause of BOT deficit is relative price levels between a country and its trading partners.

- When the country's price level increased, its exports would be less price competitive as it is more expensive for foreigners. Quantity demanded for the country's exports would fall, and if the demand is price elastic or $PED > 1$ X would fall.
- In addition, when the price of the country's domestically produced and sold goods increased, demand for imports increased, M would increase.
- When X decreased and/or M increased, BOT goes into a deficit.

Requirement 2

- Another possible cause of BOT deficit is relative income levels between a country and its trading partners.
- BOT deficit might result if a country's income level is relatively higher than its trading partners.
- When the country's income level increased, the import expenditure for the country would increase as demand for imports increased.
- Given that BOT is $X - M$, when X decreased and/or M increased, BOT goes into a deficit if M is greater than X eventually.

Conclusion

- In conclusion, two of the possible causes of BOT deficit are relative income levels and relative price levels.

Part (b)

- (b) Discuss how far the policy response to address balance of trade deficit is dependent on the cause of the deficit. [15]

Introduction

- Monetary, fiscal and supply-side policies can be used to address BOT deficit.

Requirement 1

- If the cause of the BOT deficit is due to an increase in the prices of that country's goods and services, the government may want to adopt an exchange rate policy.
- The government can depreciate its currency so that the prices of its exports would be cheaper, leading to an increase in demand.
- Conversely, the price of imports for the country would be higher, leading to a fall in quantity demanded for imports.
- If Marshall-Lerner condition holds (i.e., $PED_x + PED_M > 1$), $X - M$ would increase, thus addressing a BOT deficit.
- However, if the cause of the BOT deficit was relative income, the government could adopt a contractionary demand-side policy, like reduce government spending (G) and/or increase income taxes (T), which would reduce the AD of the economy.
- The reduction in AD would result in multiple falls in real national income through the reverse multiplier process.
- This fall in income level would induce households to reduce demand for imports, thus reducing M.

Evaluation

- However, while different policies are required to address different causes of BOT deficit, some policies could still be adopted to address the problem indirectly.
- For example, a country can use supply-side policies to increase the productivity of the economy's FOPs. As a result, the quality of FOPs increased, and the economy's AS would shift to the right, resulting in a fall in general price levels.
- As the prices of the country's goods and services fall, its exports and domestically produced and sold goods would be more price competitive and X would increase and/or M would fall, thus BOT deficit may be corrected.

Requirement 2

- Size of a country's multiplier might influence the policy response.
- For countries with very high mpw, their size of the multiplier would be very small. For example, if the mpw is 0.9 it means that for every initial increase of \$1 in the AD (injection), the increase in real national income would only be 1.1 times. This is in comparison to another country with mpw of 0.1, which would result in the real national income increasing by 10 times.
- For a country with small k to use demand-side policy, it will have to have a very large change in AD for it to be effective in causing the desired level of change in income.

Evaluation

However, this factor may only be applicable to a small group of very small and open economies.

Conclusion

In conclusion, the causes are important factor to consider but it is insufficient to fully influence the choice of policy response.

Essay Question 6

"Cheap consumer products are sold to us as some achievement of globalisation, but they have come at the price of middle-class jobs, craftsmanship and stable communities."

Elizabeth L Cline, author of *Overdressed: The Shockingly High Cost of Cheap Fashion*

- (g) Explain how globalisation may worsen the standard of living of a country. [10]
 (h) Discuss whether government policies used to correct market failure due to positive externalities will always create unintended consequences. [15]

Suggested Answers

Part (a)

"Cheap consumer products are sold to us as some achievement of globalisation, but they have come at the price of middle-class jobs, craftsmanship and stable communities."

Elizabeth L Cline, author of *Overdressed: The Shockingly High Cost of Cheap Fashion*

- (a) Explain how globalisation may worsen the standard of living of a country. [10]

Introduction

- Globalisation refers to increasing integration of national economies in terms of financial flows, trade, movement of factors of production, ideas, and changes in information and technology.
- Standard of living (SOL) of a country can be unpacked by considering both material and non-material aspects. Material SOL refers to the amount of goods and services that consumers have to satisfy their material needs and wants, whilst non-material SOL refers to the quality of life within the country, which includes considering the education level, healthcare quality and level of income inequality.

Requirement 1

- Due to the increasing interconnectedness of economies, there is greater instability / volatility and higher likelihood of contagion. An example could be the 2009 global financial crisis, where the rapid and sudden decline of the US economy led to negative repercussions on many other countries, especially her trading partners. When the economies of large or significant trading partners suffer falling real national income due to poor economic conditions, this could result in a decrease in X of the country. In addition, there could be a fall in foreign direct investment into the country, since these other economies would have less ability to channel investments or capital into other countries.
- When X and I falls, AD would also fall, which prompts firms to reduce their production of goods and services. Thus, firms might lay off some workers to cut their costs, triggering a reverse multiplier effect.
- The result is a multiplied decrease in real national output from Y_F to Y_1 as shown in Figure 1.
- As a result of economic contraction and a loss of jobs, this would lead to falling material SOL, as people would be able to consume fewer goods and services.

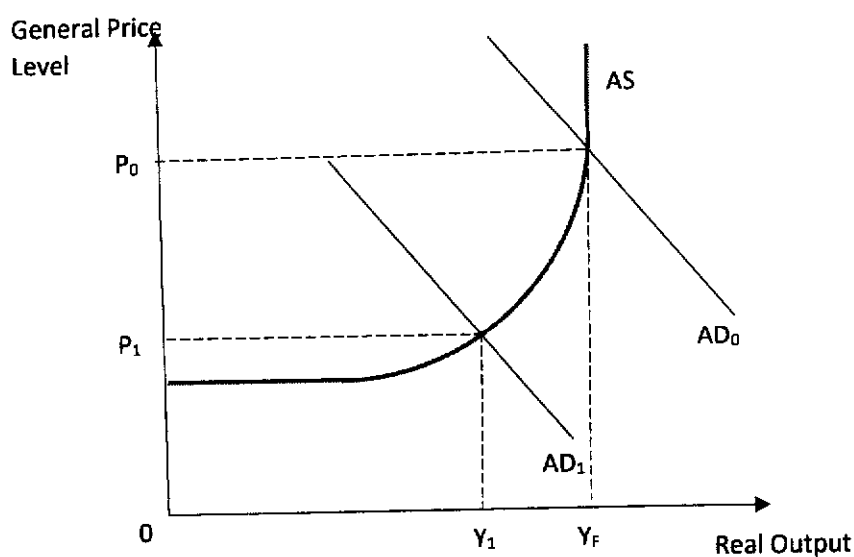


Figure 1

Requirement 2

- Globalisation could also create more pollution and exhaustion of natural resources, since there is increased production of goods and services. MNCs are seen as exploitative and lacking in social responsibility, setting up their operations in a country where they can exploit the cheap resources and having no regard for the damage they may cause to the environment. With more pollution and environmental degradation they would lead to a worsening of the air quality, and thus there may be more health issues amongst citizens. Quality of life and hence non-material SOL may worsen.

Conclusion

- In conclusion, globalisation may worsen both the material and non-material SOL of a country.

Part (b)

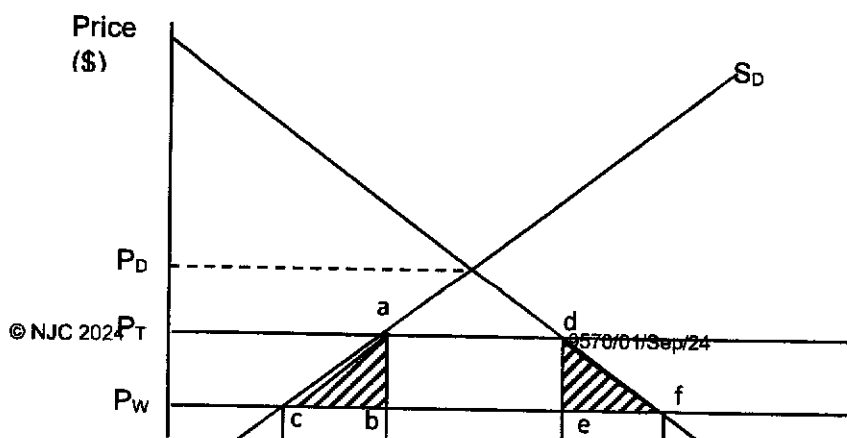
- (b) Discuss whether protectionism is the best way to reduce the negative effects that globalisation may bring about. [15]

Introduction

- Protectionism refers to the restriction of free trade to protect one's own domestic economy. This could entail the raising of trade barriers, such as imposing tariffs on imported goods and services.
- To reduce these negative effects, protectionism could be adopted, but other policies to improve the economy's competitiveness could also help.

Requirement 1

- Protectionism could entail the imposition of taxes on imported goods.
- If a tax is imposed on an imported good, this increases the price of imports from P_W to P_T . At the price P_T , domestic producers will supply Q_2 , while quantity demanded is Q_3 . The amount of imports is now reduced to Q_2Q_3 , which implies that import expenditure falls, as given by the area Q_2beQ_3 from the initial import expenditure given by Q_1cfQ_4 .
- Thus, since import expenditure M falls, AD rises. Thus, real national output increases. At the same time, firms need more workers to produce the goods. Thus, employment also rises. This helps to counteract the possible rise in cyclical and/or structural unemployment that globalisation may bring about.
- In addition, with an import tariff, the government also collects more tax revenue, as represented by area 'abed' in the diagram below.



Evaluation

- However, protectionism through the imposition of import tariffs could result in a fall in consumer surplus represented by $P_W P_T df$. There is also a net loss in consumer welfare shown by the shaded areas 'abc' and 'def'.

Requirement 2

- The use of supply-side policies will broadly help to achieve this aim of increasing competitiveness of an economy, in terms of export price and quality competitiveness, as well as attracting and retaining FDI and skilled labour within the country.
- Investing in R&D, which could raise the quality of the good whilst lowering the costs of production. For example, the use of automation could help to increase productivity as more goods can be produced per day, thereby lowering the average costs of production. This allows producers to set lower prices for the exported goods, raising export price competitiveness. Thus, export revenue rises. If product innovation is successful, export revenue increases too. The country will be in a better position to gain from globalisation, rather than lose out in terms of trade.

Evaluation

- However, supply-side policies aimed at increasing competitiveness of an economy might not achieve the desired outcomes, as these policies may not be effective. For example, investing in R&D may not bring about successful product and process innovation, because the R&D may fail.

Conclusion

- Protectionism could be used as a stop-gap measure especially if there needs to be a more immediate solution to reduce the negative effects, especially since supply-side policies have a long time-lag and are only more effective in the long-run.