

Q4a MJ 2013

Explain the meaning of 'protection' in the context of international trade and describe 2 methods of protection used by governments. [8] 6/8

Protectionism refers to any attempt by a government to impose restrictions to protect domestic producers from foreign competition. They are referred to as expenditure switching policies in that they aim to switch both domestic and foreign expenditure to the output of goods and services of the domestic economy. There are several types of protection, which included tariff and export subsidies.

Tariff is a tax on imports or exports. Tariff can be divided into specific which means tax per unit and ad-valorem which means tax based on a percentage of the price. The purposes of imposing tax on exports are to raise government's revenue and to increase supply of the product in the domestic market.

The purpose of imposing tax on imports is to discourage consumption of imports and protect domestic industries if demand is elastic. As such, protectionism can safeguard employment rate in the home economy. If demand is inelastic, government could raise revenue. Besides, protectionism can be used to prevent the import of demerit goods. For examples, drugs, tobacco and alcohol which have adverse social effects. Protectionism take account of externalities and help deal with such goods through the imposition of high tariffs.

Moreover, export subsidies are direct subsidies on exports. This increases the supply of a country's exports in the world market which will reduce the price below the free market price. Export subsidies are given to both exporters and domestic firms in order to compete with imports. Gainers are domestic producers when they experience a fall in cost of production and consumers. Losers are the foreign firms and domestic taxpayers who have to pay for the subsidies.

Export subsidies can be used to safeguard infant (sunrise) industries which have a low output and a high average cost. Once the industries are stabilised, the industries may be developed into a profitable business and face competition with foreign firms when trade barriers are removed.

In addition, protectionism can correct balance of payments disequilibria. For example, if a country's current account is deficit where imports exceed exports, a government may impose tariff to encourage consumers to switch from imports towards domestic goods. The imported goods are at a higher price. Export subsidies, on the other hand, lower the exported goods price in the market and increase its competitiveness in world trade.

Q3b ON 2013

Discuss whether it would be better if smoking were banned completely or whether it should be subject to an indirect tax. [12] 7/12

Demerit goods are the goods that have negative externalities associated with it. Demerit goods are often overproduced in the free market situation because of the lack of information about the harmful effects of such goods. For example, cigarettes. Hence, we shall determine if smoking were banned completely or subject to an indirect tax would be better.

Smoking bans are laws or policies that prevent people from smoking. The most common bans are those that prevent people from smoking in public areas, but there are certain countries that have put a total tobacco ban in place. Bhutan, for example, forbids its people to grow, harvest, produce, and sell tobacco as well as tobacco products.

The advantages of smoking bans are **improve national health level**. Smoking bans prevent non-smokers from exposing to second-hand smoke which may cause respiratory problems and lung cancer. The bans also help smokers in the sense that they reduce their chances of getting ill. Thus, they will not need to suffer from costly hospital bills and even improve their productivity at work.

Besides, smoking bans **decrease the possibility of fires**. There have been some cases which fires started from lit cigarettes. By following smoking bans, people can reduce the risks of fire in places with highly flammable materials. Thus, they may prevent fire incidents which destroy properties, personal belongings and taking lives.

On the other hand, the disadvantages of smoking bans are cause **unemployment**. For example, tobacco farmers, business owners of where smokers used to smoke and workers employed in the production of cigarettes industry will be affected. Some may lose their job while some may earn much lesser than they used to.

Moreover, smoking bans **limit people's freedom**. Smokers may feel offended as smoking is not a crime. The government seems like interfering in their lifestyle. This may further leads to **black markets** where the illegal trades of cigarettes happen. This is mainly caused by certain smokers who are too addicted to smoking are willingly to buy the cigarettes even though being charged at a higher price.

However, some may suggest that smoking should be subject to an indirect tax. The advantages of indirect tax on smoking are **provide government's revenue**. As smoking is tax heavily, it contributes a lot to the country's economy. If the government has sufficient revenue, they could allocate the revenues into public sectors by providing merit goods such as healthcare and education.

Furthermore, indirect tax on smoking can **reduce the production and consumption of cigarettes**. Due to the indirect tax, the price of the cigarettes increases. Hence, the smokers will reduce their demand towards cigarette smoking as they could not afford that much. Thus, the producers will also cut down the supply as lesser people are willing to buy. As such, indirect tax can minimise negative externalities such as air pollution too.

Nevertheless, indirect tax on smoking has its disadvantages such as **inefficiency in reducing negative externalities**. For example, negative externality is air pollution due to cigarette smoking. The effectiveness of reducing negative externality is depends upon the setting of the appropriate tax rate. The tax revenue collected need to be sufficient to pay the cost of improving the quality of the polluted air to the quality before externality arise.

Lastly, indirect tax **increase smoker's burden** in the sense of expenditure on cigarettes and also healthcare costs. As cigarette smoking is addictive in nature, the demand is inelastic. Some smokers will still buy no matter how much the price has hike up. Soon, when they got sick, they also need to fork out a large amount of money to cure the illnesses occurred by smoking.

In conclusion, I am of the opinion that it would be better if smoking were banned completely. Majority of the people would be benefitted as they can live in a healthier and safety environment. However, smoking will not be eliminated completely as there are black market scenarios.

Q3b ON 2015

Discuss whether money is able to perform all its functions effectively in an economy that is experiencing a high rate of inflation. [12] 8/12

Money refers to anything which is regularly used to buy goods and services. Money can take various forms which include cash, cheques, credit and debit cards, bank deposits and also e-money. In order for money to fulfil its functions effectively, it needs to be generally acceptable, durable, portable, divisible into small units and scarce.

Firstly, money functions as **medium of exchange**. It enables people to sell products and then use the money received to purchase other products, thus overcoming the problem of barter trade, which is the double coincidence of wants. This often leads to problems since this is not always present and thus a potential exchange may not occur. For example, in barter trade, if a person needs coffee in exchange of tea, then he or she must search for a person who is ready to trade coffee for tea.

Besides, money functions as **standard for deferred payment**. This concerns money's ability to allow people to lend and to borrow. Specialisation and exchange would now become common and can extend to the international level. Credit can now be introduced since there is a standard by which future transactions can be measured against. Again, it helps to make contracts which involve future payments.

Moreover, money functions as **unit of account**. It is a 'unit' by which prices are established for current and projected transactions. It allows for different values to be added, measured and compared. For example, a two-liter of Coca-Cola costs \$0.89 while Pepsi costs \$0.99. Thus, customers can compare products' prices easily. Due to this, the likely effects of the introduction of money into a system which uses barter would be that trade would now be easier, quicker and more widespread since money is now an intermediary and thus, coincidence of wants is no longer a necessity for exchange.

Lastly, money functions as **store of wealth**. It can be held or 'stored' for a period of time before it is used. As long as a currency is not experiencing rapid inflation, holding wealth in money form allows us to delay purchases for a sunny or rainy day. The currencies are now in coins and paper notes, making money in convenient denominations, solves the barter's problem of absence or lack of divisibility.

Inflation refers to a situation where there is a general and sustained increase in prices. Monetary inflation occurs when the growth of money supply is greater than the increase in the level of output in a country.

If prices are changing rapidly, it will be very difficult for money to function as a unit of account. This is because inflationary noise will make it difficult to assess what is happening to the price of goods and services. Consumers and producers may make suboptimal decisions.

If an economy is experiencing a high rate of inflation which is also known as hyperinflation, people may lose confidence in money and tend to move back to the barter system. Hence, money may cease to function as a medium of exchange. Large amounts of currency will need to change hands for relatively small transactions.

Furthermore, due to inflation, the value of money depreciates. Money may not function properly as standard for deferred payment. This is because all the banks will not grant loans to individuals as easy as when the economy has stable. The banks are unsure about their profit through providing loan services for individuals such as personal loan, housing loan and car loan.

Inflation will cause the real value of money to decline. The higher the inflation rate, the greater will be the decline in the value of money. Thus, high levels of inflation will result in money losing its ability as a store of value. Under such circumstances, people may resort to the use of other mediums such as precious metals like gold as a store of value. Individuals may prefer to open gold investment account instead of ordinary savings account or fixed deposit account.

which is a period of time during which national income is rising, it should increase its production capacity in order to be able to meet the higher demand when the economic expansion comes. Furthermore, the higher the YED is, the larger will be the increase in the demand and hence the larger the extent the firm should increase its production capacity. Conversely, if the firm predicts an economic contraction which is a period of time during which national income is falling, it should decrease its production capacity to minimise excess capacity when the economic contraction comes.

The concepts of elasticity of demand may not be useful to a firm that produces smartphones as they are subject to several limitations. The data that are used to calculate elasticities of demand may be irrelevant or unreliable. Data from past records may no longer be relevant to calculating elasticities of demand as some of the determinants of demand may have changed. Although data from current market surveys are relevant to calculating elasticities of demand, they may not be reliable as the respondents may not be truthful in their responses. Furthermore, if the sample sizes of the market surveys are small, the results may not be reliable as they may not be reflective of the actual markets for the goods. The assumption of *ceteris paribus* that is made in calculating elasticities of demand is unlikely to hold in reality. In reality, many factors such as the level of income, the price of the good and the prices of related goods are changing simultaneously. Although PED may be useful for increasing total revenue, this is not true for increasing profit due to the omission of total cost. For example, if demand is price elastic, a fall in price will lead to a larger proportionate increase in quantity demanded resulting in an increase in total revenue. However, if total cost rises by a larger extent, profit will fall. PED and XED do not take production capacity into consideration. For example, if demand is price elastic, a fall in price will lead to a larger proportionate increase in quantity demanded resulting in an increase in total revenue. However, total revenue will not rise if there is no excess capacity to increase production.

In the final analysis, for a firm that produces a fashionable product such as smartphones, PED can be useful for making proactive business decisions but YED and XED can only be useful for making reactive business decisions. In other words, unlike the use of PED which does not have a precondition, the use of YED and XED requires a change in consumers' income and the price of a related good respectively. In this respect, one can argue that PED is more useful than YED and XED for making business decisions. However, if the firm also sells a complementary good such as applications for the smartphones, XED can also be useful for making proactive business decisions. Although PED can be more useful than YED and XED to a firm that produces a fashionable product such as smartphones for making business decisions, its usefulness depends on several factors. For example, if the firm wants to increase sales revenue due to factors such as it being the key performance indicator of the management, PED is likely to be useful. However, if the firm is a new entrant in the market, it may want to increase market share to compete with the incumbent firms. In this case, PED is likely to be of limited use to the firm.

