

2024 International Trade Tutorial – Essay Q2 Suggested Responses

[2018 A Level Question 6]

- a) Describe two different types of protectionist policy measure and explain how each type would affect trade. [10]

Question Analysis:

Command	Explain <ul style="list-style-type: none">Start: explain how each protectionist policy works with economic analysis to impact the export (X) and imports (M) of an economy (diagram included where relevant)End: Link to impact of (X-M)
Context	Any economy
Concepts	DD/SS analysis, AD/AS analysis, Impact on (X-M) and link to trade position (refer to syllabus content 3.3.1)

Introduction

The **aims and types** of protectionist policy measures:

- Protectionism may help an economy to achieve its macroeconomic goals such as preventing rise in unemployment, improving its balance of trade position by protecting its domestic firms/ market.
- Protectionism often arises due to government's attempt to protect its economy from unfair trading competition from trading partners that affects its export competitiveness or expensive imports from trading partners that may impact its consumers and firms.

The **impact** of protectionist policy measures on trade (X and M):

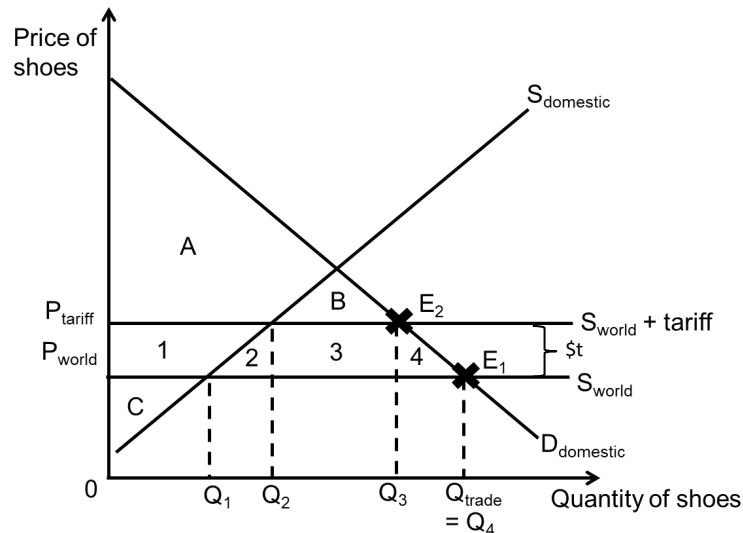
- These measures may eventually increase country's export revenues or reduce import expenditures, enabling country to improve its trade position.

R1: Impact of Tariff on trade

- A tariff is a tax that is imposed on importers and their imported goods. A specific tariff is a tax calculated as a fixed amount of money per unit of import.
- Countries place tariff on imported goods and services in hope of decrease reliance of imported goods and encouraging the switch to domestic markets. This may thus reduce import expenditure, improving BOT position.
- If free trade were allowed, prices of goods such as shoes would be sold in US at P_{world} . The domestic producers will have to sell their shoes at the world price P_w . This is because if domestic producers were to sell shoes at a price higher than P_w , they will lose all consumers to the foreign producers, assuming that the shoes are close substitutes to one another.

After the imposition of the specific tariff of \$t per unit,

- The supply curve of imports will shift up to $S_{\text{world}} + \text{tariff}$ since the tariff is added to the price of every unit of import sold in the country.
- Domestic prices will thus increase from P_{world} to P_{tariff} .



Tariffs reduce imports and increase domestic production as at this higher price,

- Quantity demanded for shoes falls from Q_4 to Q_3 .
- More domestic firms are willing and able to sell shoes, and domestic production increases from Q_1 to Q_2 .
- Overall, the volume of imports will fall from $Q_1 - Q_4$ to $Q_2 - Q_3$.
- Hence, import tariffs allow domestic firms to enjoy higher domestic demand and gain greater producer surplus. This can be seen by the original producer surplus before tariffs, triangle area C, to the new producer surplus of area C + 1.
- Overall, tariff has reduced country's reliance on imports by allowing consumers to switch to domestically produced goods and services, improving the trade balance of its country.

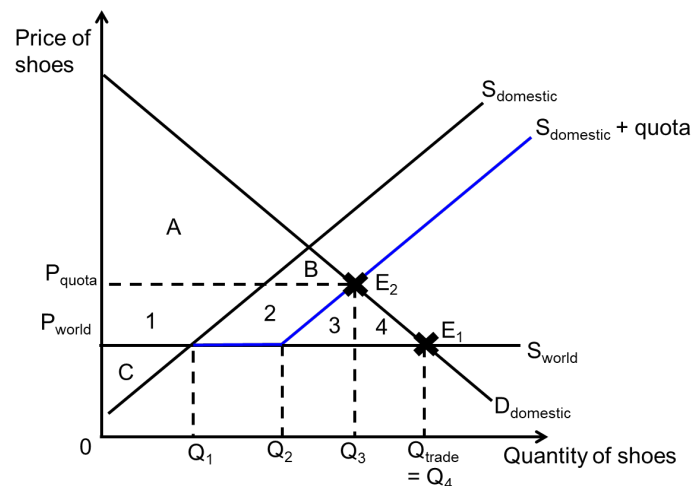
An example is the trade war between US and China, as each countries impose tariff on goods imported from one another. For instance, US has imposed tariffs on various Chinese goods ranging from steel and aluminium, semiconductors, electric vehicles etc. This could decrease import expenditure from trading with China by US, and may improve trade deficit situation in US, assuming ceteris paribus.

EITHER

R2: Impact of Import Quotas on trade

In addition to tariff, countries could also impose import quotas. Import quotas are quantity restrictions on imports, which leads to a fall in supply of imports. This fall in supply will raise price, subsequently reducing the equilibrium quantity.

The effect of an import quota on trade can be seen in the following diagram,



- Before the quota is imposed, market equilibrium is at E_1 .
- Assume the government imposes a quota of Q_1Q_2 . Domestic producers will produce up to Q_1 while Q_1Q_2 is imported.
- However, there is now a shortage of Q_2Q_4 at price P_{world} . This shortage creates an upward pressure on price.
- Since importers are not allowed to supply more shoes, domestic producers begin to enter the market, attracted by the higher price of shoes.
- The domestic supply curve shifts right to $S_{\text{domestic}} + \text{quota}$ and a new equilibrium is reached at E_2 with a price of P_{quota} and quantity of Q_3 .
- Overall, domestic production increases to $0Q_1 + Q_2Q_3$.

Overall, import quota has reduced country's reliance on imports by allowing consumers to switch to domestically produced goods and services, improving the trade balance of its country.

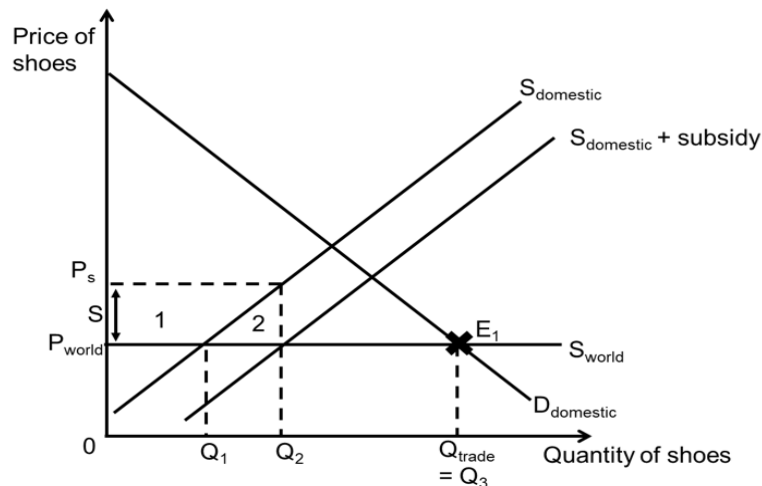
OR

R2: Impact of Subsidies on trade

In addition to tariff, countries could also provide subsidies for domestic firms in order to reduce import expenditure or increase export revenue, promoting economic growth in the country and improving its BOT position. Subsidy can come in the form of:

- Subsidy for the home production of domestic goods: This makes prices of domestically produced goods artificially cheaper than imported substitutes. This leads to a fall in import expenditure, and an increase in domestic consumption expenditure. This is called the substitution effect.
- Subsidy for the production of exports: This will make prices of exports artificially lower, hence become more competitive in the international markets. Export revenue would then increase.

For instance, for subsidy provided to home production of domestic goods,



- Before the subsidy is implemented, market equilibrium is at E_1 . (domestic producers sell from 0 to Q_1 units, while foreign producers sell from Q_1 to Q_3 units)
- Subsidies lower the cost of production for domestic producers, shifting the domestic supply curve to the right by the amount of subsidy given. While the market price remains at P_{world} , and the total quantity demanded remains at Q_3 . However, subsidy has increased the domestic producers' production from Q_1 to Q_2 , due to the S amount of subsidy for each unit produced.
- Overall, subsidy has reduced country's reliance on imports by allowing consumers to switch to domestically produced goods and services, reduce import expenditures and hence improving the trade balance of its country.

For an example, U.S. government heavily subsidizes the domestic agricultural sector. It also subsidizes oil and energy producers etc, to protect its domestic market from external competitions.

Note that

- Students may also explain subsidy in the form of **export subsidies**. **Subsidy to produce exports** make prices of exports artificially lower, hence become more competitive in the international markets. Export revenue would then increase, improving trade position of its country as well.
- The explanation using devaluation can also be accepted.

Conclusion

- Thus, protectionist policies such as subsidies and tariff improve the trade balance for countries.
- However, such benefits could only be enjoyed if there is no retaliation for other countries.
- In the case of US, when the Trump administration placed a tariff on Chinese goods, China retaliated by placing a tariff on US products, reducing US export to China. It is also worthy to note that given current global supply chain, protectionist policy adopt by one country will have repercussion in other countries, reducing the world trade.

Marking Scheme:

Level	Knowledge, Application, Understanding and Analysis	Marks
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L3	<ul style="list-style-type: none"> Well-developed analysis on both requirements: <ul style="list-style-type: none"> Good use of relevant economic concepts in analysis Good use of examples to illustrate the different types of protectionist policy measures and how the policies affect trade Good use of diagrams to illustrate the policies. No major conceptual inaccuracies. Start and end point are clearly explained with no missing links in elaboration to show how the two types of protectionist policy measures affect trade, thus achieving the macroeconomic aims of the country. 	8-10
L2	<ul style="list-style-type: none"> Lacking in any one of the L3 criteria – under developed responses 	5-7
L1	<ul style="list-style-type: none"> Descriptive answer without any or with minimal economic reasoning. Largely irrelevant answer. Major conceptual errors. 	1-4

Annotation	Level	Mark out of 10
A+A	L3	10
A+C or C+A	L3	8-9
A+K or K+A	L2	7
C+C	L2	6-7
A+0	L2	6
K+C or C+K	L2	5-6
C+0	L1	4
K+K	L1	2-4
K+0	L1	1-2

Cambridge report (FOR TEACHER'S REFERENCE ONLY)

(a) Most answers gave an appropriate tariff diagram. The stronger candidates explained that tariffs were a type of fiscal policy measure and gave a clear and precise explanation of how an import tariff might affect trade. Either import quotas or deliberate devaluation was frequently chosen as the second type of protectionist measure. In contrast to the tariff diagram, there were variations in the quality of the diagram used to explain the impact of quotas. Weaker explanations either did not explain the usually correctly drawn tariff diagram or gave a largely rehearsed response on the negative consequences of tariffs much of which was more relevant to (and repeated in) part (b) of the question. In addition, several responses did not fully answer the question and only gave one type of protectionist measure, usually tariffs.

b) Discuss the extent to which protectionism would be beneficial to an economy. [15]

Question analysis:

Command	Discuss = Explain + Evaluation <ul style="list-style-type: none"> Start point – protectionism End point – increase benefits and harm an economy (macroeconomic goals)
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Context	Any economy
Concepts	<ul style="list-style-type: none"> Costs and benefits of using protectionism (refer to syllabus content 3.3.1)

Introduction

Explain the aim for countries to engage in protectionism (benefits of protectionism)

- Governments know that trade involves costs as well as benefits. Although the choice is not between whether to engage in free trade or not to trade at all. Instead, countries consider the extent to which they should trade.
- This main reason is because free trade does not necessarily result in equal benefits to all trading partners. Governments engage in protectionism thus to ensure it is able to achieve its macroeconomic goals and ultimately benefits the standard of living of its citizens.
- Thus, the extent to which protectionism can benefit or harm an economy more or less vary across different countries due to the differences in the nature of an economy, as well as the needs of an economy in different time period.

R1: Protectionism may help the economy to achieve macroeconomic goals

Protectionism could be beneficial as it allows an economy to achieve the macroeconomic aims of sustainable economic growth, low unemployment, price stability and favourable balance of trade position.

- Protectionism could be beneficial **if the country is suffering from unfair trade practices adopted by other countries.**

For instance, the use of dumping by foreign firms/ manufacturers:

- **Dumping** is the practice of selling exports at prices which are lower than domestic prices or production costs. This is a practice of price discrimination, which enables the manufacturer to benefit from foreign markets or to monopolise the foreign markets through predatory pricing. Dumping, if proven true by WTO; is an illegal practice in international trade agreements.
- Dumping by foreign producers can result in domestic firms having a smaller share of the domestic markets, leading to a fall in demand for goods from domestic firms and lower total revenue earned → lower profit margin for domestic firms (ceteris paribus).
- This may discourage firms from investing in the economy → fall in AD → assuming economy is not overheated, fall in real national income (RNY) can arise. As less output is produced, this could lead to rise in (demand- deficient) unemployment and negative economic growth as less profitable domestic firms choose to lay off its labour or relocate abroad.
- For example, the US and EU have long accused China of adopting unfair trade practices against them. This has led to US and EU adopting protectionism against Chinese goods in an attempt to protect their domestic markets from unfair trade practices. In the case of EU, EU adopted trade restriction against the import of Chinese solar panel as China has been accused of unfairly subsidising the production of solar panel.

R1 Evaluation: Effectiveness – unintended consequences: Protectionism could protect country from unfair trade practices and achieve the macroeconomic aims, such action could result in retaliation from other countries. This could thus result in fall in an economy's export market to trading partners or rise in price of imported goods → adversely affecting macroeconomics goals such as worsen BOT

OR

Protectionism could **be beneficial to protect domestic firms temporarily (infant industry argument)**

- Temporary protection may be considered necessary to give affected home industries sufficient time to adjust, retrain workers, develop new products or even diversify/go into new industries. This will thus prevent a sudden and large decline in domestic employment.
- A possible instance is the argument to protect **Infant Industry to create a more level playing field for the young industries to compete** with established industries.
 - This refers to an industry that has a potential comparative advantage but is too young to realise its potential yet as it may have a difficult time competing with established industries in other countries. A protected infant industry If such an industry is undercut by large and established foreign firms, the comparative advantage might never develop. Without protection, these infant industries are unlikely to survive competition from abroad.
 - This is because, these industries are too small to benefit from the cost savings and/or earn enough revenue to compete effectively.
 - A period of temporary protection may be needed for this growing industry to have the opportunity to benefit from, cost-savings via the improvement of productivity and efficiency and higher revenue in terms of growing demand as the infant industry establishes its reputation.

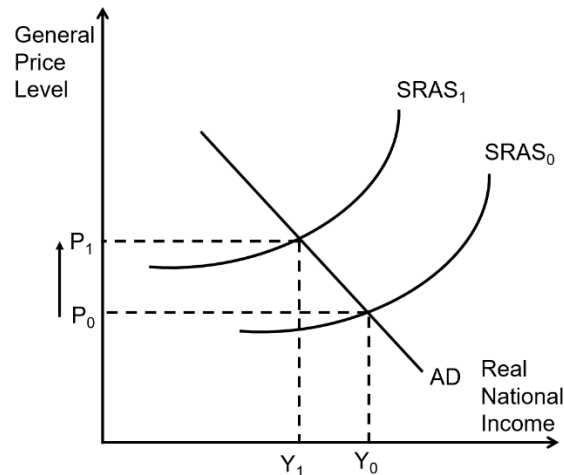
R1 Evaluation: Effectiveness - uncertainty in outcome: Though the infant-industry argument has logical validity, to apply protection successfully, the government would need to determine which infant industries can achieve economic maturity and therefore deserving of protection. However, this is a very difficult decision-making process for the government to determine. and the difficulty of removing protectionist measures such as tariffs and subsidies even after the specified protected period is well over.

Either

R2: Protectionism may worsen an economy to achieve macroeconomic goals

Protectionism may adversely affect economic growth, worsening unemployment and cause imported inflation.

- Tariff could lead make the imported inputs/ raw material and half-finished goods to be more expensive → unit COP increase lead to a fall in SRAS from SRAS1 to SRAS2.
- This would decrease the RNY (from Y_0 to Y_1) by multiple times due to the reverse multiplier effects leading to negative actual economic growth. The fall in real national output would also result in increasing unemployment as the demand of labour is derived from the production of outputs. In addition, the GPL would increase from P_0 to P_1 as profit-maximising firms seek to protect its profits margin by passing the rising cost to consumers in term of higher prices of, causing imported inflation.
- Thus, countries may not benefit from adopting protectionism.

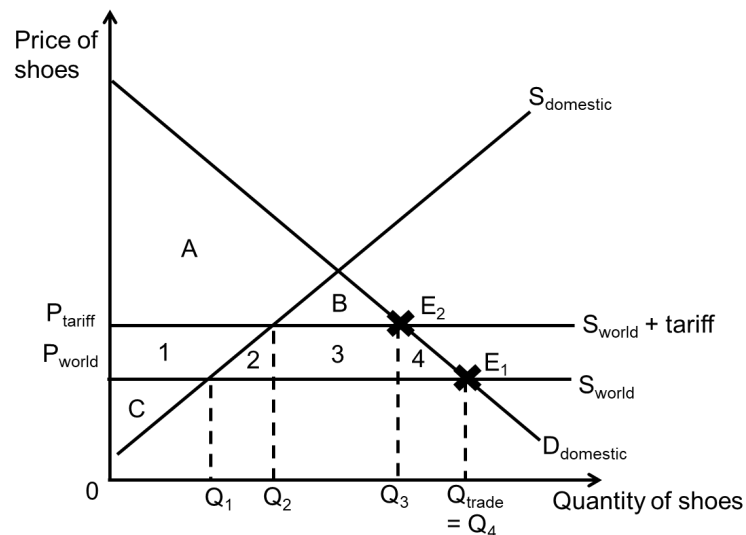


R2 Evaluation: Nature of economy: While protectionism may adversely impact the economy, the impact may vary depending on the nature of the country. Countries that are resources scarce and heavily dependent on imported raw material and half-finished goods for re-export, such as Singapore, would likely see a major negative impact on her economy compare to countries who are less dependent on import. Hence, protectionism may not be an appropriate option for resource scarce country like Singapore even if faced with unfair trading practices from trading partners. At best Singapore may choose to reduce her reliance on such trading partners and raise her import reliance on other economies for similar goods/ services.

OR R2: Protectionism may lower consumer surplus & welfare loss

While countries hope that protectionism may improve the economy by encouraging EG, reduce unemployment and improve BOT, it would adversely affect the consumers in the country.

- In the case of the use of protectionist measures such as tariffs, the tariffs have also resulted in a lower consumer surplus and incur welfare loss to society
 - With rise in price paid by consumers (from P_{world} to P_{tariff}), the consumer surplus fell from Area (A+B+1+2+3+4) to now Area (A+B) and so there is a loss of Area (1+2+3+4).
 - Consumers consumed fewer shoes than before (Q_3 instead of Q_4), so there is a total welfare loss of area 4 due to a lower consumption.
 - Q_1 - Q_2 pairs of shoes are now produced by relatively more inefficient domestic firms (these shoes were previously produced by more efficient foreign firms). There is a welfare loss of area 2 due to this inefficiency.
 - Thus the use of tariff by government could lead to higher price, lower consumer surplus and loss of welfare for the society.



- For example, China placed Brazil under the list of countries that tried to dump chicken products in China's market and placed a tariff on the import of chicken products into the country.

R2 Evaluation: While tariff could adversely affect the consumers, government could benefit from tariff as it allow government to raise tax revenue from the imports. Due to tariff, the amount of import is Q_2 to Q_3 . Hence the amount of tax collected from import would be Area 3. This tax revenue could be helpful to reduce the rising debt in countries.

Conclusion

Explain your stand and offer an opinion/ suggestion:

- Protectionism is unlikely to be beneficial any economies in the long term given that trading partners may most likely retaliate.
- US often cited the need for protectionism in the face of unfair trade practices from China. But China low price goods maybe due to its comparative advantage against US falling comparative advantage. Thus, it might not be justified to adopt protectionism.
- Rather than being overly reliance on the use of protectionism, it might be more beneficial for country to allow for free trade importing goods that one has no comparative advantage in, benefitting consumers.
- If there is a need to protect the domestic market, protectionism should only be adopted for a short period, after which allow market forces to work.
- If a country, like US, wants to improve her trade position, protectionism is not the only approach. They could implement SS-side policies to develop their comparative advantage, hence promoting their export, correcting their BOT.

Mark Scheme:

Level	Description	Marks
L3	<ul style="list-style-type: none"> • Clear and developed analysis of the effects of protectionism. • Balanced explanation that considers both the benefits and cost of protectionism. • Good use of diagrams to illustrate the impact. 	8 – 10

L2	<ul style="list-style-type: none"> Undeveloped but balanced economic explanation on the benefits and cost of protectionism. Developed but one-sided answer on the benefits <u>or</u> cost of protectionism. Some use of examples, but may not always be relevant, well explained or elaborated on. 	5 – 7
L1	<ul style="list-style-type: none"> A purely descriptive answer lacking economic analysis A purely theoretical answer with no application to any country. Contains many conceptual inaccuracies. 	1 – 4
Evaluation		
E3	Well thought-out evaluation on the conditions in which protectionism is beneficial/not beneficial to an economy.	4 – 5
E2	Some attempts at making evaluative judgment but not developed and not clearly explained using economic analysis	2 – 3
E1	Unexplained one-line evaluative statements and not supported by economic analysis.	1

Annotation	Level	Mark out of 10
A+A	L3	10
A+C or C+A	L3	8-9
A+K or K+A	L2	7
C+C	L2	6-7
A+0	L2	6
K+C or C+K	L2	5-6
C+0	L1	4
K+K	L1	2-4
K+0	L1	1-2

Cambridge report

Most answers showed a familiarity with the economic principles that can be used to explain the positive and negative impacts of protectionism. Stronger candidates made good use of appropriate tools of economic analysis in both parts of the question and made good evaluative judgements that led to a well-considered summative conclusion. Weaker responses were more cursory and lacked an analytical foundation to justify the explanations given in both parts of the question. Evaluative judgements were also lacking in the analysis.

(b) Stronger candidates showed a good understanding of both the positive and negative impacts of protectionist policies and used a range of tools of analysis such as AS/AD curves or the tariff diagram to explain their conclusions. These responses were accompanied by well thought out and appropriate evaluative judgements which were clearly linked to different types of economy and to different time periods. An overall summative conclusion was also presented. Weaker candidates tended to give a list of positive and negatives which was of varying length. These candidates tended to focus on quantity rather than quality in their response. In consequence, they were descriptive and lacked analytical depth to the explanation. Evaluative comments also tended to be cursory and there was little attempt at bringing the arguments together to form an overall conclusion.