EXAMINER'S REPORT

NOVEMBER 2021

ECONOMICS OF SEA TRANSPORT AND INTERNATIONAL TRADE

General Comments

The best essays had a brief and solid introduction, well- structured and anchored on sound theory and practice and, supported by examples from the global trade and shipping Industry.

Candidates are once again, reminded that additional marks are earned by those candidates that make appropriate and relevant use of maps, as well as graphs and diagrams. To secure a pass , candidates must demonstrate an understanding of the key terms and concepts in the course, such as for example, marginal cost, supply and demand, shipping cycles, elasticity, utility, derived demand elasticity, short and long run costs, comparative advantage, short and long run costs , and balance of payments.

Question 1

Explain what is meant by 'derived demand elasticity'.

This was a very popular question and well answered. Candidates were required to explain that freight shipping is an intermediate part of a process of production and the demand for shipping, like the demand for raw materials or intermediate goods, is a derived demand; derived from the consumers' demand for the final product.

The explanation would include the four particular set of rules relating to its elasticity: There are few , if any substitutes for shipping, although there may be alternative sources of the product, these too will normally require transportation by sea, freight rates are a small proportion of final costs, and finally the elasticity of demand for the final product will be an important factor in the elasticity of the derived demand for shipping.

A simplified model of the whole idea could be put into the following words:
The demand elasticity of demand for shipping = Transport cost is a fraction of final price X
Elasticity of demand for the final consumer product.

Question 2

Explain how a global pandemic, macro-economic and geo-political event can impact liner freight rates.

This was a popular question and produced some answers, the best answers, highlighted COVID with an emphasis on the liner freight sector and its response:

- freight rate stabilization through capacity cutting, emphasis on profitability instead of market share, digitalization and elimination of paper, managing space limitations, diversified production and manufacturing sites and suppliers work:

- vaccination of seafarers and other COVID related interventions.
- congested ports, and other related facilities - reduced staff and attendant issues etc.
- how all the above factors impact determination of freight rate.

Macro Economics analysis:
Some key questions including: what causes unemployment? what causes inflation? what creates or stimulates economic growth?

Geopolitics Analysis of the geographic influences on power relationships in international relations and includes arguments about the political effects of geography—particularly climate, topography, arable land, and access to the sea

Events including Iran US Conflict, US China Trade War, Silk Road project, Brexit, Renegotiated NAFTA, EU Africa trade deals , EU Green Deal etc

Selected Trade Routes
- including East West China , South East Asia - Europe, Pacific West etc

Examples
- US China trade war impact on East West Textile and Apparel &FMCG, manufactured goods and other value added product trade flows
- disruptions from factory closures in China and changes to global supply chains and impact on national, regional capabilities
- moving manufacturing closer to consumers and reduction in tonne-mile demand
- the prospect of a return to more local manufacturing as fragility of the traditional just-in-time logistics model is exposed
- Bangladesh, Turkey, India, , Vietnam, Indonesia, Cambodia and Sri Lanka indeed all of East Asia benefit from factory flight from China , placing new challenges and demands on their domestic supply chain management capabilities.

Question 3

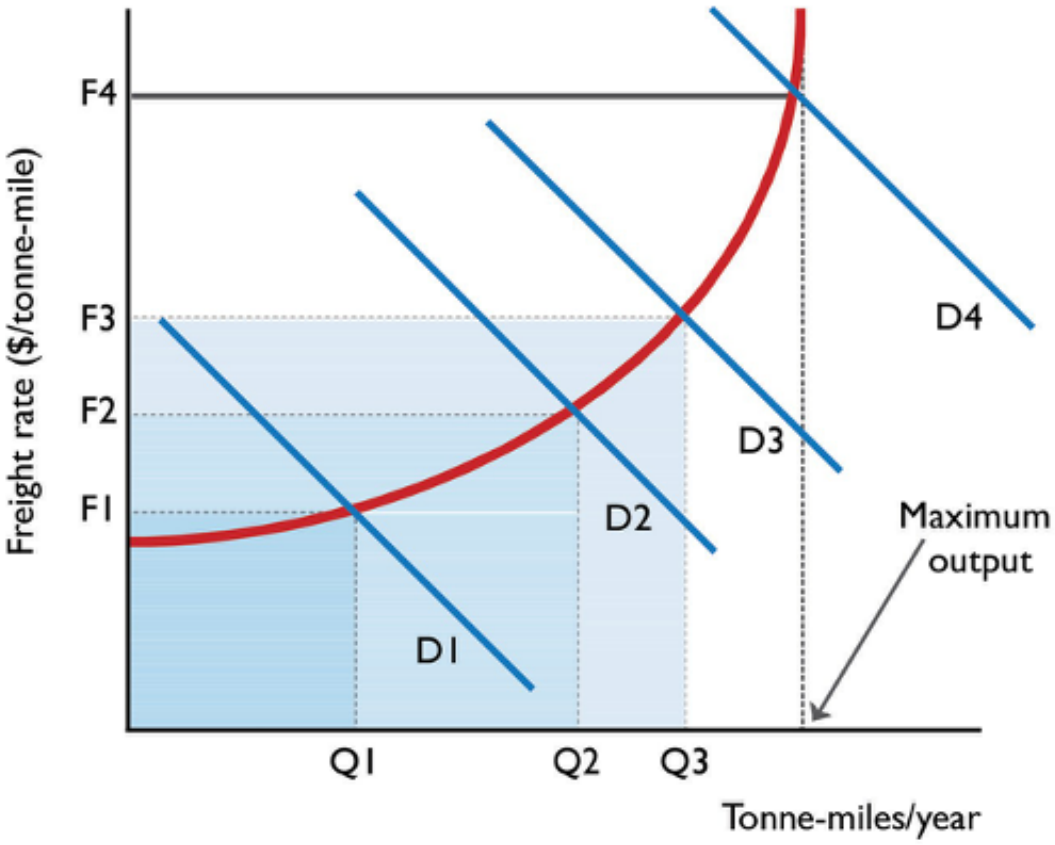
Using a diagram to support your answer, explain how the "equilibrium freight rate" is determined.

Candidates who scored the highest marks stated:
A market is defined as the interaction of supply and demand, which both together determines the equilibrium freight rate and quantities sold at that rate:

Identified the keys factors including :

- Volume of world's trade driven by overall economic activity growth and changing degrees of openness towards trade by individual nations
- Identified prevailing conditions and explained :

1. Freight rates sensitive to short run market conditions, reflecting both present and expected future situations
2. a strong positive co-relation between demand growth and new orders, provided that the present stock of vessels is highly utilised with low levels of lay –up
3. positive correlation between freight rates and new orders
4. exceptional events will generate significant increases in rates



Question 4

Describe the economic effects of a tariff. Use a diagram to support your answer.

This was a straight question and required candidates to include:

Definition of Tariff:

The traditional means of restricting imports. These taxes are placed on imported goods which raise their prices in the levying countries domestic market above those in international markets.

Two basic ways:

- on an ad valorem basis or
- as a specific duty

The net result is that 1) domestic output has risen 2) imports have fallen , 3)consumers now pay a higher price.

World price before tariff is Pw and at this price, domestic demand is Qd and domestic supply is Qs. Because of the tariff , the import price rises to Pw + T. This causes a contraction in demand to Qd2 and an expansion of supply to Qs2. The result is that the volume of imports falls to quantity M. Analysis diagram below shows effects of an import tariff on an imported product.

The rise of the market price generates three principal effects:

1.Demand declines slightly

2.Domestic supply increases , as domestic producers supply more at a higher market price.

3. Importers suffer a decline in business.

However , this does not mean that the economy is better off , protected.

Two principal effects:

1.Consumers are worse than in free trade position, as they pay higher prices and therefore buy less of the product being protected. Consumers are worse off, and suffer from a loss of surplus.

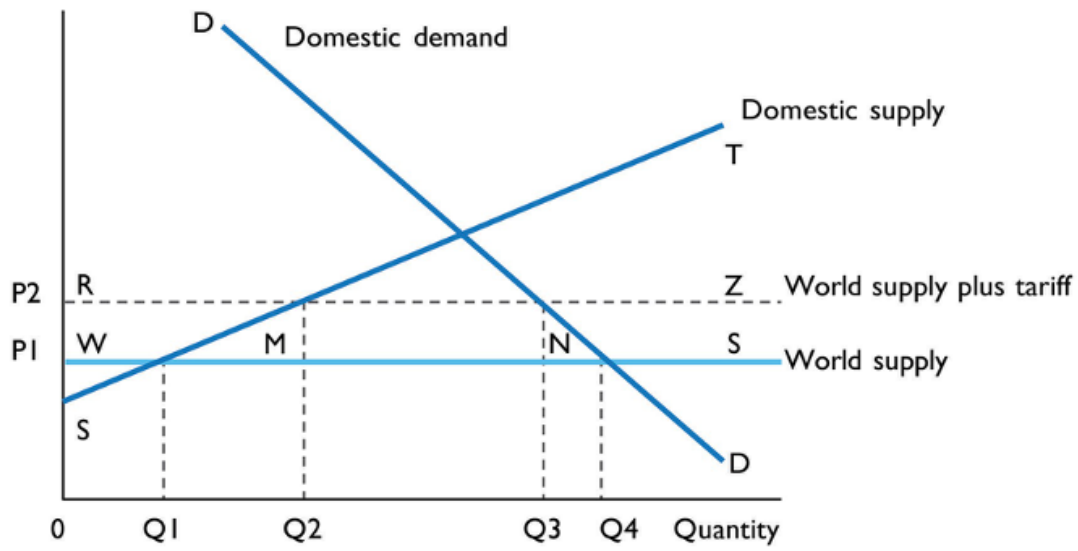
2.Producers may appear to be better off as they have expanded. In a sense they are, but this is false, because comparative advantage assumes full employment, meaning that resources have been redeployed in the protected sector have been moved from

Overall, there is a loss to consumers and also an efficiency loss on the production side , as resources are redeployed in an inefficient manner.

3.Supply side policies: aimed at improving competitiveness of the economy eg privatisation and deregulation

4.Lower Wages: which has the overall effect of reducing production costs and increased increased the competitiveness of the economy

5. STEM Education, advanced skills training and other value added initiatives and programmes.



Question 5

With the use of a graph, explain your understanding of the concept of "elasticity of Supply".

This question required candidates to include:
Definition of "Elasticity of Supply"

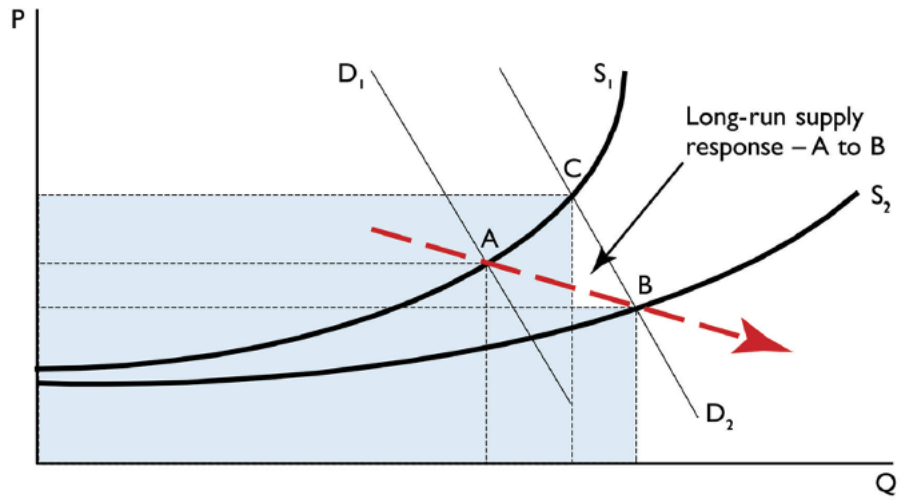
Elasticity of supply is measured as the ratio of proportionate change in the quantity supplied to the proportionate change in price.

The responsive of supply to changes in freight rates is influenced by the time period allowed for that response. By permitting the stock of vessels to alter; supply is more flexible than it is in the period when the stock of vessels is fixed.

One extreme case is to imagine how shipping markets respond in an even shorter time frame.

Supply might even be perfectly inelastic, for instance, having a supply price elasticity of zero. Suppose a charterer wants a vessel at very short notice from a particular port moved in 24 hours and the ship-owner knows this, the ship-owner could extract the maximum price. The charterer is prepared to pay. The arrival of other vessels in the next 24 hours could change the whole scenario.

The potential, to exploit the market is thus transient.



Question 6

Using the Suez Canal as an example, examine the critical role of sea canals in the global transport system.

This was a topical question and was very popular with very good answers.
Candidates were required to give a brief history of the canal:

- Opened 1869
- Located in Egypt links Mediterranean sea with Gulf of Suez, **separates Asia from Africa and the shortest route to Asia and far east from Europe**
- Recognised as a maritime route to be open all times
- 12% of world trade transits every day
- Reference to closure due Ever Green vessel blockage
- Massive impact on world trade due to closure
- Critical role of canals in global trade and transport
- Specifically built along major seawater routes to facilitate passage of vessels
- Offer alternative route to vessels, particularly cargo vessels, as well as shorter transportation routes across major seawater network

Question 7

Define ALL of the following:

Economies of scale

Price discrimination

Shipping cycles

Protectionism

This was a straight forward question and required candidates to provide brief and clear definitions of the terms and concepts above.

Question 8

Explain how foreign exchange rates between countries are determined. Use a diagram to support your answer.

This was a very popular question and produced some very with good answers and diagrams.

Exchange rate - Is the price of a nations currency. The more competitive an economy the more it's products are sought as well as it's currency and its strength and convertibility. The rate of exchange between international currencies affects the prices of exports and imports and hence the current account on the balance of payments and has a direct effect on the economic performance of a country .Trade, purchase of goods by one country requires payment in country of origin(of the good) in the currency of that country.

Purchaser has to provide funds which calls for the purchase of currency of supplying country, as more and more gods are purchased , so supply of currency decreases in value. Normally, this is balanced by exports (of a good) from buying country. Imbalances between result in exchange rate adjustments. Level of overseas investment FDI as well as increased level of productivity and competitiveness between countries / comparative advantage.

However, other factors include:

Speculation, sanctions, embargoes, tariffs, public perceptions and, confidence in the economy.

Examples: Turkey: Politically motivated US sanctions imposed on Turkey

US doubling of tariffs on Turkish steel and aluminium, worsening the position of the Turkish currency the Lira.

Russian, Iranian, Venezuela and, Zimbabwean currency woes and US/EU sanctions and embargoes.

Critical analysis of both economic and, non-economic influences.