

6. US has embarked on protectionist policies by imposing high tariffs on imports from China and EU to reduce its trade deficit and unemployment as its economic growth continues to pick up.
- a) Explain why an economy's pattern of trade might change over time. [10]

### **Approach to Question 6a:**

- Explain what is meant by pattern of trade
- Explain how comparative advantage principle explains an economy's pattern of trade
- Analyse the factors that can lead to change in an economy's pattern of trade using relevant examples

### **Introduction**

**Pattern of trade refers to the direction, volume and composition of trade between countries.** Composition of trade refers to what is being exported or imported, while volume of trade refers to the real value of goods and services that is being exchanged. Lastly, direction of trade refers to the direction of exports and import flows.

### **Body:**

- **Change in pattern of trade due to change in comparative advantage (Supply factor)**
  - One factor that causes a change in an economy's pattern of trade is the **change in its comparative advantage**. According to the principle of comparative advantage, a country should specialise in the good it has comparative advantage in, i.e. the good it can produce at lower opportunity cost than its trading partners, *ceteris paribus*.
  - Change in comparative advantage can be **due to changes in factor endowment, technological advancement and government policies**.
    - A change in an economy's pattern of trade due to **changes in its or its trading partner's state of technology**. The US, for example, may have lost its CA on manufactured products due to China's rapid technological development and advancement enabling China to produce some manufactured goods at lower opportunity cost than its trading partners.
    - **Government policies to encourage the development of certain industries** can also change the economy's pattern of trade. China's government policies in subsidising firms in its manufacturing industry to innovate and develop new technology advancement has helped to change the economy's pattern of trade from being a export of cheap labour-intensive manufactured goods to being an exporter of high-end manufactured goods.
    - China's **rising number of highly skilled and efficient workers** has led to rising productivity and hence the ability to produce high quality goods at lower opportunity cost than its trading partner, making it an exporter of higher end manufactured goods instead of being largely an importer in precious years.
- **Changes in demand preferences (demand factor)**

**Increase in economic growth** is a factor that can change an economy's pattern of trade.

For China, the high economic growth in the last decade or so has led to a rising number of middle income earners, hence rising affluence and changing lifestyles. The higher income group has changed the economy's consumption pattern in favour of high-end branded luxury goods

e.g. the luxurious Mercedes and B&W cars as well as Louis Vuitton luxury leather products. The **large increasing in the volume of import** of such exclusive luxury brands has changed in China's pattern of trade to being a **major importer** of luxury goods.

- **FTAs and government trade policies**

- **Bilateral and regional free trade agreements** such as ASEAN Economic Community (AEC), North America Free Trade Agreement (NAFTA) and the EU Customs Union have led to **trade creation** between member countries, thereby **changing the direction of patterns of trade** of member countries.
  - The Zero-tariff policy agreement among members of NAFTA, for example, has seen greater trade among the north American countries and less trade between north and south American countries.
  - EU's common high tariff on non-members has artificially increased the prices of imports from non-member countries, enabling them to be each other's major trading partners.
- **Increase in protectionist policies** such as increase in import tariffs and increase in subsidies to stimulate domestic firms' production, will **artificially increase import prices and lower domestically produced goods**, leading to a fall in import of the affected goods. For example, an US increase in import tariffs of solar glass panels will artificially raise the price of imported solar glass panels as consumers' demand shift to the domestically produced one. This will **lower its import** of solar glass panels, hence changing the direction of its trade pattern.

	<b>Knowledge, Application / Understanding and Analysis</b>	
<b>L 3</b>	Well-developed answer that <b>thoroughly analyses</b> the factors that change an economy's pattern of trade, with <b>scope and rigour</b> , with good use of concept of comparative advantage and other relevant economic concepts, and good use of relevant examples.	8 – 10
<b>L 2</b>	Answer that explains the factors that change an economy's pattern of trade, using relevant economic concepts and some relevant examples but is not developed.	5 – 7
<b>L 1</b>	For an answer that shows some basic but largely unexplained knowledge of pattern of trade.	1 – 4

- b) Assess whether the use of protectionist policies to correct the country's trade deficit and employment can ever be justified. [15]

### **Approach to Question 6b:**

- Explain what is meant by trade deficit and unemployment and how protectionist policy can help to correct trade deficit and unemployment.
- Explain and assess the conditions in which protectionist policy to correct trade deficit can be justified and the conditions in which protectionist policy is not justifiable.

### **Introduction:**

- **Trade deficit occurs when a country's import expenditure is greater than its export revenue. Trade deficit is a cause of concern** as it affects both the country's domestic and external economy. Trade deficit leads to a worsening of BOP and eventually the stability of its currency. It also leads to falling AD, falling production, rising unemployment as well as economic slowdown.
- **Unemployment is a situation where workers are able and willing to work at the going wage rate but cannot find paid employment** despite an active search for work. High unemployment means that the economy is producing below full capacity, i.e. there is low output being produced in the economy leading to low economic growth hence lowers material standard of living.
- Hence measures have to be taken in correcting trade deficit and rising unemployment in the economy. One such measure is the use of **protectionist tools** such as imposing import tariffs and subsidising domestic firms **to make imports artificially more expensive** than domestically produced goods.
- **Provision of subsidies to domestic firm** will lower the cost of production of goods for exports, thereby reducing price of export and making export more competitive both in the domestic market as well as in the international market. At the same time, **tariff on imports** will artificially increase import prices, leading to fall in demand for import as consumers switch their demand to domestically-produced substitutes. These two policies will improve the economy's trade balance.

### **Thesis: Conditions in which protectionist policies is justifiable to correct trade balance**

- **Domestic economic performance is affected by trading partner's unfair trade practices**
  - Protectionist policies is justifiable when the country's trade deficit is caused by its trading partner's **unfair trade practices, e.g. superficially low currency, large subsidies given to firms in export industries**. Such unfair practices will lower the economy's exports competitiveness both in its own domestic market and the global market.
  - Protectionist policies are also necessary **to prevent dumping** by foreign producers that can **affects the domestic firms' ability to increase production and enjoy economies of scale**. The lack of demand in its own domestic market, and the inability to enjoy economies of scale to reduce their costs will affect the domestic firms' ability to survive as they cannot compete against the cheaper imports. The shut-down of many of these domestic firms will not only lead to **worsening of trade deficit but also high unemployment**. Therefore, protectionist policies to protect against such unfair competition to address the current trade deficit and high unemployment is certainly justifiable.

- **Evaluation:**  
Imposing import tariff in response to a perceived unfair competition can **lead counter-retaliation** from trading partners and **eventually leading to trade wars, reducing the country's export**, hence affecting the effectiveness of the protectionist policy to correct its trade deficit.
- **Government support is required for certain potential industries to grow and contribute to the economy's positive economic performance in the long run**
  - In the case of developing countries, **trade deficit occurs as large imports of resources and technology are required for economic development**. Protectionism is needed **to protect their growing industries** with the potential to develop comparative advantage so that they will be able to compete in the global market in the long run. Such infant industries incur very high initial start-up costs and take time to develop, and will need the domestic market demand to develop itself, to gain the revenue to cover their costs and to gain economies of scale and experience in production. Without protectionism these firms may not be able to survive to compete against the strong competition from imports. Protecting these industries for a period of time will **give the firms time to restructure themselves and sharpen their comparative advantage**.
  - Protectionist policies can also help to **develop import-substitute industries** so that the country **can be self-sufficient in those industries**, and perhaps even **develop new industries**. The artificially higher-priced imports may encourage residents to switch from imports to locally-produced substitutes, thus boosting production in this local industry and protecting jobs at the same time.
  - **Evaluation:**  
The lack of competition in the economy can lead to **complacencies hence breed inefficiencies among the firms**.  
Hence, protecting these industries **should only be a short-term policy** to give the firms time to develop the comparative advantage to compete effectively in the global market. Prolonged protectionism on these firms can lead to inefficiencies in production and inability to compete in the global market and not helping to improve the country's trade balance.

### **Conditions in which protectionist policies is not justifiable**

- When the trade deficit and unemployment are **caused by falling export due to loss of comparative advantage and lack of export competitiveness**
  - Protectionism is not appropriate in the case where the trade deficit is mainly due to falling export rather than rising imports. This could be due to loss of comparative advantage or inefficiencies in production in the export industries that lowers the country's export competitiveness.
  - **Evaluation**  
A better option for the government to address its trade deficit in this situation is to impose **supply-side policies** via improving technology and innovations **to improve productivity and the quality of its products to improve its export competitiveness** in the global market. This may incur **high cost and longer time is taken to correct its trade balance**, but the effective of policies to improve AS and enhance export competitiveness would be **more long-term** than protectionist policy can ever be.

### Antithesis:

- Protectionist measures such as Import tariffs and large subsidies for domestic production is a quick-fix that **improves the trade balance in the short run** by switching domestic consumers to locally-produced goods, reducing import spending to improve trade balance.
  - Protectionist policies to correct the country's trade deficit **at the expense of its trading partners' exports** does not seem fair to the other economies and may **instigate them to retaliate** by imposing tariffs on the country's exports hence dampening the effectiveness of its protectionist policy to correct its trade deficit.
  - Protectionist policies to correct trade balance and reduce unemployment may **back-fire** on the economy if import tariffs it impose on its trading partners include **tariffs on imported resources** and intermediate goods that are heavily required in some essential industries such as steel and energy. Such tariffs will cause the firms in these industries to **face higher costs of production forcing them to raise prices** in order to stay afloat. This will **affect the country's export competitiveness**, worsening the country's trade deficit.
  - Protectionist measure may be to the advantage of the domestic firms and help to protect the economy's employment, but this is at the expense of the domestic consumers. Tariffs and lack of competition will **increase consumer prices and reduce consumer welfare**.
  - The high government spending on subsidising domestic firms to protect them against competition can be a **strain on the government's budget**, and may increasing the already high government debt, like the US and UK. Protecting the inefficient firms in labour-intensive low-end manufacturing products to protect employment is very **likely to be a long-term burden** or the government is little or no effort is made to the economy's export-competitiveness or in training the workers the skills required to move to other industries.

### Synthesis / overall evaluation

- Protectionist policy may not seem justifiable to solve the economy's own economic woes at the expense of its trading partners as it may seem **an unfair punishment to its trading partners for having healthier trade balance**. However, protectionist policy is **justifiable if it is implemented as a short-term measure**, for example to give time for potential industries to grow and develop the comparative advantage to compete more effectively in the global market in the future hence ensuring an improvement in trade balance in long run.
- However, there is a **need to be mindful of the possibility of retaliations** from other economies that can reduce the effectiveness of the policies in correcting trade deficit.
- Furthermore, the **improvement in trade deficit** brought about by the protectionist policy is **likely to be short-lived if the root-cause for the trade deficit is not addressed**.

Protectionist policy is aimed at artificially raising the price of imports so that domestic demand would be in favour of the domestic producers. This will increase domestic production, employment and economic growth. Unfortunately, **unless there are other government policies to increase export competitiveness and hence increase export**, the increase in income will lead to higher import demand, **worsening trade balance again**.

<b>Level</b>	<b>Knowledge, Application, Understanding and Analysis</b>	<b>Marks</b>
<b>L3</b>	<ul style="list-style-type: none"> <li>For a balanced well-developed answer on whether protectionist policies to correct trade deficit is justifiable, with good use of relevant economic concepts and illustrated with good relevant examples.</li> <li>High L3 for answers that pay equal attention in discussing trade deficit and unemployment.</li> </ul>	<b>8 – 10</b>
<b>L2</b>	<ul style="list-style-type: none"> <li>For an answer that explains whether protectionist policies to correct trade deficit is justified using economic analysis but not developed and limited in scope.</li> <li>Attempt at some use of relevant examples as illustration. If a balanced argument is given, it is probably limited in depth.</li> <li>Maximum of 6 marks for a one-sided answer.</li> </ul>	<b>5 – 7</b>
<b>L1</b>	Irrelevant answer; points are incidental; major conceptual errors	<b>1 – 4</b>
	<b>Evaluation</b>	
<b>E3</b>	<p>For an answer that is able to judge on the conditions that affect the extent of the justification of protectionist policies to correct trade deficit</p> <p>e.g. despite the condition that makes protectionist policies justifiable, retaliation from trading partners may dampen the effectiveness of the policies in correcting trade deficit.</p>	<b>4-5</b>
<b>E2</b>	<p>For an evaluative assessment which weighs conditions for protectionist policies to be justifiable/unjustifiable</p> <p>e.g. for an answer that weighs the net benefit of protectionist policies to correct trade deficit.</p>	<b>2-3</b>
<b>E1</b>	For an answer that makes some attempt at an evaluative weighing of the benefits and costs of globalisation in different countries.	<b>1</b>