T3W6 Class Test 5
Globalisation & the International Economy
Mark Scheme

"The word tariff is the most beautiful word in the dictionary" - Donald Trump

Discuss the extent to which the imposition of tariffs on imported goods would benefit producers and improve the economic performance of the United States. [15]

Suggested Answer

Introduction:

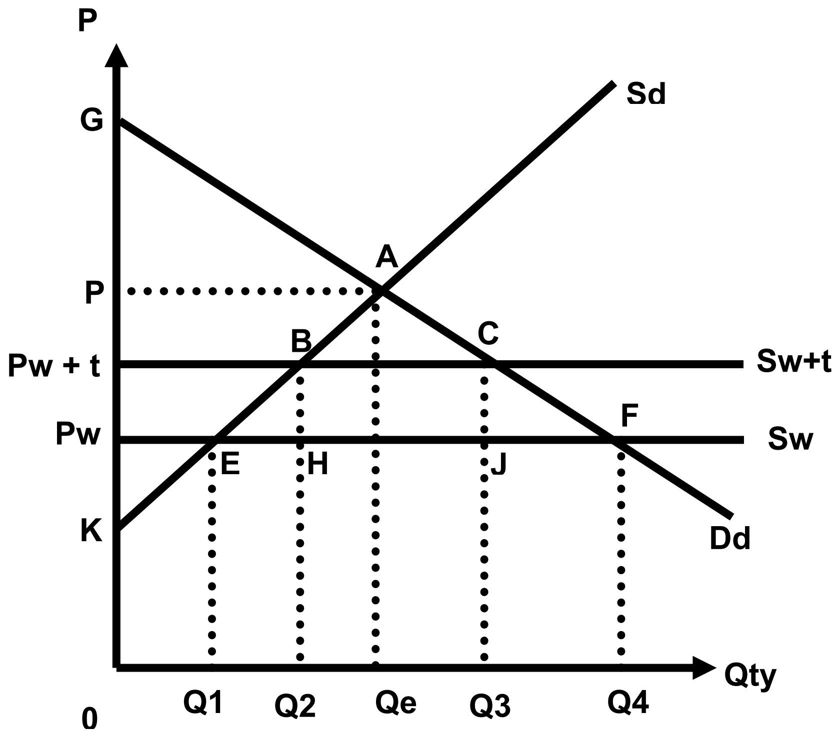
- Imposition of tariffs is a form of protectionism.
- Protectionism is a policy of sheltering domestic industries from foreign competition through the imposition of trade barriers on imports.
- This could impact domestic producers and the economic performance of the US in terms of its economic growth, unemployment rate, inflation rate and its balance of trade.

Body: Discuss the effects of tariffs on producers and KEI

<u>R1: Effects of tariffs on producers</u>

Thesis: Explain how the imposition of tariffs on imported goods would benefit producers

- Tariffs on steel may benefit steel producers as they increase the total revenue and producer surplus of these producers
- In the diagram below, Sd and Dd show the country's domestic supply and demand.
- Assume that country is a price taker, and this means it can import as much steel at the price of Pw. Countries which has CA in steel production includes China who can produce steel at lower price than the US.



- The imposition of tariffs on the steel industry would artificially raise the world price to Pw+t.
- Due to the rise in price of foreign steel, domestic quantity supplied rises from Q1 to Q2.

- Producer surplus is the difference between the minimum price a producer is willing and able to accept and the actual price they receive.
- Producers will have an increase in producer surplus from KPwE to KPw+tB as the price they receive will increase from Pw to Pw+t and increase in quantity supplied from Q1 to Q2.
- Total revenue also increases from 0Q1EPw to 0Q2BPw+t this is because of the rise in price from Pw to Pw+t and the increase the domestic quantity supplied from Q1 to Q2.
- Hence, the imposition of tariffs on imported goods could benefit domestic producers

Anti-thesis: Explain how the imposition of tariffs on imported goods would worsen impact on producers

- However, as steel is also an imported factor of production, these tariffs on steel would increase the price of imported factors of production.
- For example, car companies in the US such as Ford and Tesla might need to pay more for foreign steel or choose to buy more expensive domestic steel.
- This would raise the cost of production.
- Using DD/SS framework, this would reduce the SS of cars → Rise in price of cars, fall in Qty sold → Fall in producer surplus
- Alternatively, using firm's analysis, a rise in MC would cause profits to fall.
- This would harm other producers which use the steel as a factor of production

- Moreover, tariffs are a 'beggar-thy-neighbour' policy, and the benefits to domestic producers are achieved at the expense of its trading partners.
- Trading partners who experience a decline in export sales may enact similar retaliatory tariffs on other goods and services the protectionist country exports.
- If so, this would eventually lead to a fall in total revenue for these producers, which may cause a fall in profits

R1 EV:

- On balance, tariffs are likely to harm producers. Even though they benefit protected industries, these benefits are likely temporary.
- Trading partners are likely to retaliate, and the domestic producer will remain uncompetitive.
- Moreover, only producers from one industry benefit, other producers are likely to be worse off.

R2: Impact of tariffs on Key Economic Indicators (at least 2 indicators)

Thesis: Explain how the imposition of tariffs on imported goods would benefit economic performance

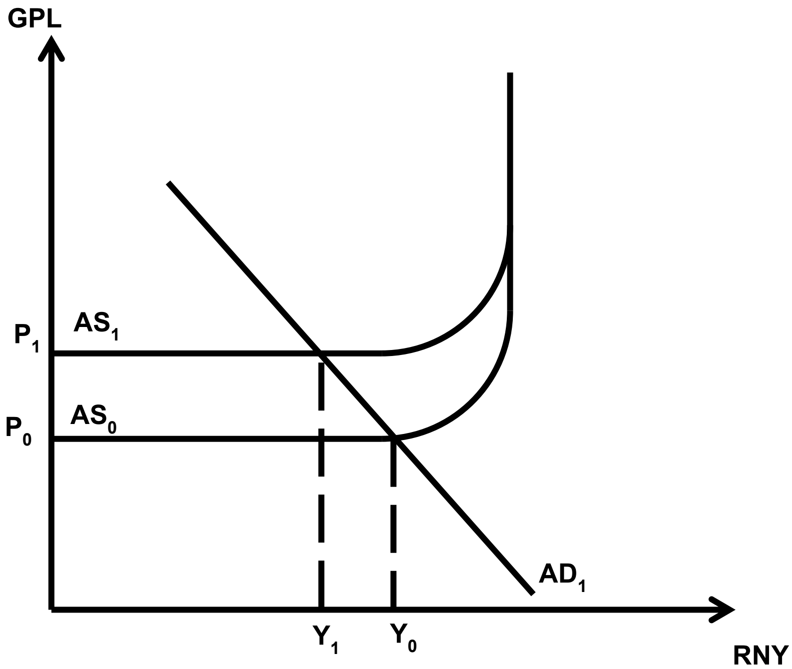
- Tariffs can also be used to reduce import expenditure and improve the country's balance of trade (BOT) and hence, its current account position.
- An enacted tariff shifts the world supply curve to Sw+t, given that the tariff is added to the price of every unit of import sold in the country. Price rises to Pw+t.
- As a result the amount of steel imported decreases from Q1Q4 to Q2Q3.
- Thus, import expenditure decreases from EFQ4Q1 to BCQ2Q3
- Ceteris paribus, a fall in import expenditure will cause the balance of trade to improve, which benefits economic performance.
- This could extend to increase in AD (as more switch to Cd) → increase in RNY → EG and fall in UE.

- Moreover, steel workers in the US may face unemployment due to competition from cheaper imported steel.
- These steel workers lack the skills to move into higher skilled growing industries, and there is a skills mismatch, and occupational immobility.

- The imposition of tariffs on the steel industry would artificially raise the world price to Pw+t.
- As a result, this raises domestic production from Q1 to Q2 as they can compete with the higher price of imports.
- The increase in domestic production would mean an increase in derived demand for labour, which would increase employment in the steel industry
- This also helps to provide additional time to retrain workers in the steel industry to move into other industries
- Thus, tariffs help to improve economic performance by alleviating structural unemployment.

Anti-thesis: Explain how the imposition of tariffs on imported goods may worsen economic performance

- However, the use of tariffs might create cost push inflation.
- This is because the tariffs increase the price of imported factors of production.
- For example, car companies might need to pay more for foreign steel or choose to buy more expensive domestic steel.
- This would raise the cost of production.
- As the cost of production rises,
- Firms will face a decrease in their profit margins,
- Hence, they are only willing and able to produce the same output at a higher price
- the AS curve shifts up from AS0 to AS1
- As total spending exceeds total output, there would also be a shortage, causing households to compete for limited goods and services.
- Thus, firms would raise prices, causing GPL increases from P0 to P1
- This causes cost push inflation



R2 EV:

- To evaluate, tariffs are likely to harm economic performance. Even though there seem to be benefit to balance of trade and structural unemployment, these benefits are likely short lived.
- In the long run, tariffs may cause protected firms to be dependent on protection because they have no incentive to improve. This complacency may cause the industry to be even more uncompetitive, requiring more and more protection.

- Thus, the benefits are likely short-lived, but the harm on the country's other macroeconomic goals will increase in the long run.
- Alternatively: for large countries like the US, the probability of retaliation is low – it is possible to improve the economic performance such as reducing the BOT deficit.

Conclusion and Overall evaluation:

- In conclusion, tariffs do not benefit producers or the macroeconomic performance of a country as it does not solve the root cause of the problems producers face, or the country's macroeconomic problems.
- To the extent that supply-side policies are used while the tariffs are imposed, these policies will help improve the competitiveness of producers, address the loss of CA of the US in these industries, and improve the country's macroeconomic performance.

Mark Scheme:

- *R1 A: use of economic framework (tariff diagram, T/AT, depth – links to PS, application – type of industry/egs*
- *R2 A: use of economic framework (AD/AS or BOT/structural UE), T/AT, depth – depending on KEI*

	Knowledge, Application, Understanding, Analysis	
L1	• *Little / non-existent use of economic theory / framework in the explanation – no use of tariff diagram or AD/AS framework* • *Conceptual errors made* • *0/K, K/K*	***1 – 4***
L2	• *Lack of scope – only R1 or R2* • *Insufficient depth of explanation – did not use the tariff diagram to explain the rise in producer surplus or elaboration of how BOT/EG/UE will be affected* • *One-sided answer – no AT (max C)* • *K/C, C/C*	***5 - 7***
L3	• *A well-balanced answer with good use of economic framework* • *Answer has good scope and good depth of explanation.* • *C/A, A/A*	***8 - 10***
	Evaluation	
E1	*An unexplained judgement/conclusion that is not linked to the context of the question – only EV of R1 or R2, or only summative EV*	***1 - 2***
E2	*Evaluative assessment supported by justification* *Some substantiation of an evaluative comment and/or conclusion* *4m – 2 well explained judgements (context of US, SR v LR benefits/costs)*	***3 - 4***
E3	*Well explained evaluative judgements PLUS a summative conclusion*	***5***