



Examiners Report

Economics of Sea Transport & International Trade

May 2019

General comments

It is a pleasure to present the 2019 May Economics of Sea Transport & International Trade Examiner's Report. The pass rate continues to be well above average and consistent with the trend in recent years.

The majority of the essays submitted were; well structured, supported by sound theory with examples derived from industry. The best essays submitted also exhibited an impressive and sound grasp of theory and practice, well founded critique, an understanding and appreciation of current global shipping and economic issues as well as their impact on the state of the world economy.

Notable, as well, was the application of sound examination techniques, acquired from tutors and revision sessions, such as answer plans - listing the main points, at the beginning of every essay. The structure and flow of most of the essays could therefore be safely attributed to this approach.

Students are advised to study the course material thoroughly and to pay particular attention to the definition of key concepts and theories, such as: the law of supply and demand; utility and price, elasticity, opportunity cost, economies of scale, derived demand and the price mechanism.

Students are further reminded that they are required to demonstrate an understanding of the key terms and concepts in the course, such as derived elasticity, marginal costs and shipping cycles, going forward. In fact, experience shows that students, who are able to define key theories and concepts embedded in a question are more likely to provide better and well balanced essays, than those that are unable to do so.

An example of the main elements expected in the definition of such key terms and concepts is given in question 7.

Question 1.

Explain the factors that determine the freight rate. Use diagrams to support your answer.

The definition of a market would be a good starting point;

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.

The Key factors, that need to be mentioned are:

- the volume of worlds trade driven by overall economic activity growth and changing degrees of openness towards trade by individual nations.
- Prevailing market conditions.

1. Freight rates should be sensitive to short run market conditions, reflecting both present and expected future situations.

2. A strong positive correlation between demand growth and new orders, provided that the present stock of vessels is highly utilised with low levels of lay –up.

3. A positive correlation between freight rates and new orders.

4. Exceptional events will generate significant increases in rates.

Graph: Modelling Demand and Supply in Short Run

This essay could quite easily be concluded with a concise explanation of the chief factors that help determine the freight rate.

Question 2.

Identify and comment on the demand factors that influence a lay-up decision and on the costs incurred when a ship is laid up.

Again, a good starting point, to this question would be the definition of Lay-Up.

What is Lay-up? It is a Barometer on market conditions, fuel costs. A brief explanation in regard to Warm and Cold lay-up.

- Identification of demand conditions including:

1. Derived Demand
2. Recessionary conditions
3. Low productivity
4. Diminishing global trade and high operational costs
5. Low future growth prospects with reference to prevailing conditions

Comment on costs incurred when a ship is laid up including:

Capital costs, crew, essential maintenance and management.

All the above could be presented in clear paragraphs , with a concise summary of the narrative.

Question 3.

Answer BOTH parts of the question.

a) Describe the types of ships and routes associated with a liner trade of your choice.

b) Discuss all the associated fixed, variable and capital costs for this trade.

This question, required candidates to describe type of ships, routes, and associated fixed costs of a liner trade of choice.

The essay could start with a description of the liner service, in general and the chosen trade in particular, followed by detailed descriptions of:

- Ship types
- Service schedules, combined with the associated routes
- Capacity utilization would help explain the nature of the liner trade and how this influences the management of the trade, delving into:
 - Ship costs – bunker costs
 - Port Charges and canals
 - Deployment and mix of containers type and size in the trade
 - Containers costs, covering capital costs, terminal handling, maintenance and repair
 - Insurance and administrative costs

All the above could be presented in paragraphs concluding with a brief description of the chosen Liner trade, in conclusion.

Question 4.

Within the tanker market, describe ALL of the following:

- a) THREE examples of typical cargoes types.**
- b) The main exporters and importers for these cargoes.**
- c) The three major factors that impact the market.**

This question required candidates to mention and describe the under mentioned:

- crude oil
- refined oil products and chemicals
- wine, orange juice, vegetable and other food oils

Crude Oil tankers move large quantities of unrefined crude oil from its point of extraction to refineries

Refined Oil tankers move refined oil products from refineries to terminals in importing countries /destinations

The chemical seaborne trades consists of: Petroleum Products derived from organic chemicals, sulphuric acid and phosphoric acids derived from inorganic chemicals

Specialised tankers move wine, orange juice, water and vegetable and other food oils.

Exporters: Arabian Gulf, West Africa and Russia

Importers: All countries.

The description of three main factors that impact the market, would include, supply and demand, economic activity, geopolitics and attendant speculation.

The essay could conclude with a few examples of typical cargoes, exporters and importers and the three major factors that impact the market.

Question 5.

Answer both parts of the question.

a) Define absolute and comparative advantage.

b) Discuss the advantages and disadvantages of free trade policies.

This question required candidates to define absolute and comparative advantage and to discuss the advantages and disadvantages of free trade policies, as follows:

Absolute advantage:

Is the ability of an individual, company, region or country to produce a good or service at a lower cost per unit than another entity that produces the same good or product. An entity with an absolute advantage can produce a good or service using a smaller number of inputs or a more efficient process than another entity producing the same good or service.

Comparative Advantage:

Refers to the ability of a person or a country to produce a particular good at a lower marginal cost and opportunity cost than another person or country. It is the ability to produce a product most efficiently given all the other products that could be produced.

Advantages of Free Trade Policies:

- trade in goods and services without taxes or other trade barriers
- the absence of "trade-distorting" policies
- free access to markets
- free access to market information
- Inability of firms to distort markets through government-imposed monopoly or oligopoly power
- free movement of labour between and within countries

Disadvantages of free trade policies:

- can eliminate domestic industries
- reduces the tax revenues available to the government
- can encourage poor working conditions
- degrades the value of domestic natural resources
- encourages outsourcing of jobs
- can hinder the growth of a nations infant industries

The conclusion of the essay could consist of brief definitions of absolute advantage, and comparative advantage, and the advantages and disadvantages of free trade policies.

Question 6.

Using examples to support your answer, explain the concept of 'utility' as it applies to the shipping industry.

This question, required candidates to explain the concept of 'Utility' as it applies to the shipping industry. It proved rather challenging to some, and needed to include the under mentioned:

Resources are used in production to create what economists call utility. It is the power of goods or services to give pleasure, satisfaction or what is termed 'real need'.

Shipping and the maritime industry as a whole is an important element in the process of creating utility. It is involved in creating utility in a number of ways:

Place utility: the accessibility of goods at a certain place such as table grapes shipped from Namibia to a supermarket in London.

Time Utility is the accessibility of goods at a certain time, for example, heating oil from West Africa to the storage tank of a small house in Norway in midwinter.

Other forms of utility are also contributed to by shipping or transport, such as the act of providing a service.

Import and export of goods or the act of exchange.

It could be stated in conclusion, therefore, that shipping is a major factor in creating utility, in other words creating the entire amount of satisfaction obtained from consuming various amounts of a commodity in a given period and price.

Question 7.

Define ALL of the following;

a) Gross Domestic Product

b) Opportunity Cost

c) Balance of Payments

d) Shipping cycles

The definitions required here, must contain, the following key elements:

- **Gross Domestic Product:** Is the value of goods and services produced within the boundaries of a country during a specified period of time, normally a year. GDP growth rate is an important indicator of the economic performance of a country and can be measured by three methods: Output, Expenditure and Income methods
- **Opportunity Cost:** Is the loss of potential gain from other alternatives when one alternative is chosen. It is a key concept in economics and has been described as 'expressing the basic relationship between scarcity and choice.'
- **Balance of Payments:** is also known as the balance of international payments of a country, is the record of all economic transactions between the residents of the country and the rest of the world in a particular period of time. These transactions are between by individuals, firms and government bodies.
- **Shipping Cycles:** is an economic concept that explains how shipping companies and freight charges respond to supply and demand. It examines how and why ships build up in sea trading ports. The cycle also seeks to explain what effects the selling price of ship fleets and what types of ships sell during slow business periods. The four stages of the shipping cycle are, all based on customer demand, are trough, recovery, peak and collapse.

Conclusions could be based on the key elements of the terms/concepts.

8.

Critically examine the cost implications of flag registry for an owner /operator and comment on current developments in the open registry sector. Use examples to support your answer.

This question required a critique of the cost implications of flag registry for an owner/ operator as well as comments on current developments in the open registry sector. Below are some of the main cost implications and examples required to secure a good grade.

Shipping companies are assumed to be profit maximisers and strive to reach their objective by seeking the production input combination which allows them to minimise costs.

Open Registry allows:

- Favourable tax regimes; unrestricted choice of crew in International markets.
- Not subject to onerous national wage scales and more relaxed manning rules.
- cost differences for selected EU flags and lower cost open registry vessels; range from + 22% to + 333%.
- Lower operating costs generated by lighter maintenance programmes and less stringent enforcement of safety standards by traditional register:
 - escape bureaucratic control high costs of compliance with standards of national flag. Flagging also affects:
 - location of management company, number of strategic decisions at corporate level: such as investment actual market sectors, fields and industries, trade routes, protected areas and even types of ships.
- Examples such as Norway; traditional maritime response , introduction of own version of open registry; Norwegian International Register.
- Future Developments.

A concise summary of the cost implications of flag registry for an owner and comments on current and possibly future developments in the sector, would have done justice to this question.