EXAMINER'S REPORT

NOVEMBER 2020

ECONOMICS OF SEA TRANSPORT AND INTERNATIONAL TRADE

General comments

I am pleased to present the November 2020 Economics of Sea Transport & International Trade Examiner's Report. As in previous years the pass rate continues to be well above average.

It is also heartening to report that, as in recent years, most essays were well structured, anchored on sound theory and practice and supported by examples from Industry, proof that candidates read examiners reports!

Remember, a well structured essay is one step closer to securing a pass!

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, fiscal and monetary policy, supply and demand, elasticity, utility, derived elasticity, marginal costs, comparative advantage, short and long run costs ,shipping cycles, and economies of scale.

Unfortunately, unlike in the recent past, only a minority of candidates made use of the maps provided.

1. **Explain why freight rates can differ by the direction of cargo transportation.**

This question required candidates to start by explaining that transport costs differ depending on direction of shipments, reflected, for example by the freight rates on the three major liner trade routes:
eg Asia - USA + Asia – Europe +
Europe – USA + USA – Europe -
Asia – USA -
A mention of the Key factors including:

- how transport prices are affected by location of economic activities, industrial, manufacturing and production establishments ,raw materials, concentration of populations and their economic activities, consumption patterns and living standards of regions, exclusive production areas or regions of certain goods and products and value of cargoes;

- Volume of Trade, being one of the most important reasons for the imbalance of freight rates;

- centrality of cost per round trip , since transport firms produce transport services in two directions; ‘return constraint’ a physical constraint as equipment has to return to a home port;

Conclusion - brief summary of how the direction of cargo transportation influences the freight rate.

2. Explain what is meant by "Price Discrimination" in Liner Trades.

This was a straight forward question and required candidates to

Explain price discrimination, preferably by starting with a definition of the term.

- flexible pricing offering benefits to both supplier and liner company The liner company charges different freight rates for different commodities, low rates for low-value commodities and higher rate to high value cargoes. Also called ‘yield management’, a pricing strategy that maximizes revenue from a fixed ‘perishable ‘resource, and include:

-practice: widely practiced by liner companies though this is more difficult since containerization has standardized the physical cargo, with large shippers being offered lower rates for higher volumes of cargo.

-Three applicable conditions: a fixed amount of resources available for sale – capacity, resources sold are perishable and different customers willing to pay a different price for using same amount of resources.

Conclusion: brief definition of concept, mentioning practice, and conditions and finally the three applicable conditions.

3. Explain the term derived demand elasticity in the context of shipping.

Very popular question and well answered, and required candidates 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, and that demand is derived from the consumers’ demand for the final product.

A mention of the 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 that the elasticity of demand for the final product will be an important factor in the elasticity of the derived demand for shipping.

Conclusion - explanation of the term and the set of rules relating to its elasticity.

4.Using a diagram to support your answer, explain how the "Equilibrium Freight Rate" is determined.

Candidates were required to explain how the "Equilibrium Freight Rate" is determined using a diagram, by stating for example that the market is defined as the interaction of supply and demand, which both together determines the equilibrium freight rate and quantities sold at that rate, including key factors such as :

- volume of world trade driven by overall economic activity growth and changing degrees of openness towards trade by individual nations and prevailing conditions, such as :

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

5. Using either the tanker chartering trade or the Liner Trades, discuss how current macro-economic and political activity affects world trade.

Candidates, who were well- prepared, submitted well reasoned and supported essays and scored high marks on this question.
The best answers begun by defining Macro Economics:
- a branch of economics that studies how an overall economy—the market systems that operate on a large scale—behaves, economy-wide phenomena such as inflation, price levels, rate of economic growth, national income, gross domestic product (GDP), and changes in unemployment.

Tanker Chartering Trade

Those who chose the tanker chartering trade raised and discussed:

- COVID 19 impact on Oil and Gas markets and world economic growth and recovery, intensifying trade tensions,disruption of global financial and commodity market, slipping of oil markets into structural deficit:

- April 2020 scenario when oil fell to -$37.63 a barrel due to lack of storage space and diminished demand and impact of the growth of green energy fuel sources, natural gas , hydrogen etc.

Some key questions/ issues included: causes unemployment? What causes inflation? What creates or stimulates economic growth? Macroeconomics attempts to measure how well an economy is performing, to understand what forces drive it, and to project how performance can improve.

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

Liner Trades
Candidates that chose the Liner Trades:

Selected Trade Route, including East West China , South East Asia - Europe, Pacific West etc and discussed issues such as:

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

- How Turkey, India, Bangladesh, 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

- the US election cycle

Conclusion: based on how current macro economic and political activity affected world trade, from either the Tanker Chartering market or the Liner market.

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

A Definition of "Elasticity of Supply" would be a good starting point, followed by a brief explanation:

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

-the responsiveness 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.

Example:
-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 shipowner knows this, he/she 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.

Conclusion: based on the definition and a simple example.

7. Within the grain and soya market, describe ALL the following:

a) The major cargoes

b) The main importers and exporters for these cargoes

c) Three factors that impact the market.

Straight forward question that required candidates to describe the following:

-Major Grain cargoes : Wheat, Rice, Corn , Barley ,Sorghum, Oats and Rye

-Major exporters: USA, Canada, Ukraine ,Australia, EU ,Argentina.

-Major importers: China, Egypt , Sub Saharan Africa, Developing America, Europe, East and Western Asia

Soya

-Major exporters: Brazil, USA, Argentina ,Paraguay, Canada, and Ukraine

-Major importers: China, Japan , Egypt , EU ,Turkey and Iran

Three factors that impact the market including:

- Variable year and year production and movement, disasters, crop failures, population growth, increased wealth, disposable income and economic advancement and geopolitics.

Conclusion: brief summary of the major exporters and importers of major grain cargoes and soya and the three factors that impact the respective markets.

8. Examine the impact of a tariff on an imported item. Use a graph to support your answer.

This question called for the examination of the impact of a tariff on an imported good, with the use of a graph.

Defining a Tariff would be a good starting point:

Tariff: a tax duty on an import imposed by the government of the importing country.

Tariffs may be levied in two basic ways; on an ad valorem or specific duty basis. Also called import duty, a traditional means of restricting imports. These taxes raise the price of imported goods in the levying countries domestic market above those in international markets. By imposing what is in effect an import tax, the government raises the domestic price level of a product, stimulates domestic production, reduces or eliminates imports and of course raise revenue.

-Implications:
Consumers:- does this mean that the economy is better off being protected? NO!
Consumers are worse off than they were in free trade position, since they now have to pay higher prices and buy less of the product being protected.

Producers:
It may appear that producers are "better off" when tariff is imposed since they expand production, but this is in fact a false impression. Comparative advantage assumes full employment so one can

argue that since resources have been redeployed in the protected sector, output in another sector would have fallen, resulting in economic inefficiency.

Conclusion: there is a loss to both consumers and the economy as resources are redeployed in an inefficient manner. These aspects render support to the argument that free trade is superior to no trade.