

TRADE POLICY

For a

Small Country

- **Readings**
 - Chapter 8- sections 1 – 3

Introduction:

So far:

Free trade contrasted with autarky

-Find that Trade benefits all countries.

-But within a country there are gainers and losers

- sectors

- different types of factors

The fact that some people might lose as a result of trade creates incentives for “Trade Policy”

Now:

- Between free trade and restricted trade

- Who are gainers and losers?

 - consumers, producers, taxpayers

- Why does the government intervene?

 - Political economy-reflects political power of gainers and losers

- Institutions of trade policy

 - affect political economy

Outline of Section

- Definitions of trade interventions
- Various instruments of trade policy
- Basic trade policy diagram
- Effect of taxes/subsidies on welfare
- Effect of Quotas on welfare
- Why do we have trade policy? The political economy

Trade Interventions

- Definition of Trade interventions
 - policies causing deviations from free trade
- Some interventions aim at improving general economic welfare
 - Example: setting standards for imports, as revenue generator (important for poor countries)
- Another concept: Trade distortions
 - taxes and subsidies, tariffs and NTBs, externalities, incomplete information, and imperfect competition. Any deviation from perfect competition.
- Main question: Do interventions increase our welfare?

How can a Government Intervene?

- Choose tariff or non-tariff intervention
 - Affect prices or affect quantities
- Choose between tax and subsidy

	Tax on...	Subsidy to...
Exporters	Export tax	Export Subsidy
Importers	Tariff	Import Subsidy

- Most Common: Tariff = tariff on imports
 - Specific: \$ amount per unit
 - Ad valorem: % of value of good

Other instruments of Intervention

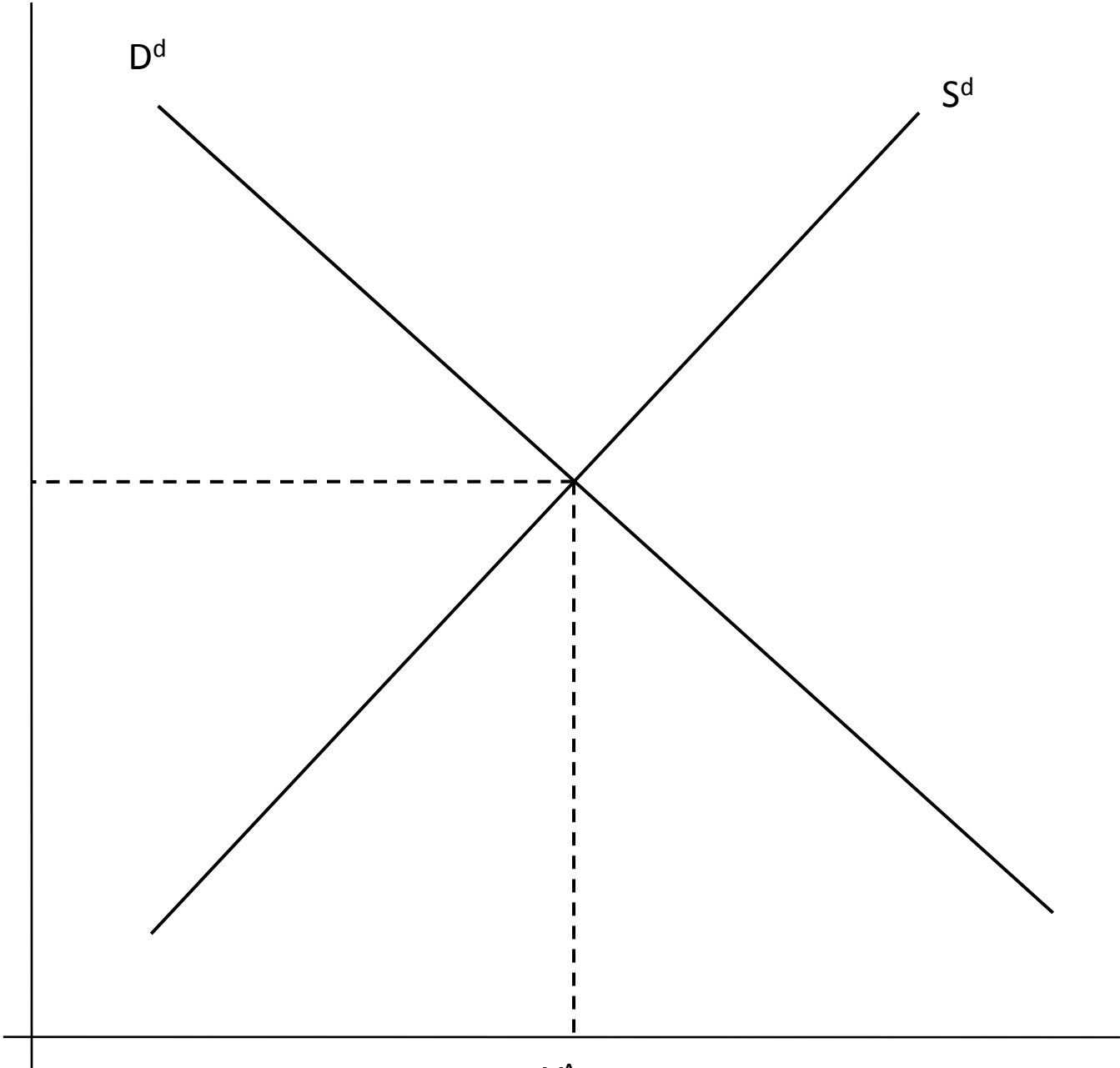
- Quotas: quantity limit on imports/exports
 - Highly specific down to variety of good, months of the year and country involved
 - Highly popular for above reason!
- Voluntary Export Restrictions
 - hidden import quotas
 - implemented by foreign country under pressure e.g. Japanese cars in 1980's
- Offshore assembly provisions: Reduce tariffs, assessing only on value-added
 - example: *maquiladoras*, US-Mexico border
 - US made computer components exported to Mexico
 - assembled computer imported into US
 - tariff assessed on value of computer minus value of components

- Rules of origin: Importing country specifies % of product that must be made in exporting country
 - Especially important in free trade areas or preferential trade agreements
 - Important so that some third country does not take advantage of “Access” given to trading partner.
- Domestic content requirements
 - applies to domestically produced goods
 - limits % of components from imports
- Technical or regulatory standards
 - introduced for legitimate reasons
 - even then can be a barrier to trade
 - manipulated by producers and politicians
- Government procurement rules
 - government often favors domestic producers

- Anti-dumping measures
 - Intuitive definition of dumping: Exporting “below” cost
 - Legal definition of dumping: exporting at "low" price
- Why could there be dumping?
 - anti-competitive measure
 - government intervention
- “Anti-dumping measures” punish dumping e.g. special punitive tariff
- Politically popular
 - Can be highly targeted to protect specific domestic producers
 - “macho” seeming
 - Are “allowed” under WTO rules

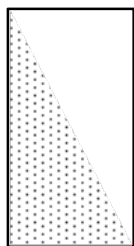
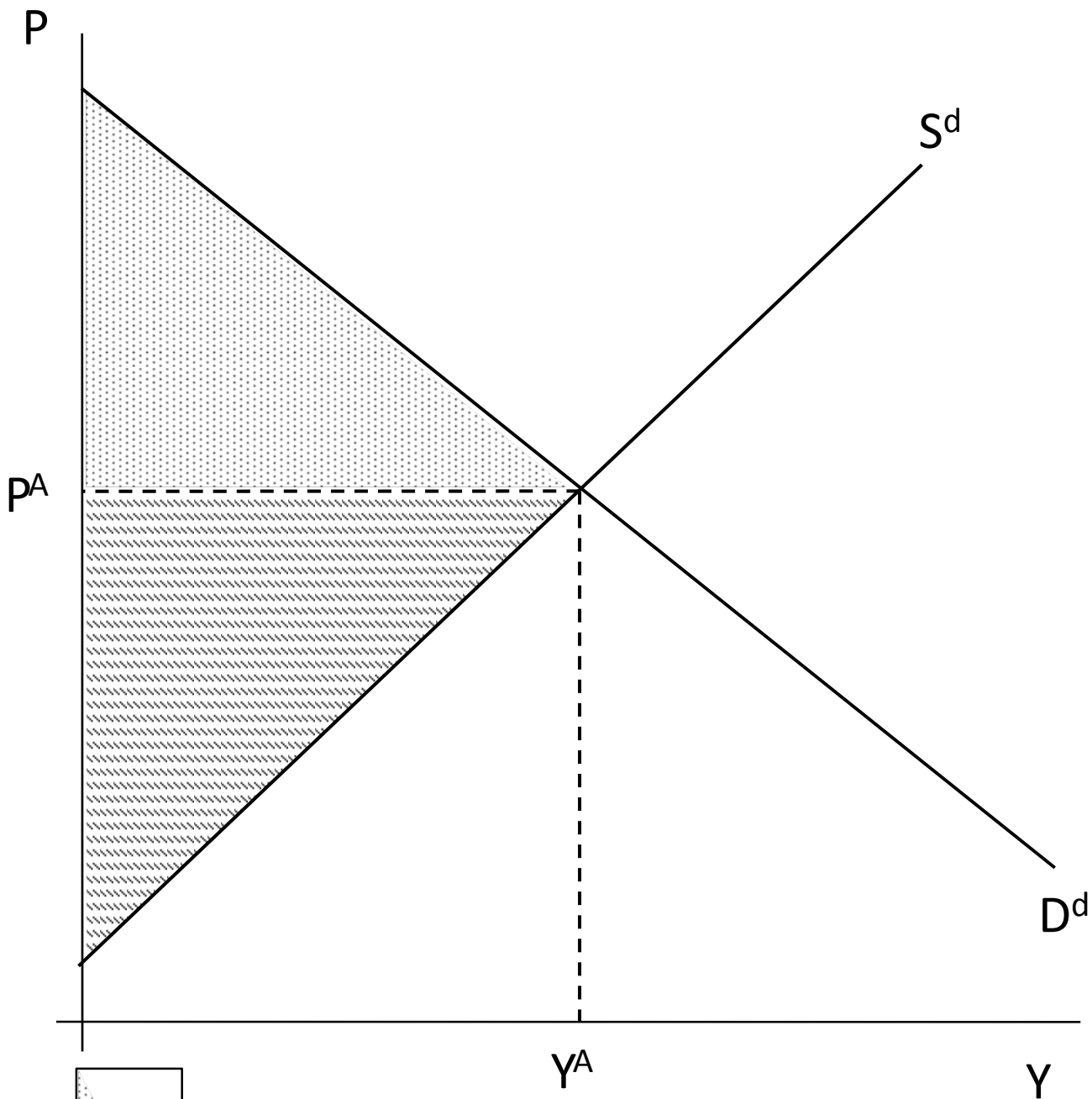
Modeling Trade Policy: Basic Diagram

Price (P)



Y^A

Quantity (Y)

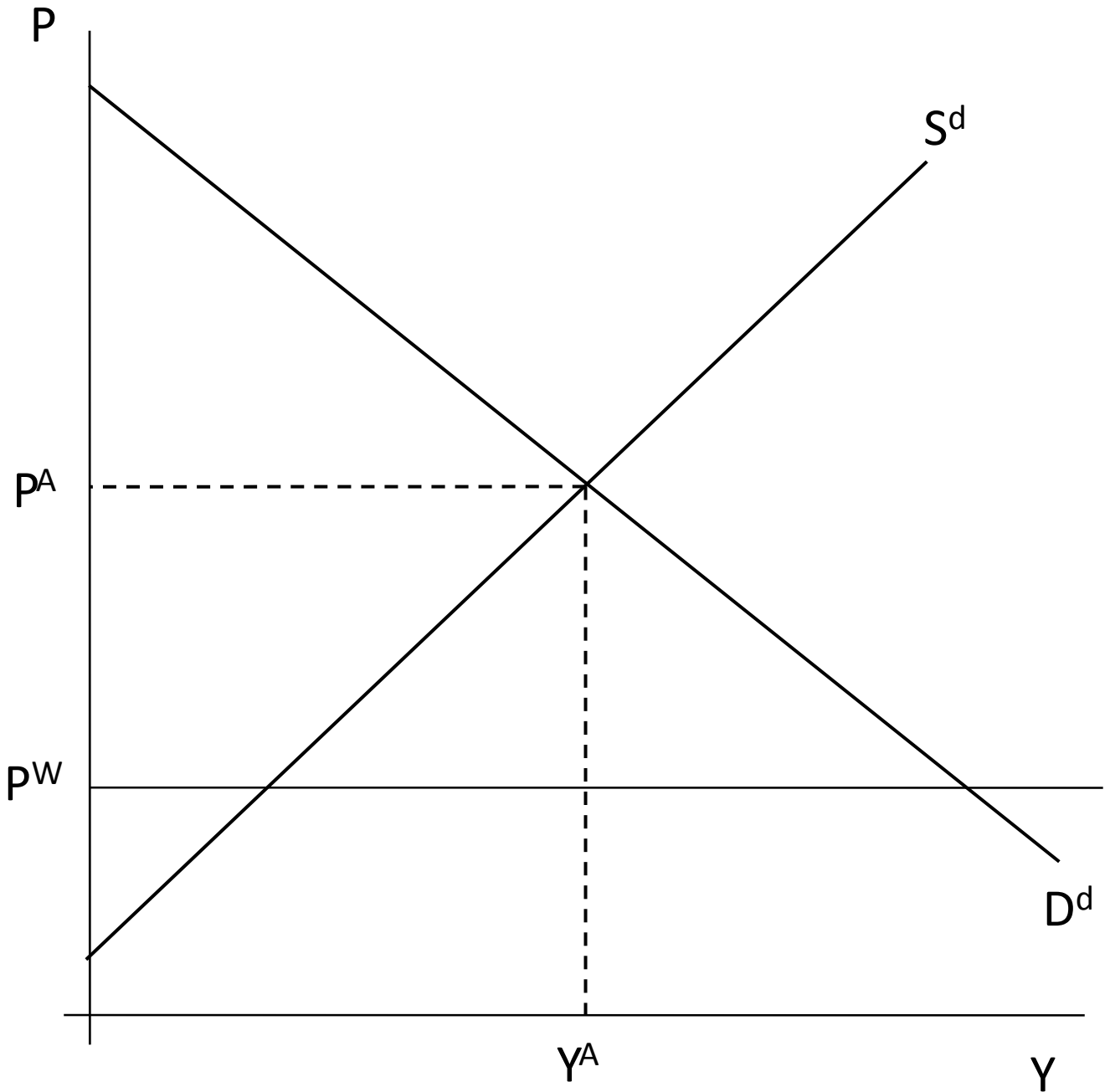


Consumer surplus



Producer surplus

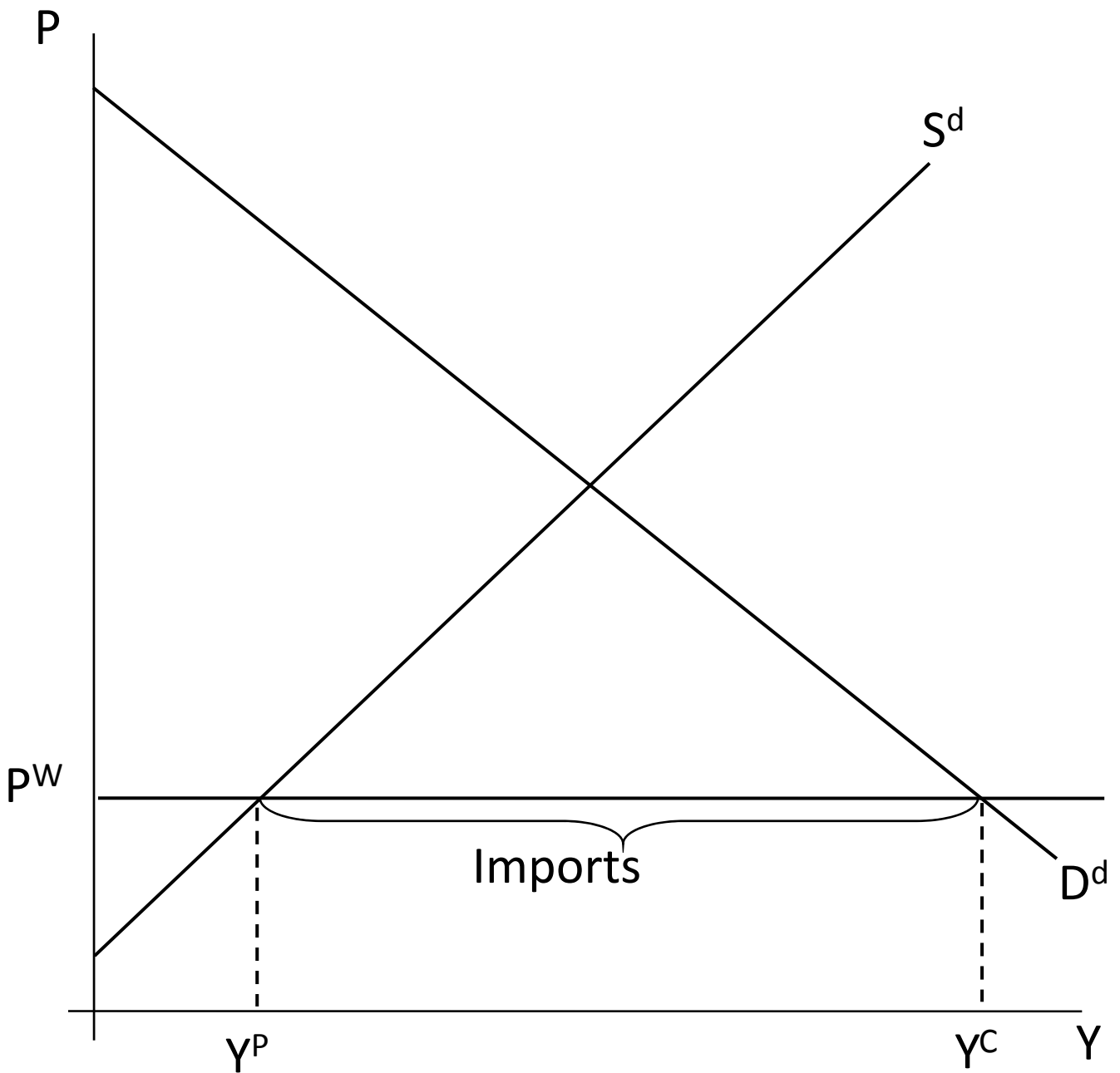
Introducing world supply and demand



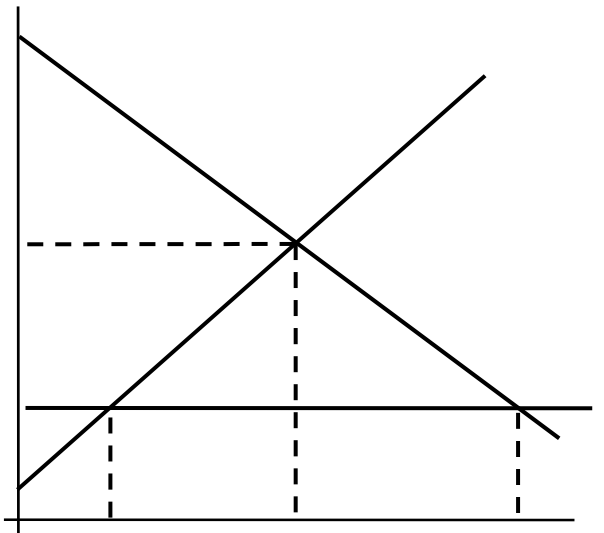
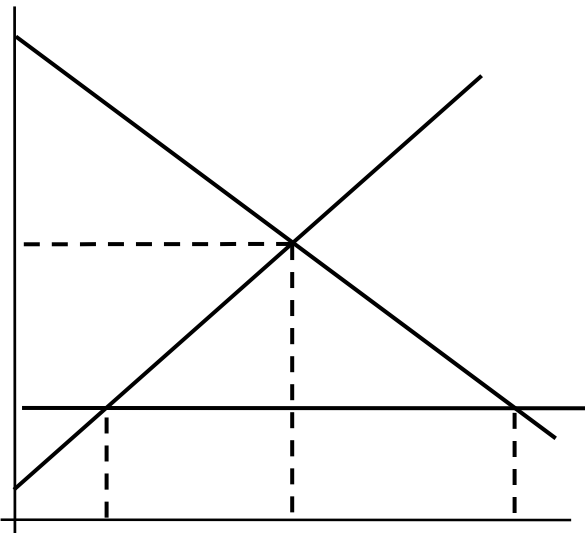
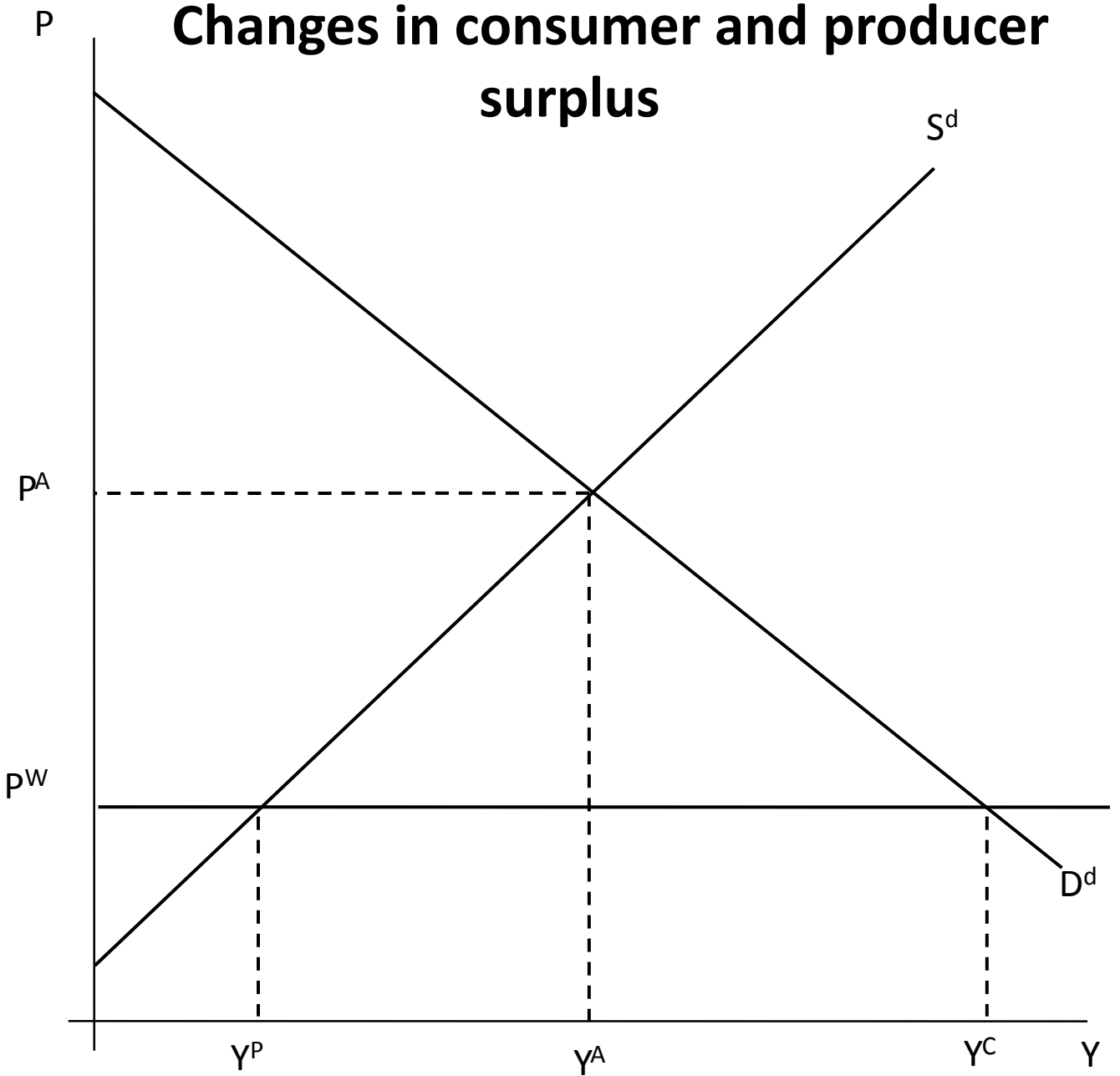
Small country assumption: this country's actions do not affect world price.

$\Rightarrow P^W$ is world supply or world demand

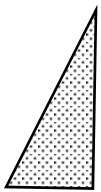
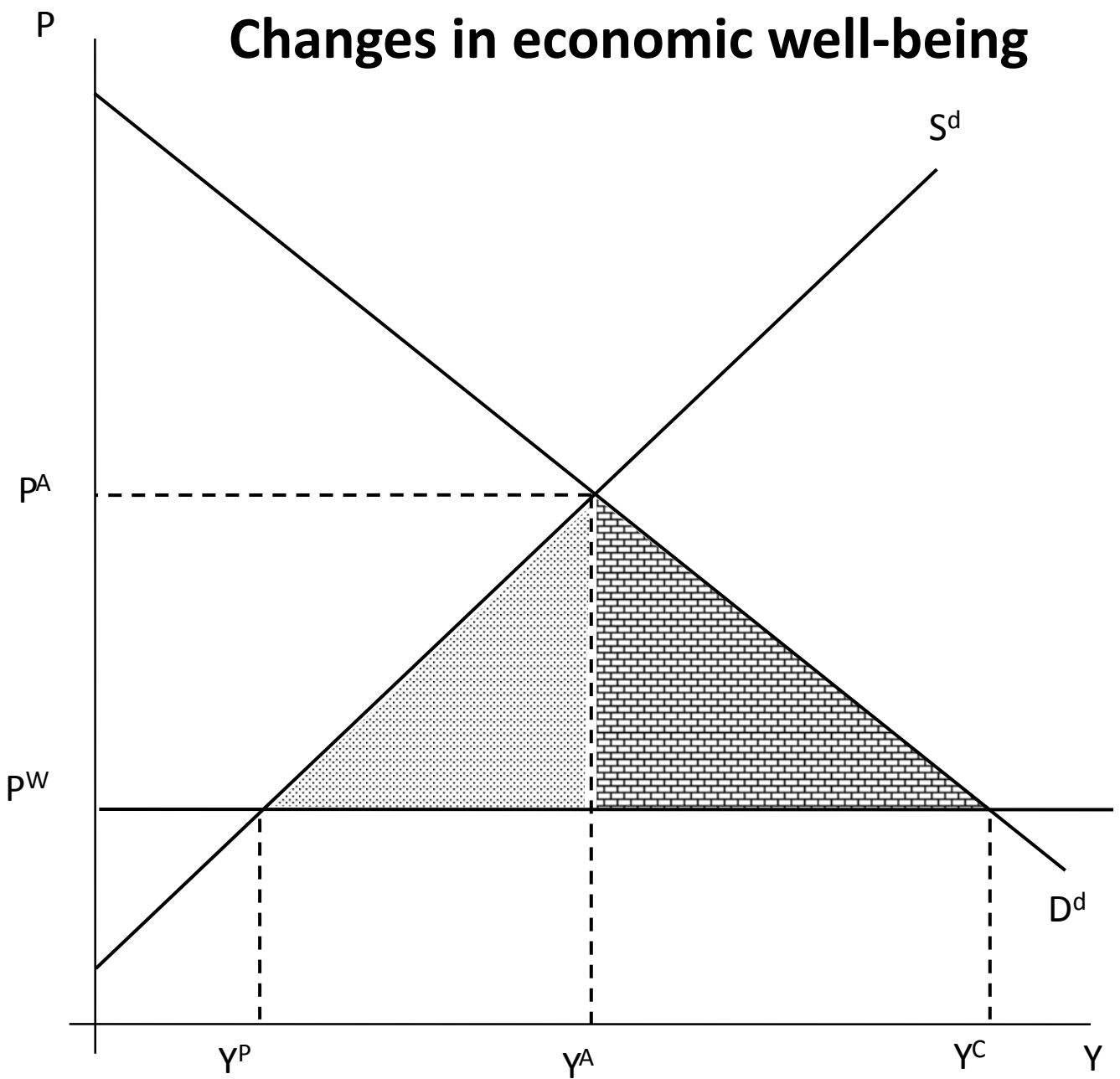
Levels of Imports, Consumption and Production after Trade



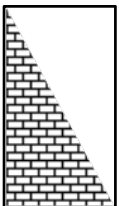
Changes in consumer and producer surplus



Changes in economic well-being



Gain because consumers replace more expensive home produced goods with cheaper imports



Gain because consumers consume more of this good (and less of others) when price changes from autarky price to world price