

Cambridge IGCSE · Economics 0455 · Notes

Globalisation, free trade and protection

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Last checked 5 October 2026

Read first: International specialisation, Price changes, Price elasticity of demand (PED)

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What you need to know

This topic has six syllabus outcomes:

1. **Globalisation**: what the word means.
2. **Multinational companies (MNCs)**: what they are, and the **costs and benefits** they bring to their **host** country (where they set up) and their **home** country (where they are based).
3. **The benefits of free trade** for **consumers**, **producers** and **the economy**, in different kinds of countries.
4. **Methods of protection**: **tariffs**, **import quotas**, **subsidies** and **embargoes**.
5. **Reasons for protection**, including protecting **infant**, **declining** and **strategic** industries and **avoiding dumping**.
6. **Consequences of protection**: whether it works, and what it does to the home country and to its **trading partners**.

Why countries specialise and trade at all is the previous topic (international specialisation). Exchange rates and the balance of payments have their own topics; here you only need to link protection and MNCs to imports, exports and the current account.

Understand it

Globalisation

Globalisation is the process by which the world's economies become more and more connected: more goods and services are traded between countries, firms produce and sell in many countries, and money, people, ideas and technology move across borders more easily.

It is sped up by **cheaper, faster transport** and **communications** (the internet lets a firm sell anywhere and manage factories far away), by **fewer trade barriers** (lower tariffs, free trade agreements, trade blocs) and by the growth of **MNCs**.

What slows it down: **protectionist policies** (new tariffs, quotas, bans), controls on moving money or people, rising transport costs, and wars or pandemics that cut supply chains.

Multinational companies

A **multinational company (MNC)** is a firm that has its headquarters in one country (its **home** country) and produces or operates in at least one other country (a **host** country). Owning a shop that only exports is not enough: it must operate abroad.

Why MNCs choose a location. An MNC sets up where it expects the highest **profit**, so look for lower **costs** or higher **revenue**:

- cheap or skilled **labour** (low wages, good literacy and training);
- low **taxes** on profits, or tax breaks and subsidies offered to attract it;
- a large or fast-growing **market** (high or rising incomes, a big population, high growth), and **rising demand** for its product;
- access to **raw materials** and land;
- good **infrastructure** (roads, ports, power, internet);
- political and economic **stability**, and few regulations;
- getting **inside a trade barrier**: producing in the country avoids the tariffs it would pay on exports to it.

The reverse explains why **few** MNCs go somewhere: high wages or taxes, a small or poor market, poor infrastructure, a shortage of skills, strict rules, instability. MNCs are **footloose**: if costs rise or a cheaper location appears, they can close and move.

Benefits to the host country:

- **Jobs**: the MNC hires local workers, so unemployment falls, incomes rise and poverty can fall; its spending raises total demand.
- **Investment, capital and technology**: new factories and machines raise the country's productive capacity; local firms can copy the technology.
- **Training and skills**: workers learn skills they can use elsewhere, raising productivity.
- **Tax revenue** from the MNC's profits and its workers' incomes, which the government can spend on education, healthcare and infrastructure.
- **Exports**: much of what the MNC makes is sold abroad, and it may replace imports, which improves the **current account**.
- **Local suppliers** gain from selling it raw materials and services; extra **competition** can push local firms to become more efficient, lowering prices for consumers.
- **Infrastructure** the MNC builds (roads, ports, power) can be used by others.

Costs to the host country:

- **Profits sent home** (repatriated) to shareholders abroad, so the income does not stay to be reinvested; this is a debit on the current account.
- **Local firms forced out**: the MNC's lower costs and economies of scale let it undercut them; it may gain **monopoly power** and later raise prices.

- **Few jobs or poor jobs:** it may use **capital-intensive** methods, bring managers from its home country, or offer low-skilled jobs; it may **exploit** workers with poor conditions.
- **Tax avoidance:** it may move profits to low-tax countries, or demand tax breaks to come.
- **Natural resources used up** (mining, logging), leaving less for the future; **pollution** and environmental damage.
- **Instability:** it can leave at short notice, causing sudden unemployment.
- **Relative poverty can widen:** skilled workers at the MNC gain much more than unskilled workers.

When judging wages, ask what local firms pay: an MNC may pay less than at home but **more than local employers**, or people would not choose to work for it.

Benefits to the home country:

- **Profits flow back** from abroad, raising national income (primary income on the current account) and tax revenue.
- **Cheaper inputs:** raw materials and components from its overseas plants.
- The firm grows bigger, gains **economies of scale** and **access to larger markets**, so it competes better worldwide; jobs at headquarters (research, management) stay at home.
- **Exports** of parts and services to its own overseas plants.

Costs to the home country:

- **Jobs lost** when production moves abroad to cheaper locations, causing structural unemployment.
- Less **investment** and tax paid at home; less output at home.
- The home country's image can suffer if the MNC behaves badly abroad.

Free trade

International trade is the exchange of goods and services between countries: **exports** and **imports**. **Free trade** is international trade with **no restrictions**: no tariffs, quotas, embargoes or subsidies to protect home producers. A **free trade agreement** removes the barriers between the countries that sign it.

Free trade lets each country **specialise** in what it produces best and trade for the rest. Its benefits:

For consumers:

- **Lower prices:** imports from lower-cost producers, and competition forces home firms to cut prices; no tariff is added to import prices.
- **More choice**, including goods the country cannot make.
- **Better quality**, because firms must compete with the world's best.
- Higher **real incomes** and living standards.

For producers:

- **Larger markets** to sell to, so more sales, revenue and profits.

- **Economies of scale** from producing for the world, lowering average costs.
- **Cheaper raw materials, components and capital goods** from abroad, lowering costs of production.
- Pressure from competition to become **more efficient** and innovate; access to new technology.

For the economy:

- **More efficient allocation of resources:** resources go into the industries where the country is best, so total output is higher.
- **Economic growth:** more exports raise total demand, output and **employment**; cheaper capital goods raise investment.
- Lower **inflation** through cheaper imports and competition.
- Closer ties and the spread of ideas and technology.

Low-income countries gain cheap capital goods and technology and access to rich markets; high-income countries gain cheap goods and big export markets for their services and high-tech products.

Drawbacks of free trade (the other side of a Discuss): infant industries cannot grow up against established foreign rivals; declining industries close faster, causing structural unemployment; imports can replace home output and worsen the current account; the government loses **tariff revenue**; large foreign firms may gain monopoly power; other countries may **dump** goods; the country becomes dependent on others.

Methods of protection

Protection means a government restricting imports to shield home producers from foreign competition.

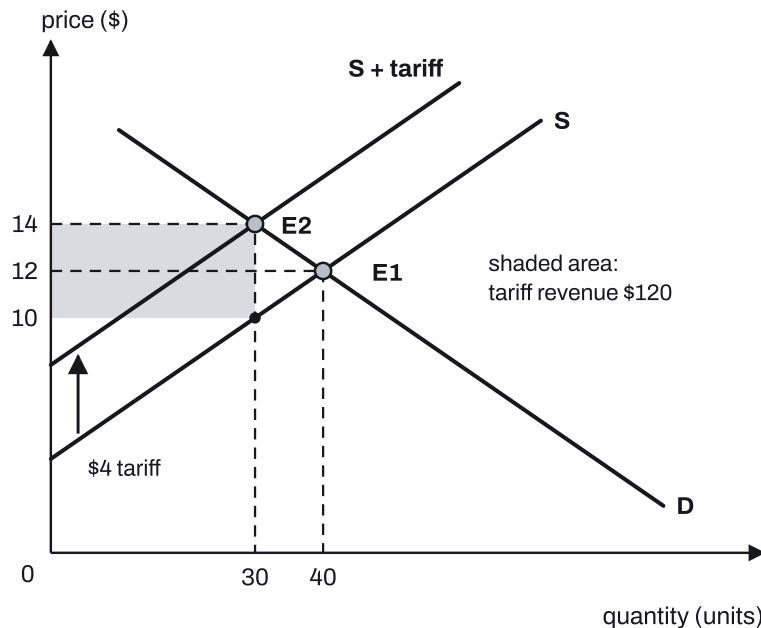
Method	What it is	How it protects
Tariff	A tax on imports (a fixed amount per unit, or a percentage of the price)	Raises the price of imports, so buyers switch to home-produced goods; the government earns revenue
Import quota	A limit on the quantity (or value) of a good that can be imported in a period	Imports cannot go above the limit; the shortage raises the price, so home producers sell more
Subsidy	A payment by the government to home producers	Lowers their costs, so they can cut prices and undercut imports (or sell more cheaply abroad, an export subsidy)
Embargo	A complete ban on imports of a good, or on all trade with a country	Imports fall to zero

Other barriers that mark schemes accept when asked for "methods": import **licences**, strict **product standards** and regulations (rules that foreign goods must meet), and red tape at the border.

A quota **fixes the quantity** but not the price; a tariff **raises the price** but does not fix the quantity. Only an embargo is certain to cut imports to zero.

What a tariff does: the diagram

A tariff is a tax on imports, so foreign firms supplying the market need a higher price to supply each quantity: the **supply curve of the imported good shifts up (to the left) by the amount of the tariff**. The new equilibrium has a **higher price** and a **lower quantity**.



In the diagram, demand is $Q_d = 100 - 5P$ and the supply of imports is $Q_s = 5P - 20$, so before the tariff the price is \$12 and 40 units are imported. A tariff of \$4 a unit gives a new price of \$14 and 30 units:

- **Consumers** pay \$2 more and buy 10 fewer units: they lose.
- **Foreign producers** now receive $14 - 4 = 10$ dollars a unit for 30 units: their revenue falls from $12 \times 40 = 480$ dollars to $10 \times 30 = 300$ dollars.
- **The government** collects $4 \times 30 = 120$ dollars of tariff revenue.
- **Home producers** of the same good face dearer imports, so demand switches to them: they sell more at a higher price, and hire more workers.
- **Trade** between the two countries falls.

How price elasticity of demand changes the result:

- If demand for the import is **price elastic**, the higher price cuts imports by a lot, so many buyers switch to home producers: the tariff **protects jobs well**, but raises little revenue.
- If demand for the import is **price inelastic** (no good home substitute, such as a basic necessity the country cannot grow), buyers keep buying it: imports fall only a little, consumers pay much more, the tariff protects few jobs, but **tariff revenue rises**. Foreign producers still lose revenue, because they sell less and may receive less per unit.

Reasons for protection

- **Infant industry:** a new industry has high average costs at first, because it is small and inexperienced. Against large, established foreign firms it would be driven out before it could grow. Protection (often a subsidy or tariff) gives it time to expand, gain **economies of scale**, lower its costs and become competitive, when the protection can be removed. The aim is a bigger home industry with more **employment**.
- **Declining industry:** an old industry losing out to cheaper imports would close suddenly, causing mass **structural unemployment** in its region. Protection slows the decline so that workers can retrain and move to other jobs.
- **Strategic industry:** industries vital for the country's security or survival, such as **food, energy, defence and steel**, are protected so that the country is not dependent on others if trade is cut off by war or crisis.
- **Avoiding dumping:** **dumping** is selling exports at a price **below their cost of production** (or below the price at home). Foreign firms may do it to clear surplus stock while keeping the price high at home, or to drive rival firms out of a foreign market and gain market share or **monopoly power**, and then raise prices. An **anti-dumping tariff** or an **embargo** stops it. Dumping is seen as unfair competition.
- **Protecting jobs:** if buyers switch to home goods, home firms produce more and employ more workers.
- **Reducing a current account deficit:** fewer imports means less spending abroad, so the gap between import spending and export revenue narrows.
- **Raising government revenue** from tariffs, especially in low-income countries where other taxes are hard to collect.
- **Stopping imports of harmful goods**, such as demerit goods or goods that do not meet safety standards.
- **Retaliating** against another country's barriers.

Reducing **exports** is never a reason for protection: governments want more exports.

Consequences of protection

Why protection may work:

- Imports cost more or are limited, so demand switches to **home-produced substitutes**; home output, profits and **employment** rise.
- Import spending falls, so the **current account** improves.
- Tariff revenue can be spent on training, education or subsidies that help home firms.
- Infant industries survive and grow; strategic industries stay in the country; dumping stops.

Why protection may fail, or harm the home country:

- **Retaliation:** trading partners put their own tariffs on this country's exports. Exports fall, so jobs are lost in export industries and the current account may not improve; a **trade war** can follow.
- **No home substitutes**, or home firms cannot expand quickly (they lack capacity, skills or resources, or the economy is at full employment); then consumers keep buying the dearer imports.
- **Inelastic demand** for imports: spending on imports may hardly fall.

- **Dearer imported raw materials and components** raise home firms' costs (**cost-push inflation**) and make their exports less competitive.
- **Complacency**: protected firms face less competition, so they have little reason to cut costs or improve quality, and may raise prices; an infant industry may never grow up.
- **Consumers lose**: higher prices, less choice, lower quality; the poor are hit hardest by dearer food.
- **Smuggling** to avoid tariffs and quotas.
- A **quota set above** the quantity people want to import does nothing; a tariff or quota on only a few goods changes little.
- Less trade means less **specialisation**, so resources are used less efficiently.
- Lower import spending can raise the exchange rate, making exports dearer.

Effects on trading partners: their exports fall, so their output, profits and employment in export industries fall, and their growth slows. They may retaliate. Their consumers may gain if goods that cannot be exported are sold more cheaply at home.

Key facts and formulas

There is no formula list for 0455. "Learn it" means you must remember it.

Formula or fact	Status
Globalisation: the world's economies becoming more connected through trade, MNCs and the movement of capital, people and ideas	Learn it
MNC: a firm with its headquarters in one country that operates or produces in other countries	Learn it
Free trade: exchange of goods and services between countries (exports and imports) without restrictions	Learn it
Tariff: a tax on imports. Quota: a limit on the quantity of imports. Embargo: a ban. Subsidy: a payment to home producers	Learn it
Dumping: selling exports at a price below their cost of production	Learn it
A tariff shifts the supply of the imported good up by the tariff: price rises, quantity falls	Learn it
Tariff revenue = tariff per unit $\times$ quantity imported	Learn it
Price foreign producers receive = price paid by consumers – tariff per unit	Learn it
Reasons for protection: infant, declining and strategic industries, avoiding dumping, jobs, current account deficit, revenue	Learn it

How to do it

We have tagged 82 questions on this topic (2021–2026): 50 multiple choice on Paper 1 (four of them repeats on another variant) and 32 structured questions on Paper 2, counting only the parts about this topic. Ten structured questions have parts of two or three types, so the counts add up to 93.

Question type	Questions
Explain or discuss the costs and benefits of MNCs to host and home countries	20
Work out the effects of a tariff or quota	15
Identify or explain methods of protection	13
Explain or discuss the benefits and drawbacks of free trade	11
Explain or analyse reasons for protection	9
Explain why MNCs choose (or avoid) a location	8
Discuss whether protection will achieve an aim	7
Define a key term	5
Explain what encourages or discourages globalisation and trade	5

Written answers: plan **point** → **developed chain of reasoning** → **for Discuss, the other side with new reasons** → **a judgement**. Define or Identify (2 marks) needs two short items or the two halves of a definition; Explain (4 marks) needs **two** points, each identified (1) and explained (1); Analyse (6 marks) needs about **three** developed chains; Discuss needs at least two developed points on each side and a judgement saying what the answer depends on.

1. Explain or discuss the costs and benefits of MNCs to host and home countries (20 questions)

Multiple choice (11): first decide **whose** benefit or cost is asked for (host or home), then use the lists in "Understand it".

- **Host benefits** happen inside the host: local people get jobs, and goods the MNC sells abroad add to the host's exports, as well as training, technology and tax.
- **Host costs:** income that leaves the country (repatriated profit) is the clearest cost, and the reason some governments restrict MNCs; local firms face stronger rivals and may close.
- **Home benefits** arrive from abroad: mainly the profit the overseas plants send back. Jobs, wages and investment created by the plant are in the host, not at home.
- **Home costs:** work that used to be done at home is moved to the cheaper country, so home workers are laid off.
- A **benefit-and-cost pair** must match: for an MNC extracting minerals, extra jobs today are set against a resource that cannot be replaced.

Written questions:

- **Identify two benefits to the home country (2):** profits, exports, cheaper raw materials, jobs at headquarters, higher national income. "Reputation" is not accepted.
- **Explain two benefits to the host (4):** each point named (1) and taken one step further (1), for example "creates jobs (1), so unemployment falls and incomes rise (1)". Write about the **host** if the question says host.
- **Analyse how an MNC could reduce poverty in a host (6):** chains that **end in poverty**: jobs → incomes → afford necessities; training → skills → better-paid work; tax revenue → spending on healthcare, education and benefits; lower prices from efficient production → higher real incomes. Analyse needs only one side.
- **Discuss whether MNCs benefit host countries, reduce poverty, improve economic performance or cut a current account deficit (6 or 8):** develop two host benefits and two host costs from "Understand it", each ending at the aim asked about, then judge (it depends on whether the MNC hires and buys locally, reinvests its profits and pays its taxes). For the **current account**, say how: MNC exports rise and imports are replaced, but profits sent home and imported components are debits.
- **Whether outward investment benefits a home firm (6):** larger markets, lower costs, avoiding tariffs, economies of scale; against: risks abroad, exchange rates, high set-up costs, poor management at a distance.

2. Work out the effects of a tariff or quota (15 questions)

Mostly multiple choice. Use "What a tariff does: the diagram".

1. **Price and quantity:** a tariff pushes the good's price up and the amount bought down. It sets no limit on quantity; only a quota does that.
2. **On a diagram** of the imported good, supply moves up by the tariff, so the new equilibrium lies higher and further left along the same demand curve.
3. **Winners and losers:** home producers, their workers and the government gain; buyers of the good lose. The foreign sellers' income goes down while the tariff-collecting government's goes up.
4. **Wider effects:** buyers switch to home goods, so home firms make more, and the two countries trade less. A tariff does not cut inflation, widen choice or make protected firms more efficient.
5. **Quotas:** capping imports lifts the home price, so home producers earn more (but the government collects nothing). Scrapping a quota does the reverse: more imports, less spending on home output.
6. **Elasticity:** the more price elastic demand for the import is, the more buyers switch to home goods, so the tariff saves more home jobs. With inelastic demand, a higher tariff still cuts what foreign sellers earn, but the government's tariff takings rise.

Written form: "Explain two disadvantages of import tariffs" (4): two of the "might not" points in "Consequences of protection" (retaliation, higher prices, dearer imported inputs and cost-push inflation, inefficient protected firms, less choice, less specialisation), each named (1) and explained (1). "Less competition" counts only once.

Numbers: tariff revenue = tariff × quantity imported; foreign producers receive the price minus the tariff; spending = price × quantity.

3. Identify or explain methods of protection (13 questions)

Multiple choice: match the description to the method in the table in "Understand it".

- A ban is an embargo, the only method certain to stop all imports of the good.
- A maximum amount allowed in is a quota, so a quota is the tool for holding imports to a fixed number.
- Money paid to home producers (a subsidy) lowers their costs so they can charge less than importers.
- Against dumping, block or tax that one good (an embargo or a special tariff on it); interest rates, the exchange rate or help for exporters do not target it.

Written questions:

- **Identify two methods** (2), or two **apart from a tariff**: quota, subsidy, embargo, import licences, product standards and regulations.
- **Explain two methods** (4): name it (1) and say how it cuts imports (1), for example "a quota is a limit on the amount of a good that can be imported (1), so once the limit is reached buyers must buy home-produced goods (1)". The examiners note that many answers named methods and stopped.
- **Analyse how a subsidy protects an infant industry** (6): a long chain, one mark a link: the new industry's costs are high at first → the subsidy is a payment from the government → it can buy capital and technology and hire skilled workers → output grows → **economies of scale** → lower average costs and higher productivity → it can cut prices → it is more **price competitive** against imports → demand for its goods rises → it can export; extra investment can also raise **quality**.

4. Explain or discuss the benefits and drawbacks of free trade (11 questions)

Multiple choice:

- Match each benefit to the right group, using the lists in "Understand it": consumers (cheaper goods, wider range), producers (more customers, economies of scale), the economy (resources used where they produce most, more jobs).
- Scrapping tariffs helps consumers because imported goods get cheaper and the range widens; it cuts tariff revenue and hurts declining industries.
- Shielding home firms from foreign rivals is protection, the opposite of free trade, so it is never one of its benefits.

Written questions:

- **Discuss whether free trade increases economic growth** (8): **for**, develop two of the producer and economy benefits in "Understand it" into growth (specialisation → more output from the same resources; competition → higher productivity, lower costs; cheaper raw materials and capital goods; bigger markets → more exports); **against**, two of the drawbacks (infant industries never grow, declining industries close faster, imports replace home output, lost tariff revenue, monopoly power, dumping). **Judge**: it depends on how competitive home firms are and whether workers can move to growing industries.
- **Whether free trade benefits a city or region** (6): its firms gain export markets and cheap inputs; but its firms may lose out to imports.

- **Should a government aim for more imports (8):** **for**, the consumer and producer benefits above, plus ending shortages and tariff revenue; **against**, a worse current account, home firms closing and unemployment, dependence and dumping.
- **Data question (5):** trade as a share of GDP against GDP per head: state the pattern (usually positive), support it with two named countries' figures, give the reason (specialisation, competition, bigger markets), then the exception and why.

5. Explain or analyse reasons for protection (9 questions)

Multiple choice: the reasons in "Understand it" all aim to help the home economy: more home output and jobs, a smaller current account deficit, and fair competition (a tariff on goods sold below cost is aimed at the country doing the dumping). Infant-industry protection is meant to let home firms grow and hire. An option that would harm the home economy (fewer exports, slower growth, shrinking a surplus) is never a reason.

Written questions:

- **Identify two motives for dumping (2):** to **drive rival firms out** and gain market share or monopoly power abroad; to **clear surplus stock** while keeping the home price high.
- **Explain two reasons a government may want to reduce imports (4):** protect jobs; cut a current account deficit; protect infant or strategic industries; stop dumping; stop demerit goods. Each named (1) and developed (1).
- **Analyse why a government may protect its industries, or impose tariffs (6):** three reasons from "Reasons for protection", each taken on to its **consequence** (see Example 3).

6. Explain why MNCs choose (or avoid) a location (8 questions)

Multiple choice: pick the option that raises the MNC's profit: lower costs (above all, wages well below those at home) or more sales (a fast-growing economy, rising demand for the product). Strict laws, high import duties, a shortage of skills or high costs push it away.

Written questions (4–8): tie every reason to **profit, cost or revenue**.

1. **From a source** ("explain two reasons why a foreign firm may open a branch here"): use the source's facts, such as high incomes (→ high demand, more customers able to pay → more revenue), no income tax (→ workers keep more, so the firm can pay lower wages), high literacy (→ skilled, productive workers).
2. **Corporation tax differences (6):** lower tax → MNCs keep more profit → more to invest → more output; so they move to low-tax countries. But high tax can fund education, giving skilled workers that attract MNCs.
3. **Why few MNCs locate in a region (6):** answer the question asked, about **few**: high wages, taxes or land costs; a small or poor market; poor transport and power; few skilled workers; instability or heavy regulation.
4. **Will an MNC stay in a host for many years? (8):** it stays if profits stay high (growing market, skilled workforce, low taxes, sunk costs in its plant); it leaves if costs rise, tax rises, demand falls or a cheaper location appears (MNCs are footloose).

7. Discuss whether protection will achieve an aim (7 questions)

All Paper 2 discussions (6 or 8 marks), marked by levels: both sides developed and a judgement for the top level. Use "Consequences of protection" and choose the points that fit the **aim** asked about.

Aim	Why it might work	Why it might not
Import quotas cut a trade in goods deficit	Imports are capped, so spending on imports falls; less supply pushes up their price; buyers switch to home goods, so the gap between import spending and export revenue narrows	The quota may be above what people want to import; it may cover only a few goods; there may be no home substitutes ; partners may retaliate , cutting export revenue; smuggling ; lower import spending can raise the exchange rate and cut exports
High tariffs cut unemployment	Dearer imports → demand switches to home goods → home firms hire more; tariff revenue can subsidise firms or pay for training	Retaliation cuts exports and export jobs; the tariff may not cover the cost gap; firms cannot expand (full employment, no resources); dearer imported inputs raise costs and cut output; protected firms become complacent
Tariffs raise a country's output	Home firms sell more in place of imports; infant industries grow	The same "might not" points; consumers with less real income buy less
An export subsidy helps macro aims	Lower export prices → more exports → growth, jobs, current account	Costs the government (opportunity cost); partners retaliate; firms may keep the subsidy instead of cutting prices; inflation can cancel the price cut
A tariff or subsidy helps home producers (rice, fish)	Imports dearer, or home costs lower → more home sales	Demand for imports may be inelastic; home quality may be lower; retaliation
Protection benefits an economy	Jobs, infant and strategic industries, revenue, current account	Consumers pay more; inefficiency; retaliation; less specialisation

8. Define a key term (5 questions)

Two marks: one for each half.

- **MNC**: a firm based in one country (1) that operates or produces in other countries (1). An example earns nothing.
- **International trade**: the exchange of goods and services (1) between countries (1).
- **Free trade**: exports and imports of goods and services between countries (1) without restrictions such as tariffs or quotas (1). "Trade without restrictions" alone loses a mark.

- **Dumping:** selling exports (1) at a price below their cost of production (1). In multiple choice, look for selling abroad below cost; making goods more cheaply than rivals is not dumping.

9. Explain what encourages or discourages globalisation and trade (5 questions)

- **Multiple choice:** anything that makes trading across borders easier or cheaper (better communications, fewer barriers, ending support that shields home firms) encourages globalisation and trade; anything that adds barriers (protection, controls on money or people, scrapping trade agreements) discourages it.
- **Analyse how a government could reduce protection and move to free trade (6):** cut tariffs, remove quotas and embargoes, end subsidies to protected firms, sign free trade agreements or join a trade bloc, each taken on to its effect (imports cheaper → more trade).
- **Discuss whether more air travel benefits the global economy (8):** faster movement of goods, people and tourists → more trade and growth, jobs; against: pollution and climate change (external costs), congestion, oil use.

Worked examples

Example 1

- (a) Define a **multinational company**. [2]
- (b) Identify **two** methods of protection apart from a tariff. [2]
- (c) Explain **two** benefits a multinational company may bring to its **home** country. [4]
- (a)** A firm with its headquarters in one country (1) that produces or operates in at least one other country (1).
- (b)** An import quota (1). An embargo (1).
- (c)** Profits earned by the MNC's factories abroad are sent back to its head office (1), raising the home country's national income and the tax its government collects on those profits (1).

Producing abroad lets the firm sell in much bigger markets and gain economies of scale (1), so its average costs fall and it competes better against foreign rivals, protecting jobs at its headquarters and research centres at home (1).

Example 2

A country imports 50 000 tonnes of rice a year at a price of \$400 a tonne. The government puts a tariff of \$60 a tonne on imported rice. The price of imported rice rises to \$440 a tonne and imports fall to 42 000 tonnes.

- (a) Calculate the government's revenue from the tariff. [1]
- (b) Calculate the price elasticity of demand for imported rice, and state whether demand is price elastic or price inelastic. [3]

(c) Calculate the change in the revenue of foreign rice producers. **[2]**

(a) Tariff revenue = $60 \times 42\,000 = 2\,520\,000$, so **\$2.52 million** (1).

(b) Percentage change in quantity = $\frac{42\,000 - 50\,000}{50\,000} \times 100 = -16\%$; percentage change in price = $\frac{440 - 400}{400} \times 100 = 10\%$ (1). PED = $-16 \div 10 = -1.6$ (1). Its value (ignoring the sign) is greater than 1, so demand is **price elastic** (1).

(c) Foreign producers now receive $440 - 60 = 380$ dollars a tonne (1). Their revenue falls from $400 \times 50\,000 = 20\,000\,000$ to $380 \times 42\,000 = 15\,960\,000$, a fall of **\$4.04 million** (1).

Because demand is elastic, the tariff switches many buyers to home-grown rice: it protects farm jobs well.

Example 3

Analyse why a government may protect its country's industries from foreign competition. **[6]**

A new (infant) industry has high average costs because it is still small (1), so without protection it would be driven out by large, established foreign firms (1). A tariff or subsidy gives it time to grow and gain economies of scale (1), lowering its costs until it can compete without help (1). Foreign firms may also be dumping goods, selling them below their cost of production (1), to drive home firms out and then raise prices; an anti-dumping tariff keeps competition fair (1). Making imports dearer switches demand to home-produced goods (1), so home firms raise output and employ more workers, reducing unemployment (1); spending on imports falls, which reduces a current account deficit (1). Food and energy are strategic industries (1), so keeping them at home means supply is secure if trade is cut off by war (1). (Any 6.)

Example 4

Discuss whether or not a government should protect a declining industry. **[8]**

A declining industry is one whose output and sales are falling over time, often because imports are cheaper.

Why it should. Many workers in the industry have skills that are only used there, and are often in one region. If cheap imports close the industry suddenly, they become structurally unemployed, their incomes fall and poverty in the region rises; the government also pays more in benefits and collects less tax. A tariff or quota slows the decline, giving workers time to retrain and move to growing industries (developed point for).

Protection switches some demand from imports to home output, so firms in the industry and their local suppliers keep producing, which supports total demand and reduces import spending, helping the current account. If the industry is strategic, such as steel or farming, it also keeps essential supplies at home (developed point for).

Why it should not. Consumers pay higher prices for the protected good and have less choice, and firms that use it as an input face higher costs, making their own products less competitive abroad: cost-push inflation and lost exports can cost jobs elsewhere. Trading partners may retaliate with tariffs on this country's exports, so export industries lose sales and workers (developed point against).

With protection, the industry has little reason to cut costs, so it stays inefficient and may need help for ever. The resources kept there have an opportunity cost: they could produce more in industries where the country has an advantage, so the economy loses the gains from specialisation (developed point against).

Judgement. Protection makes sense only if it is **temporary** and tied to retraining, so it slows the fall rather than stopping it; it depends on how many jobs are at risk, whether other industries nearby can take the workers, and how likely retaliation is. Protecting it for ever is likely to cost the economy more than it saves. Both sides are developed and the judgement says what it depends on: Level 3 (6–8 marks).

Common mistakes

- **Writing about the wrong country.** March 2023 found some answers about an MNC's benefits to its **home** country when the question asked about the **host**; in June 2025 many gave "reputation" as a benefit to the home country. Underline host or home.
- **Saying MNCs "exploit workers with low wages" without thinking.** The March 2025 and June 2021 reports point out that an MNC's wages may be lower than at home but higher than local firms pay, or people would not work for it. Compare with local pay.
- **Not linking to the question's aim.** June 2022: answers on MNCs and poverty described benefits (such as the balance of payments) without saying how they reduce **poverty**. November 2021: answers about MNCs and the current account listed general costs and benefits without exports and imports. End every chain at the aim asked about.
- **Discussing when the command word is Analyse.** June 2022 notes answers that gave both sides to an Analyse question; only one side was needed, so that time was wasted.
- **Misreading the question.** In June 2022 many read "why **few** MNCs locate in a region" as "why MNCs locate there".
- **Weak definitions.** June 2022: "free trade is trade without restrictions" missed a mark for not mentioning exports and imports, or goods and services; many did not know what dumping means. November 2021: some thought free trade meant goods being free.
- **Naming methods without explaining them.** June 2022: answers that identified tariffs and quotas and stopped lost the explanation marks.
- **Calling a tariff a regulation.** November 2021: tariffs are taxes that work through prices; regulations are rules and laws.
- **Mixing up deficits.** November 2021 and June 2023: a current account deficit (imports greater than exports) is not a budget deficit (government spending greater than tax revenue). Quotas also confuse: **reducing** a quota lets **fewer** imports in; increasing it lets more in.
- **One-sided protection answers.** June 2021: few answers on whether protection helps an economy mentioned the labour market, and many did not consider that demand for a necessity such as rice is inelastic, so a tariff may hardly cut imports. Bring in jobs, elasticity and retaliation.

How to get the marks

- **Define** (2 marks): the two halves of the definition; no examples needed.
- **Identify** (2 marks): two short items, one mark each; if you write more, only the first ones count. Don't explain.
- **Explain** (4 marks): two points, each named (1) and developed (1) with "so" or "because". One point developed twice earns only one development mark.
- **Analyse** (6 marks): chains of linked steps; each correct link is a mark, and a repeated idea scores once. One side only.
- **Discuss** (6 marks, Section A): up to 4 marks for each side. Turning a point round ("jobs may rise" then "jobs may not rise") earns nothing; the other side needs a **new** reason.
- **Discuss** (8 marks, Section B): Level 3 (6–8) needs both sides developed and a judgement; Level 2 (3–5) is one-sided or thin; Level 1 (1–2) is definitions only. Define the key term first, then write two developed points a side, then say **what the answer depends on** (elasticity, retaliation, whether home substitutes exist, how long the protection lasts).
- **Use the source** in Section A: name its country, product and facts, and add your own reasons.
- **Calculations**: show the working and give units (\$, tonnes); tariff revenue uses the **new** quantity.
- **Multiple choice**: decide whether it asks about host or home, consumers or producers, benefit or cost, and look for **not** or **least likely**.

Quick check

1. A tariff of \$3 a unit is put on an imported good. Before it, the price was \$15 and 2 000 units were imported; after it, the price is \$17 and 1 600 units are imported. Calculate (a) the tariff revenue, (b) the price foreign producers now receive, and (c) the change in foreign producers' revenue.
2. For each effect, say whether it is a benefit or a cost, and to the host or the home country: (i) a car maker closes a factory at home and opens one abroad, so workers at home lose their jobs; (ii) a foreign-owned mine sells its minerals abroad; (iii) a foreign-owned factory sends its profits to its head office abroad.
3. Identify **two** benefits of free trade for producers. **[2]**
4. Explain **two** ways a country's trading partners may be affected when it raises its tariffs. **[4]**
5. Explain why an import quota may fail to reduce a country's imports. **[2]**

Answers

1. (a) $3 \times 1\,600 = 4\,800$, so **\$4 800**. (b) $17 - 3 = 14$, so **\$14** a unit. (c) Before: $15 \times 2\,000 = 30\,000$; after: $14 \times 1\,600 = 22\,400$; a fall of **\$7 600**.
2. (i) A **cost** to the **home** country (jobs lost as production moves abroad). (ii) A **benefit** to the **host** (exports improve its trade balance). (iii) A **cost** to the **host** (profits repatriated, not reinvested there), and a benefit to the home country.
3. A larger market to sell to (1). Cheaper imported raw materials and components (1). (Also: economies of scale.)
4. Their exports to this country become dearer and fall (1), so their export firms cut output and employ fewer workers, slowing their growth (1). They may retaliate with tariffs of their own (1), starting a trade war in which trade between the countries falls and consumers in both pay higher prices (1).
5. If the quota is set above the quantity people want to import, it does not restrict anything (1); and imports may be smuggled in, or imports of goods not covered by the quota may rise instead (1).

Past questions to try

- 0455/21/M/J/25 Q5: part (b), two disadvantages of import tariffs.
- 0455/23/O/N/23 Q2: part (d), whether tariffs on imports will raise a country's output.
- 0455/22/F/M/25 Q1: part (g), whether foreign MNCs reduce poverty in host countries.
- 0455/21/O/N/24 Q4: parts (a) and (d), methods of protection and whether high tariffs reduce unemployment.