2026 Y6 H2 Economics: Globalisation & the International Economy Class Test 5 – Mark Scheme

Countries may experience rising Balance of Trade deficit when they suffer a loss in competitiveness in trade.

a) Discuss whether the use of tariffs or supply side policy is the more appropriate measure to manage the above challenge when a country loses its competitiveness. [15]

Introduction

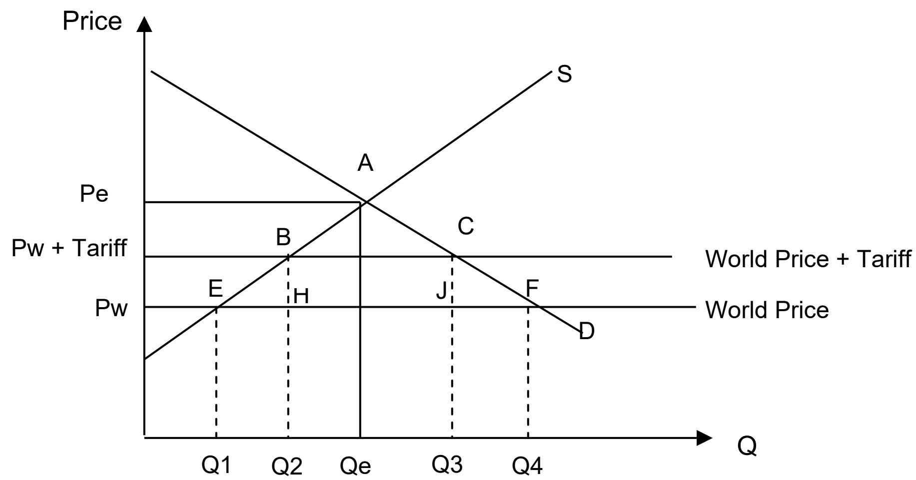
- A loss of trade competitiveness means domestic goods become relatively less attractive compared with foreign goods, causing exports to fall and imports to rise. This can worsen the Balance of Trade (BOT) and potentially reduce aggregate demand and growth.
- Appropriate or not: whether it is effective and desirable to improve the BOT

Body

Requirement #1: Discuss how Tariffs is an appropriate measure in managing the challenges arising from the loss in competitiveness

Thesis: Explain how tariffs can help address BOT concerns. Key idea: Tariff → import prices rise → imports fall → M decreases → (X − M) rises → BOT improves

Define tariff: Import tax on foreign goods/services entering the country.



Explain how tariff works using a tariff diagram:

- The import tariff raises the price of imports from Pw to Pw+tariff. The higher price reduces overall consumption of the good in the domestic market from Q_4 to Q_3. Local consumers find goods/services expensive and choose to cut down consumption of these products.
- Concurrently, the increase in import prices causes an increase in quantity of domestically produced substitutes from Q_1 to Q_2.
- Due to the fall in quantity demanded of imports from Q_4Q_1 to Q_3Q_2, import volume and expenditure would decrease. Import expenditure in the balance of trade falls from Q1EFQ4 to Q2HJQ3. This is cos even though import expenditure paid by consumers Q2BCQ3, part of it goes to the govt as tax revenue so doesn't flow out of the country – thus reducing the BOT deficit (holding exports unchanged).

- Domestic industries would also now be more capable of competing with the higher priced imported goods and services.
- Desirability: To produce this increased level of output, firms which previously were under threat from imports would now hire more domestic factors of production – reduction in unemployment
- Desirability: The tax revenue gained from implementing the tariff can also be used to support export industries via grants and thus boost export competitiveness.

Anti-thesis: Tariffs is not an appropriate measure to reduce BOT deficit from the loss in competitiveness (Choose 1 of the 3) – why it is undesirable/ineffective

1. Allocative inefficiency (undesirability): Protectionism merely perpetuates domestic inefficiency as it prolongs the inefficient use of the economy's resources and leads to allocative inefficiency. Identification of dead weight loss EBH and CJF as the gains from protectionist measures is less than the cost to society.
2. Unintended consequences (undesirable): Tariffs on imports raise cost of production and leads to import cost-push inflation. This is because many other related industries might use these goods as factor inputs. For example, an import tariff on Chinese steel might will increase cost of production for domestic U.S car manufacturers. If the raw material or factor input is used in many industries, it will lead to cost push inflation for the country.
3. Retaliation (ineffective): Should imposition of tariffs result in retaliation from trading partners, there will be a reduction in the country's exports. Thus, while import expenditure will fall, the fall in exports revenue may be greater than the fall in M and thus BOT deficit is not reduced.

Evaluation R#1 (1 insightful point)

- Protectionism is generally less appropriate for a small open economy such as Singapore because imports are a major source of production inputs, not just consumer goods. Tariffs therefore raise costs for downstream export industries, reduce international competitiveness and may offset any improvement in the balance of trade. The resulting allocative inefficiency is also more significant because the small domestic market provides limited scope for firms to achieve economies of scale under protection.
- In contrast, large, less open economies may be better able to use temporary protectionism to support infant or strategic industries, as they have a larger domestic market and are less dependent on imported inputs. Hence, protectionism is more likely to undermine long-term trade competitiveness in small open economies, making supply-side policies the more appropriate measure for correcting a worsening balance of trade

Requirement #2: Discuss how supply side policy is an appropriate measure in reducing the BOT deficit arising from the loss in competitiveness.

Thesis: Explain how ss-side policies can help address some of these challenges

Supply-side economic policies are designed to improve the productive capacity of an economy by increasing the quantity, quality and mobility of factors of production in an economy.

One example of interventionist supply-side policies is that of grants to encourage research and development. R&D refers to innovative activities undertaken by firms or the government aimed at developing new products, improve existing ones or lower the unit cost of production.

Application of policy: Firms may choose not to engage in R&D as they are high risk and uncertain in its outcomes. On top of that, the high costs in terms of investment needed for manpower, equipment, and

technology can be substantial. Hence, the government may sponsor R&D in certain industries like aerospace or life sciences to spur more R&D efforts in such areas where there is increasing demand from global markets.
Examples: In Singapore, the Research Innovation Enterprise (RIE) 2020 Plan commits $19 billion over five years to support R&D efforts. Additionally, we aim to sustain R&D spending at about 1% - 2% of GDP.

Link to BOT challenge:
Encouraging R&D can have positive outcomes in both cost and revenue aspects. This improves competitiveness in both export-oriented industries and import-competing industries.
[Revenue]: Product innovation can lead to better quality products (such as development of more advanced memory chips) which differentiates the local products from foreign competitors. This makes our goods more desirable, leading to rise in demand for our exports.
[Cost]: Due to process innovation (shorter production time, less use of factor inputs), lowering of the cost of production of our exports can lead to increase in supply of exports and thus price of exports to fall. Assuming PEDx>1, the rise in quantity demanded of our exports will increase more than proportionate to the fall in price, causing overall total revenue (exports) to increase.
The benefits of process innovation can also be seen in the increase in the productive capacity of the economy- shift of the vertical portion of the AS curve right from as well as a fall in unit cost of production due to better production processes which is illustrated by a downward shift of the AS curve.
Overall, supply side policy via encouraging R&D may reduce unit costs as well as improve the quality of the products of domestic industries, thus reducing import penetration as well as boosting export demand - overall **improving the balance of trade position.**

Anti-thesis: Supply side policy is not an appropriate measure to manage loss in competitiveness (Ineffective/Undesirable)

- [Ineffective]: Despite government support, the high start-up costs, operational effort, and the inherent risks of new ventures remain deterrents to potential entrepreneurs – limiting the likelihood of domestic industries engaging in R&D.
- [Undesirable]: Governments may need to borrow heavily to fund R&D programs for the domestic industries. This may also incur significant opportunity cost in the use of resources. Budget reallocation can lead to underfunded hospitals, longer wait times, and staff shortages. Education may be neglected as funds shift away from general education to specific industrial training.

Evaluation R#2 (1 insightful point)

Supply-side policies are a necessary part of a broader strategy to address competitiveness challenges when a country faces economic difficulties. While the effects are only seen over the long term, supply side policies directed at R&D work to improve productive capacity and quality of goods/services lays the foundation for a country to develop new areas of comparative advantage which will address BOT challenges.

Or

Developed economies with strong public finances (e.g. Singapore, South Korea, Germany) can better afford sustained investment in R&D, skills, infrastructure and technology. The opportunity cost is lower because these investments may also raise productivity, potential growth and export competitiveness.
Developing economies with limited fiscal resources may need to divert funds from healthcare, education or basic infrastructure. If the BOT deficit is caused by temporary factors (e.g. commodity price shocks or weak

global demand), expensive supply-side policies may produce little improvement in the trade balance while worsening fiscal deficits.

Overall Evaluation / Conclusion (Which measure is more appropriate) 2 points of comparison with a final summative / recommendation.

1. Based on time period: Protectionism may be appropriate in the SR to tackle the immediate threat of a worsening BOT deficit and decline in certain industries. However, for sustained improvement in competitiveness, Supply side policies are necessary to keep cost low, labour productive and retain attractiveness of exports as well as the added benefit of attracting FDI inflows.
2. Root cause of the problem. Protectionist measures do not tackle the reasons why there is a loss of competitiveness, it simply provided short term relief to the symptoms. Supply side policies appear better in tackling this root cause, allowing sustained improvement in competitiveness – focusing on improve R&D can boost labour productivity and improve the quality of exports.
3. Repercussions or unintended negative consequences. Tariffs could lead to greater problems such as higher prices and its export industries could also be negatively affected if trading partners retaliate. Whereas supply side policies can help the economy achieve its other macroeconomic aims.

- Overall summative / conclusion (important to take a final stand / recommendation):

Knowledge, Application, Understanding, Analysis		
L1	• Mere smattering of points (tariffs and supply side policy) without clear economic analysis. • No linkages made between the outcomes of measures to the problem of BOT deficit worsening. • Presence of conceptual errors.	***1 – 4***
L2	• Clear linkages are made between tariffs and supply side policies and how they are effective in reducing BOT deficit brought about by the loss of competitiveness. • Answer has also considered the <u>limitations</u> of tariffs and supply side policy, but lacks scope (number of challenges highlighted in answer) and depth (economic framework) in tackling the argument of appropriateness of the policies.	***5 - 7***
L3	• Well-balanced answer with clear theoretical analysis of tariffs as well as supply side policies to tackle the challenge brought about by loss of competitiveness in trade. Good application and examples to illustrate which policy is more appropriate.	***8 - 10***
Evaluation		
E1	An attempt at judgement but not explained.	**1-2**
E2	Judgement that answers the question with some attempt at justification. Justification is incomplete or weak.	**3-4**
E3	Judgement that answers the question with well-elaborated and insightful justification.	**5**