IB Economics IA Portfolio Coversheet

School code:	
School name:	
Candidate name:	Yingtong Li
Candidate number:	

	Commentary 1	Commentary 2	Commentary 3
Source of the article:	Sydney Morning Herald	The Timaru Herald	The Globe and Mail
Date article published:	2014-08-31	2015-09-12	2015-03-08
Date commentary written:	2015-05-22	2016-01-05	2016-02-25
Word count:	742	741	745
Section of the syllabus the article relates to:	Microeconomics	Macroeconomics	International Economics

Internal Assessment 1 - Micro Commentary

IB Economics IA Commentary Coversheet

School code:	
School name:	
Candidate name:	Yingtong Li
Candidate number:	
Teacher:	
Title of the article:	A dollar to light up: smokers brace for another jump in tobacco excise
Source of the article:	Sydney Morning Herald: `http://www.smh.com.au/federal-politics/political-news/a-dollar-to-light-up-smokers-brace-for-another-jump-in-tobacco-excise-20140831-10aln2.html`
Date article published:	2014-08-31
Date commentary written:	2015-05-22
Word count:	742
Section of the syllabus the article relates to:	Microeconomics

A dollar to light up: smokers brace for another jump in tobacco excise

Peter Martin

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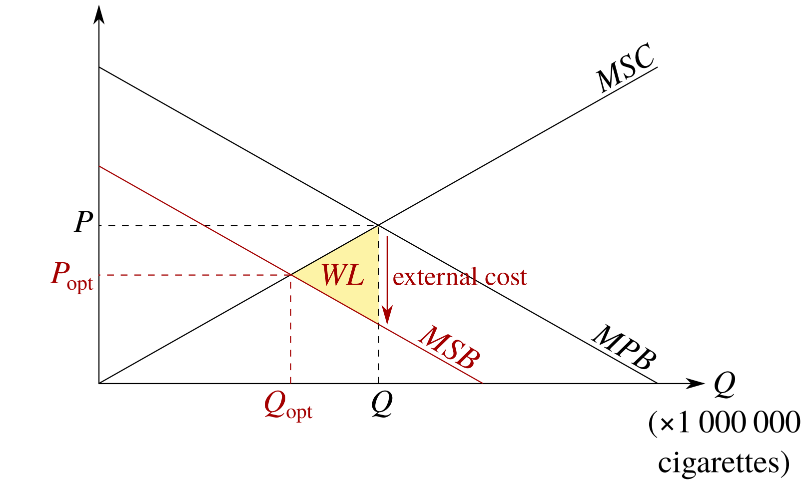
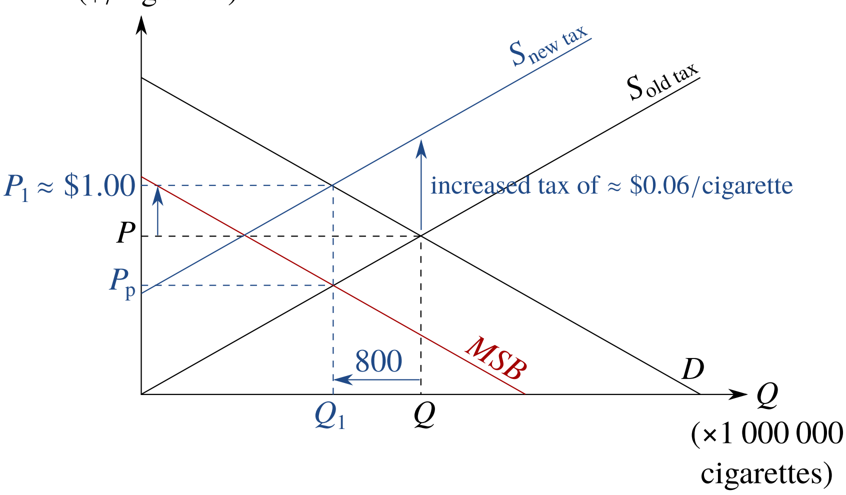
This article describes the Australian government's plan to increase the tobacco excise in order to combat the market failure caused by negative consumption externalities associated with cigarettes. Taxes can indeed be used to correct these market failures and maximise social welfare, but should be combined with other approaches for optimal impact.

Cigarettes are demerit goods as their consumption results in negative effects on third parties, such as those exposed to passive smoking, who suffer an increased risk of lung cancer, and the government, which must support smokers and victims of passive smoking who develop lung cancer through increased healthcare expenditure. These negative consumption externalities cause the marginal social benefit for cigarettes (MSB) to be less than the marginal private benefit (MPB).



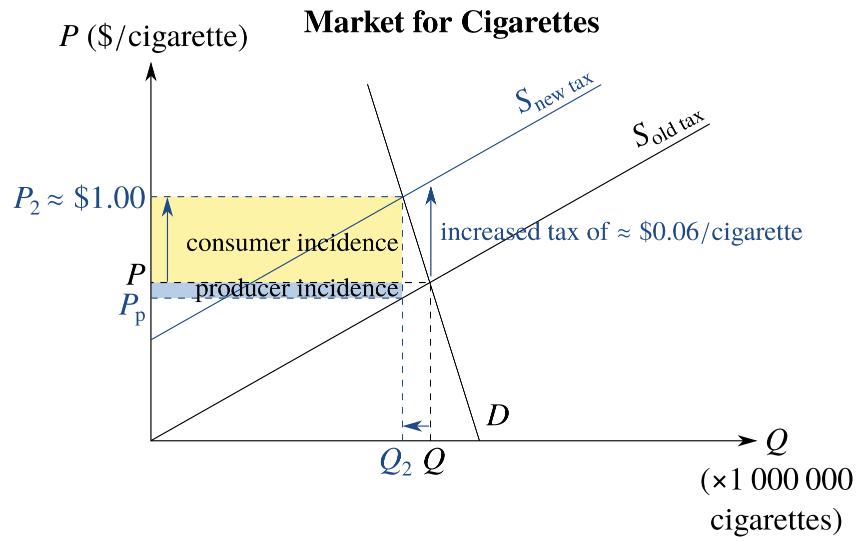
An efficient market should operate at $(P_{\text{opt}}, Q_{\text{opt}})$, however, without suitable regulation, the market fails to take into account the externalities and so instead operates at (P, Q). Consequently, cigarettes are over-provided, so a market failure exists as resources are over-allocated to cigarettes, resulting in a welfare loss from the provision of cigarettes where $MSC > MSB$.

The increase of the indirect tax on cigarettes to a suitable level causes the cost of production to increase, shifting the supply curve up by the amount of the tax increase.



As a result of the decrease in supply from $S_{\text{old tax}}$ to $S_{\text{new tax}}$, the price of cigarettes increases from P to P_1, 'approach[ing] $1 a stick', while quantity traded decreases by 'around 800 million' from Q to Q_1 correcting the over-allocation of resources, so the externalities are internalised and the market failure is corrected.

Cigarettes, however, are highly addictive. As a result, demand for cigarettes is likely to be price inelastic as cigarette users fail to reduce consumption in proportion to an increase in price.



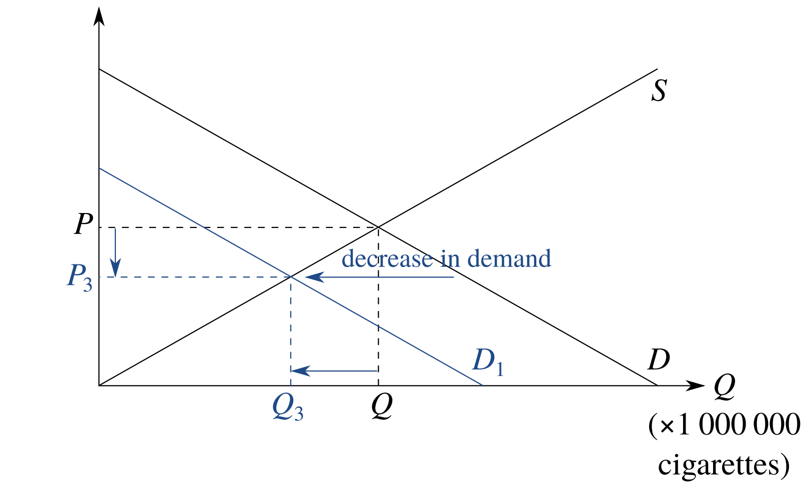
In this case, the tax will cause a large increase in price for consumers, from P to P_2, but a comparatively small decrease in quantity traded, from Q to Q_2, and so would not be as effective at discouraging consumption of cigarettes. Additionally, the decrease in price received by producers is smaller, from P to P_p, so the consumer incidence is much greater than the producer incidence, indicating that consumers shoulder more of the tax burden than producers. This creates opportunity costs for consumers who may need to reduce expenditure on other goods such as food, clothing, healthcare and education, which is particularly damaging for poorer consumers, who are also more likely to smoke. Consequently, the tax may in fact lower the standard of living for these consumers, widening income inequality.

The regressive nature of the tax is offset, however, by the fact that the tax increase raises additional government revenue of $\Delta tax \times Q_1 = (P_1 - P_\mathrm{p}) \times Q_1$, which could be spent on social services such as healthcare to address the harm caused by cigarettes, and which would benefit those on lower incomes.

If, however, consumers are unwilling or unable to quit smoking due to addiction, and also cannot afford the increased tax, consumers and producers may attempt to circumvent the tax through black markets. This would impair the ability of the tax to reduce consumption and raise revenue, and would also result in the unintended consequence of encouraging trade in illegal or less-easily-regulated markets.

The measures to be used in conjunction with the increased taxes can ease some of these undesirable consequences in yielding long-term benefits. The increase in the excise ‘breaches significant price points’, prompting an estimated ‘60,000 smokers’ to choose to quit smoking altogether, decreasing demand. The sustained future increases in price from the change to indexation, in combination with ‘measures such as plain packaging’ and the ‘great deal of publicity’ raised by advertising accompanying the tax, are likely to further encourage consumers to quit smoking, further decreasing demand for cigarettes.

Market for Cigarettes



The decrease in demand from D to D_1 causes the price of cigarettes to decrease from P to P_3 and quantity traded to decrease from Q to Q_3, which further assists in discouraging cigarette consumption and addressing the market failure in the long term.

Overall, increasing the tax on cigarettes has the capacity to raise government revenue and correct the market failures in the cigarette market through its deterrent effect. However, it disproportionately affects poorer consumers, and its effectiveness may be diminished by the price inelastic demand for cigarettes, or by trade in the black market, and so it is important that it is pursued, as planned, in conjunction with other measures such as advertising and plain packaging to most effectively reduce cigarette consumption in the long term.

Internal Assessment 2 - Macro Commentary

IB Economics IA Commentary Coversheet

School code:	
School name:	
Candidate name:	Yingtong Li
Candidate number:	
Teacher:	
Title of the article:	Cash rate cut points to softening economy
Source of the article:	The Timaru Herald: `http://search.ebscohost.com/login.aspx?direct=true&db=anh&AN=THL15091200101106053005-BO&site=ehost-live`
Date article published:	2015-09-12
Date commentary written:	2016-01-05
Word count:	741
Section of the syllabus the article relates to:	Macroeconomics

Cash rate cut points to softening economy

Edlin Bob

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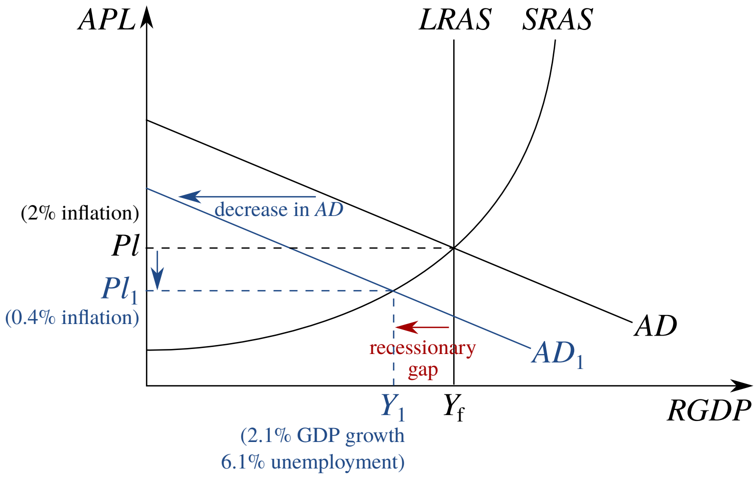
This article describes the Reserve Bank of New Zealand's move to address a weakening economy by implementing expansionary monetary policy, cutting the official cash rate to increase levels of aggregate demand and thereby stimulate the economy. Expansionary monetary policy can indeed stimulate economic growth in the short run, but may have several negative impacts on other sectors and in the long term.

In the domestic New Zealand economy, 'weakening … consumer confidence' results in decreased consumer expenditure due to fears of unemployment or cuts to wages, while 'a weakening in business … confidence' causes businesses to reduce investment due to a pessimistic outlook on future sales. Internationally, 'a weakening of economic prospects in … overseas markets' decreases demand for New Zealand's exports. These factors lower aggregate demand from AD to AD_1.

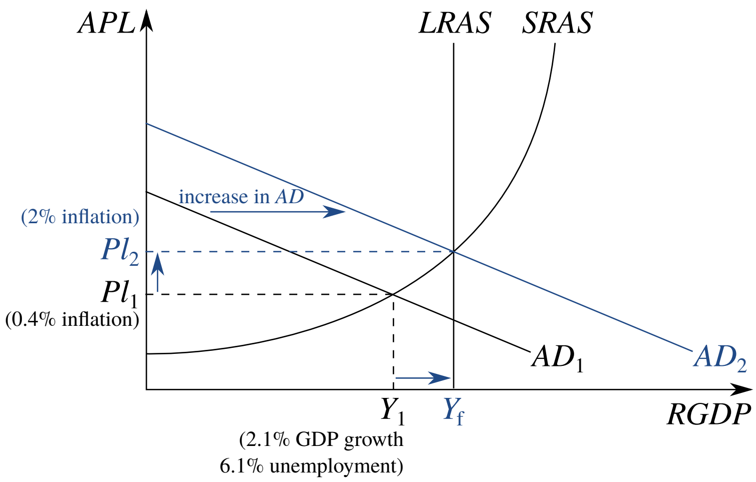
New Zealand Economy



This causes price levels to fall from Pl to Pl_1, and creates a recessionary gap, as GDP, Y_1, falls below the full-employment level Y_f.

The New Zealand Reserve Bank has moved to address this through expansionary monetary policy by lowering interest rates. Consequently, it becomes less profitable for consumers to save, so consumers increase their spending, and cheaper to borrow, 'support[ing] businesses wanting to invest', so business investment increases. Additionally, lower interest rates reduce the profitability of foreign investment into New Zealand, decreasing demand for the New Zealand dollar. This causes the NZD to depreciate, so imports become dearer and decrease, while exports become cheaper and increase. Consequently, aggregate demand increases from AD_1 to AD_2.

New Zealand Economy



This causes price levels to increase from Pl_1 to Pl_2, which is in fact desirable as inflation was previously 0.4%, less than the 2% target. Output also increases from Y_1 to the full-employment level Y_f, closing the recessionary gap, and increasing demand for labour by firms to expand output, resulting in lower unemployment, and hence higher living standards.

On the other hand, however, increased borrowing will result in higher indebtedness, which may not be desirable, particularly when poor economic conditions impair the ability of households to repay these loans. Alternatively, if the ‘jaw-dropping downgrade’ in the ‘economic forecast’ indicates that economic conditions are particularly poor, banks may be unwilling to lend, and consumers and firms unwilling to borrow, out of fear that the loans cannot be repaid. In this case, consumption and investment, and thus aggregate demand, will not increase, even if interest rates are lowered, and so expansionary monetary policy will be less effective at stimulating the economy, hence multiple ‘further OCR cuts’ may be required to overcome this difficulty.

An advantage of monetary policy is that the Reserve Bank meets frequently, and so can respond quickly to changes in economic conditions, such as the new CPI data referenced in the article, resulting in a short implementation lag. Similarly, monetary policy can be implemented incrementally, assisting in the implementation of a policy of the optimum magnitude. Furthermore, since central banks are usually independent from the government, they are also free of political constraints.

Monetary policies, however, typically have long impact lags. Over such long time periods, the effect of the policy may come too late to effectively address the issue, or the situation may have since changed – for example, the sudden increase in forecasted unemployment from 5.3% to 6.1% in only three months – so the original policy is no longer appropriate. Monetary policy also cannot be targeted, but different areas of the economy may have different policy needs: for example, ‘tourism is robust’ and stimulus likely unnecessary, but exports suffer from declining prices and poor overseas conditions.

Aside from its impact on aggregate demand, expansionary monetary policy also causes the NZD to depreciate, as mentioned earlier. While this supports domestic exporters, it also causes the cost of imports to increase, including imported capital and intermediate goods, which accounted for 64.26% of New Zealand's merchandise imports in 2014–15. This increases the costs of production for domestic firms using imports, hence offsetting some of the policy's effect of increasing output. In the long run, the lower exchange rate may also discourage foreign investment and thus inhibit the ability of firms to invest in expanding production.

Overall, expansionary monetary policy will likely be effective at addressing both the below-target inflation and recessionary gap in New Zealand by stimulating aggregate demand, while also supporting exporters, however it may be some time before the effects are seen, and the resultant depreciation of the exchange rate could have detrimental impacts on domestic firms using imports, as well as investment and long-term economic growth.

Internal Assessment 3 - International Commentary

IB Economics IA Commentary Coversheet

School code:	
School name:	
Candidate name:	Yingtong Li
Candidate number:	
Teacher:	
Title of the article:	Tariffs on Chinese solar panels may hurt Canadian renewables industry
Source of the article:	The Globe and Mail: `https://tinyurl.com/hkfhcgq`
Date article published:	2015-03-08
Date commentary written:	2016-02-25
Word count:	745
Section of the syllabus the article relates to:	International Economics

Tariffs on Chinese solar panels may hurt Canadian renewables industry

Richard Blackwell

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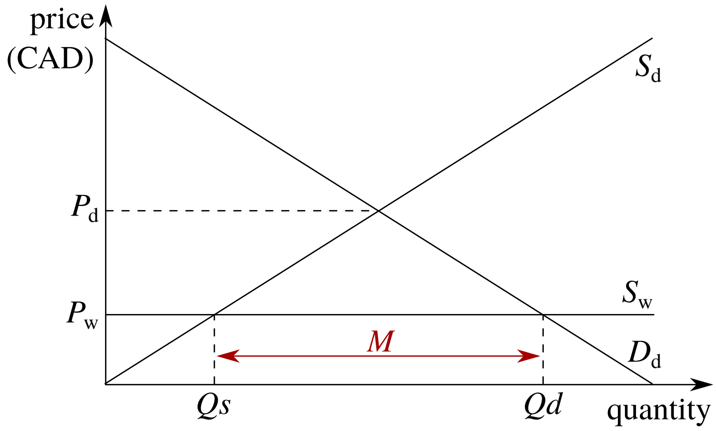
This article discusses the Canada Border Services Agency's imposition of tariffs on Chinese solar panels in response to dumping, and its effects on Canadian panel manufacturers, retailers and others.

Dumping by Chinese manufacturers, the sale of solar panels at low prices in Canada, causes the world price P_w to be less than the domestic price P_d.

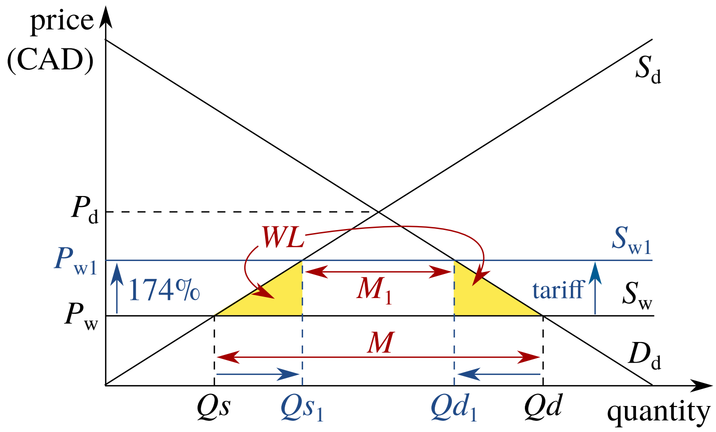
Market for Solar Panels



At P_w, domestic quantity demanded is Qd but domestic quantity supplied is only Qs, so the excess demand is met through imports, $M = Qd - Qs$.

A tariff, a tax on imported solar panels, shifts the world supply curve up by the amount of the tariff, approximately 174%, from S_w to S_{w1}.

Market for Solar Panels



This causes the price of solar panels to increase from P_w to P_{w1}, so domestic demand contracts from Qd to Qd_1 while domestic supply expands from Qs to Qs_1. Consequently, imports fall from $M = Qd - Qs$ to $M_1 = Qd_1 - Qs_1$, protecting Canadian panel manufacturers, such as the four who 'complain[ed] about cut-rate Chinese panels', from foreign competition. The expansion in domestic supply also increases demand for labour by these firms to expand production, increasing domestic employment in panel manufacturing. It also allows Canadian producers to grow and increase their efficiency through economies of scale, in the long term potentially enabling them to compete without protection.

However, by protecting domestic firms from foreign competition, the tariff may reduce the incentive for these firms to innovate, and thus 'slow development of solar projects' in future. Additionally, for consumers, the increased prices restrict choice, represented by the decrease in quantity demanded, causing a welfare loss as shown. Since electricity is a necessity in developed nations like Canada, the contraction in demand also likely represents a switch by consumers to alternative, less environmentally-friendly energy sources, such as coal, to satisfy their energy requirements. This would further discourage development of solar projects, while the external costs of the resultant environmental damage further decrease social welfare in the long term.

The increase in the cost of solar panels also increases costs of production for solar panel installers, hence supply of panel installation decreases, and demand contracts. This in turn decreases demand for panel installation labour by these firms, thus increasing unemployment in this industry, which generates ‘far more employment than panel manufacturing’. Therefore, while the tariff may increase employment in panel manufacturing, larger decreases in employment in panel installation, ‘As many as 5,000’, may outweigh these gains.

Additionally, the tariff is detrimental to importers of Chinese solar panels, as the price received after paying the tariff remains P_w, but quantity traded decreases from $M = Qd - Qs$ to $M_1 = Qd_1 - Qs_1$, decreasing revenue. Importers may therefore attempt to circumvent the tariff through the black market, limiting its effectiveness. The Chinese government may also retaliate by imposing protection themselves, risking trade wars, damaging Canada's export competitiveness, and as China was Canada's second-largest single export market in goods in 2015, potentially negating any benefits to domestic producers from the tariff.

Despite these potential disadvantages however, this tariff may be beneficial in the long term, as it follows from the CBSA's ruling that Chinese producers dumping solar panels in Canada were being subsidised. In this case, the world price is not truly representative of the foreign firms' efficiency. By protecting Canadian panel manufacturers from this unfair competition, which would otherwise force them to close, the imposition of a tariff may in fact increase competition in the long term, ‘level[ling] the playing field’ and protecting both local consumers and producers.

However, difficulties arise out of the definition of dumping. The Chinese manufacturers could simply be ‘selling below the local manufacturer's cost structure’, but not ‘below the actual cost’, suggesting that they can produce panels ‘significantly cheaper’ than Canadian manufacturers, which may result from factors such as lower labour costs, or economies of scale made possible by the large Chinese market. In this case, where the lower world price is representative of greater efficiency, then in spite of the allegations of dumping, the tariff would be detrimental to global welfare by diverting trade away from more efficient Chinese firms to less efficient local producers, distorting trade and resulting in a global misallocation of resources.

Overall, it is reasonable that the imposition of a tariff would protect local panel manufacturing industry and employment from allegedly unfair foreign competition, however, may also negatively impact the use and development of Canadian solar technology and hence the environment in the long term, damage export competitiveness and employment in related industries, and decrease global welfare, particularly if the allegations of subsidies are false, and so should be approached with caution.