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Subject: H2 Economics

Topic: Trade & Unemployment

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“US Job losses in manufacturing industries and the trade deficit with China have put many American elected officials under pressure to do something. Major presidential candidates have advocated heavy tariffs on imports from China if it fails to appreciate its currency.” - The Christian Science Monitor

Is unemployment always caused by competition from cheaper imports?

Unemployment is the state of joblessness and the unemployment rate of a country is defined by the percentage of the labour force of people able and willing to work but not with any jobs. Unemployment can take the form of frictional, structural or cyclical, each with different causes and addressed in different ways. Competition from cheaper imports is a form of structural unemployment and since the other sources of unemployment, it is apparent that unemployment is not always caused by competition from cheaper imports.

To begin, unemployment is caused by competition from cheaper imports because of the fact that the local firms are unable to produce goods at lower cost than the overseas producers. As such, the influx of imports erodes the market share of the local firms and being unable to compete, the local firms close down and jobs are lost.

As for the causes of this lost in cost advantage, it can be a result of rising factor-wage cost due to inflation, or falling productivity, or because their level of technology/production methods are such that high cost are incurred. In the case of United States, manufacturing industries are shifting out of the country because wage rate in US is too high relative to the other countries - making it cheaper for the country to import the products of manufacturing from overseas than producing them domestically. All this implies that there are structural changes taking place in the economy as the country's comparative advantage may have shifted. The skills that are demanded in the economy is not compatible with those possessed by the workers who have lost their jobs. Competition from cheap imports signals that the domestic industry may be in the sunset category.

Unemployment can also be a result of downturns in the trade cycles and such unemployment is termed cyclical or demand deficient. Such unemployment accompanies periods of contraction of the economy, where aggregate demand is falling. As AD is falling, less output in the economy is demanded and this lowers the demand for labour, resulting in unemployment. This unemployment results from overall decrease in demand for labour and not just specific to a single sector.

Finally, there is also frictional unemployment that results from imperfect information in the real world. There's a time lag for fresh graduates to find jobs and or those between jobs. Frictional unemployment is a perennial phenomenon as it stems from inherent imperfections in reality. It does not really pose a problem as it is a dynamic group and not fixed on a particular pool of people. Moreover, it usually takes up a very small proportion of the total labour. In fact, in most countries, an unemployment rate of 4-6% constitutes full employment, as frictional unemployment need not be accounted for.

Hence, unemployment is never always caused by competition from cheaper imports, which is a kind of structural unemployment. Other sources of unemployment like cyclical and frictional unemployment would may a part in causing unemployment.

Do you agree that tariffs should be used to tackle unemployment caused by cheaper imports?

Tariffs are taxes applied on imports by the authorities of the importing nation that would artificially raise the price of these imports. The purpose of the tariffs could be to reduce the competitiveness of imports to improve balance of trade or solve unemployment, raise revenue for the government. Unfortunately, imposition of tariffs is an extremely short term measure that is not sustainable as a means of coping with the structural unemployment that takes the form of job losses caused by competition from cheaper imports.

Tariffs can be used to raise the price of imports such that their competitiveness is eroded and the market share of the domestic producers can be reclaimed. This would raise the quantity demanded for the local producers and thus raise the demand for labour in these sectors of the domestic economy. This rise in market share and quantity demanded caused by the tariffs is demonstrated in the following figure:

[Tariff diagram with price rise to accommodate domestic producers and, mark out areas where government gains, welfare loss and producer gains]

In effect, the tariffs also produce a welfare loss from the higher prices, which the consumers have to pay. There's also the net increase in producer surplus resulting from the tariffs. It is not known if the addition employment and income from employment can offset the higher cost incurred by the consumers. Moreover, the tariffs distort income distribution by transferring incomes of consumers to the inefficient producers in the economy. This makes tariffs an uncertain and unsustainable measure to raise employment in the long run. Alternatively, to avoid penalizing the consumers, the government can instead subsidize these industries to help lower the cost they face in short run.

Moreover, tariffs are a form of protectionist barrier that may invite retaliation from trading partners. This can mean that exporting industries becomes affected and these industries may end up also suffering from job losses. The eventual result might be an even higher rate of unemployment. In long run, unemployment caused by cheaper imports cannot be solved by imposing tariffs. This sort of structural unemployment would be better tackled by supply side policies to cope with the structural changes of the economy.

Through policies to retrain the unemployed labour and equip them with skills demanded by the sunrise industries, the government would be able to hasten the structural reform so that the unemployed is able to find jobs quickly and reduce the rate of unemployment. Government agencies can also provide aid with job matching so that the people with the appropriate skills can be matched to the correct jobs. This is a long run solution as it solves the unemployment by getting labour to adapt to the structural changes that is taking place in the economy.

Tariffs only provide temporary protection, as the government cannot help sustain the inefficient industries indefinitely and risk trade friction with other nations. In short run, even if tariffs are imposed, the government must encourage the gradual scaling down or reforms in the relevant industries so that they can cope with the foreign competition. This is to ensure that the unemployment does not become long-term situation when the tariffs are removed. As earlier mentioned, even in short run, tariffs are not the best solution since they penalize consumers and distort the distribution of income - subsidies would avoid such problems although the government may not be able to afford to do that.

In conclusion, tariffs should not be used to tackle unemployment caused by competition from cheaper imports because they are extremely temporary measures that do not help solve the root of the problem associated with the unemployment. In short run the government can

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choose to subsidize the firms for them to maintain production and retain their pool of labour and in long run, these labour have to be retrain and equipped with skills demanded by rising sectors of the economy. Production methods or technology in the sunset industry must undergo reforms to cope with the structural changes and remain competitive. Only then, can the unemployment problem be effectively tackled in long run.