THE INSTITUTE OF CHARTERED SHIPBROKER

2017 May ICS Examiner's Report

Economics of Sea Transport (EST)

General comments

It is indeed heartening to report that the pass rate for the Economics of Sea Transport & International examination continues to improve. The improved quality and length of essays submitted year on year is a source of great satisfaction and pride to us all. Marking examination scripts is now a source of satisfaction and pride to us all.

These high educational and professional standards are not just evident to us at the institute, but have in fact been recognised by industry. The professionalism exhibited in the structure of answers, the quality of analysis, depth and scope of knowledge is down to our collective determination at candidate, tutor and administrative staff levels to perform to the highest professional standards.

We should all build on these achievements and strive to become even better.

Candidates are reminded that Economics of Sea Transport & International Trade essays have an introduction, a body;   consisting of distinct paragraphs and a conclusion and that graphs, graph paper and maps are used to support arguments/ answers.

 Please aim to write not less than one and half pages as anything less than that is unlikely to secure a pass and always think carefully about the keywords within a question such as : examine, analyse identify, comment, discuss, describe, predict , apply, explain, compare and contrast.

Study the course material thoroughly and pay particular attention to the definition of key concepts such as: Utility and price, elasticity, opportunity cost, economies of scale, law of supply and demand, derived demand and the price mechanism.

Question 1. What is a balance of trade deficit and explain how it can be corrected.

This question was really about the economic health of a country as measured by its' balance of trade' i.e. value of imports against value of exports.   A trade deficit is not a healthy thing for a country nor the international trading community, as a country suffering from this condition cannot be expected to be health global trading partner. Every student of maritime economics is therefore, expected to know how the economic health of every country is assessed, maintained and if need be, restored.

 This question was therefore designed to test candidate's ability to demonstrate an understanding of the above. The best answers explained what a balance of trade deficit is and then proceeded to explain how it can be corrected. Candidates that did not know what a trade deficit meant naturally struggled to explain how it could be corrected. The best answers included the following corrective measures; devaluation, growth friendly monetary policy, improved global competitiveness, reduced production costs and protectionism: tariffs etc, increased national value addition, exports, cost competitiveness and concerted national industrialisation development programmes and strategies. These corrective measures were accompanied by explanations as to how exports would be increased and the country's overall competitiveness enhanced and the imbalance redressed by increased foreign exchange earnings.

Question 2. Explain economies of scale in deep sea shipping and how it affects the global pattern maritime of trade.

This was a popular and well answered question. A detailed definition of economies of scale was essential if candidates were to a explain how cost advantages that a business obtains due to expansion, cause the average cost per unit to fall as the scale of output increases and to explain this in the context of; trades, geographic specificities, frequency of shipping's, value of inventory, volume of business, infrastructure dynamics as well pricing strategies.

With regard to the global pattern of trade, candidates were required to focus on the three major global   economic blocks; Western Europe with trade North America and S.E Asia. Bulk dry & wet, refined oil products and materials in bulk vessels to the West and manufactures from S.E Asia to the West using mega container vessels. Essays that secured maximum marks were those that made use of maps and as well provided relevant examples from industry. Once again candidates are reminded that maps and graph paper are there to be used.

Question 3. Identify and explain the factors that influence the supply of vessels over time.

This was the most popular and best answered question. Candidates that had prepared well showed off their understanding of theory and its application to practice. This was a two part question .The best answers identified the factors that influence the supply of shipping and then proceeded to explain their influence on shipping over time.

 The main factors mentioned included :world commodity demand, geopolitical ,global tonnage supply issues , deliveries, orders, designs , scrappings, costs, locational shifts and capacity, seasonal pressures, infrastructure, freight rates, environmental and increased productivity of port/ canal and waterway infrastructure. What equally impressed were industry examples cited and the length and breadth of the essays.

Evidently, some candidates had prepared very well for the examination and chose to address this question from a short and long term perspective. This was a very welcome development and made very interesting reading! Well done to all those candidates that attempted this question and gave it, their best.

Question 4. Explain what is meant by 'price discrimination' in liner shipping.

Surprisingly, this was the least popular question and yet one of the best answered! This question was straight forward and required candidates to explain what is meant by the concept of 'price discrimination in the liner shipping. Candidates were required to define price discrimination and to and explain how this flexible pricing facility offers benefits to both supplier and cargo interests; different freight rates for different commodities, low rates for low-value commodities and higher rate to high value cargoes, with large shippers being offered lower rates for higher volumes of cargo. Candidates that scored highly explained how 'yield management' and the three conditions under which it operates, delivers benefits to all parties involved.

Candidates that attempted this question demonstrated a sound knowledge of subject matter and were therefore able to apply theory to practice and briefly explained the unique nature of liner shipping.

Question 5

What is the relationship between long run costs and output?

Use suitable diagrams to support your answer.

This was another unpopular question and recorded some of the lowest grades. It may be interesting to see how questions of this nature are tackled in the future! This question required candidates to demonstrate an understanding/ knowledge of long run costs in economic theory and explain their relationship to output. The definition of 'long run costs' is a crucial starting point in answering this is question. Long run costs by definition do not exist, since production process can be varied, therefore long run average cost measures the average cost of producing a given level of output , given the prices of inputs employed in the production process. Long run costs can therefore be related to output in three different ways: long-run average costs may fall, as output level rises; may remain unchanged as output levels change and may rise as output levels rise. Candidates were required to

use suitable diagrams to support their answer .Clearly the use of an unsuitable diagram t in support of an answer results in loss of marks. Marks are allocated for the use of a suitable diagram. Additional marks are also awarded for well labelled diagrams/graphs. The most appropriate diagram to use in this case was: The long run cost curve.

Question 6

How are subsidies used in the shipping industry?

 This question was about subsidies and how they are used in shipping. This was a s straight forward question and whilst it was not one of the more popular questions, the standard of answer was impressive and included, the definition of subsidies; main types of subsidies ; export and general relevant examples of subsidies such as cheap finance by banks and ship yards, location grants, tax relief on profits and raw materials   as well as payments by the government agency to the domestic producers of goods which enable them to charge lower prices for their products. Examples were numerous and included entities such ship yards and banks; both government and private as well as quasi government bodies mainly; German, Chinese and Korean.
 It was also pleasing to note that part two and three of the answers offered sound theory backed explanations for the intended purposes of the subsidies in the general context of protectionism and national economic and industrial development - typically the infant industry development strategy.

The essays that scored maximum marks were those that separated the essay into three distinct categories: definition of subsidies, types of subsidies and their intended purpose supported by relevant shipping and industry examples.

Question 7

Analyse the factors that determine the equilibrium freight rate.

Use suitable diagram to support your answer.

Most candidates attempting this question were able to identify the factors that determine the equilibrium freight rate and then went on to conduct a theory based analysis of the same factors with the support of suitable diagrams. Once again, although few candidates answered this question those that did, produced well reasoned arguments supported by good and well labelled graphs. Typically they all defined the market as the interaction of supply and demand, which both together determine the equilibrium freight rate and quantities sold at that rate. In addition, the best answers identified the following key factors: volume of world trade driven by overall economic activity, growth and changing degrees of openness towards trade by individual nations , prevailing market conditions: freight rates sensitive to short run market conditions, reflecting both present and expected future situations, a positive co-relation between demand growth and new orders, utilization of available stock of vessels, levels of lay- up , correlation between freight rates and new orders and exceptional events will all generate significant impacts on freight rates . Candidates are reminded once again that, a well labelled graph/diagram when asked for is, essential to secure maximum points.

Question 8. Explain derived demand elasticity.

This was the second most popular question and produced some fine well argued and supported answers. The best answers divided the essay into two categories: candidates firs defined derived demand and then proceeded to explain the rules relating to its elasticity. Most candidates explained that freight shipping is an intermediate part of a process of production and that the demand for shipping, like the demand for raw materials or intermediate goods, is a derived demand. The demand is derived from the consumers' demand for the final product. Upon this solid platform, they argued that derived demand has a particular set of rules relating to its elasticity as follows: few, if any substitutes, alternative sources of supply exist, but they too require sea transportation, freight rates are small proportion of final costs and finally that the elasticity of demand for the final product will be the crucial factor in the elasticity of the derived demand for shipping. Those candidates that prepared well showed off their knowledge of economic theory and even went to the extent of using diagrams to support their arguments and scored maximum marks!

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