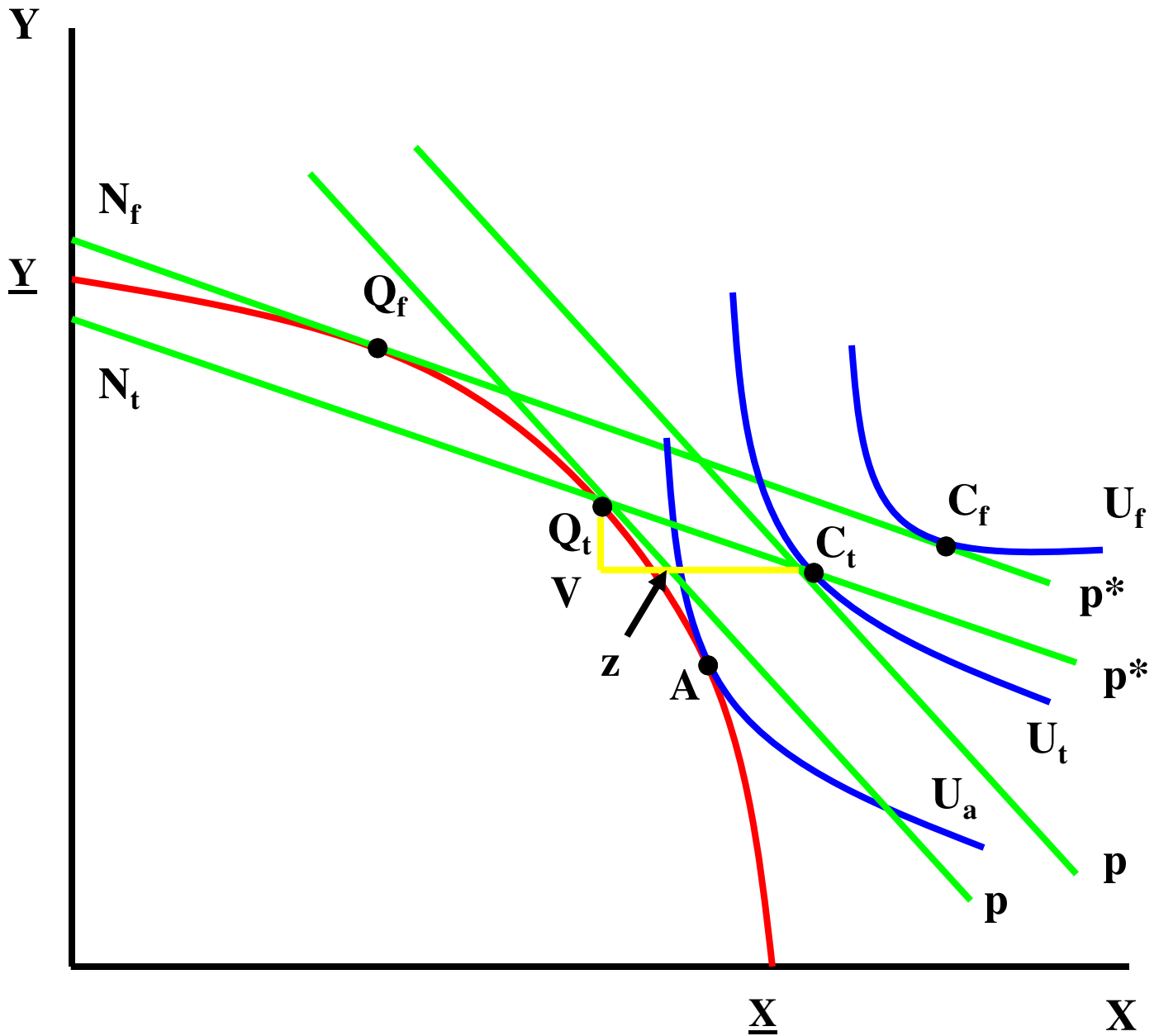


EFFECTS OF TRADE DISTORTIONS

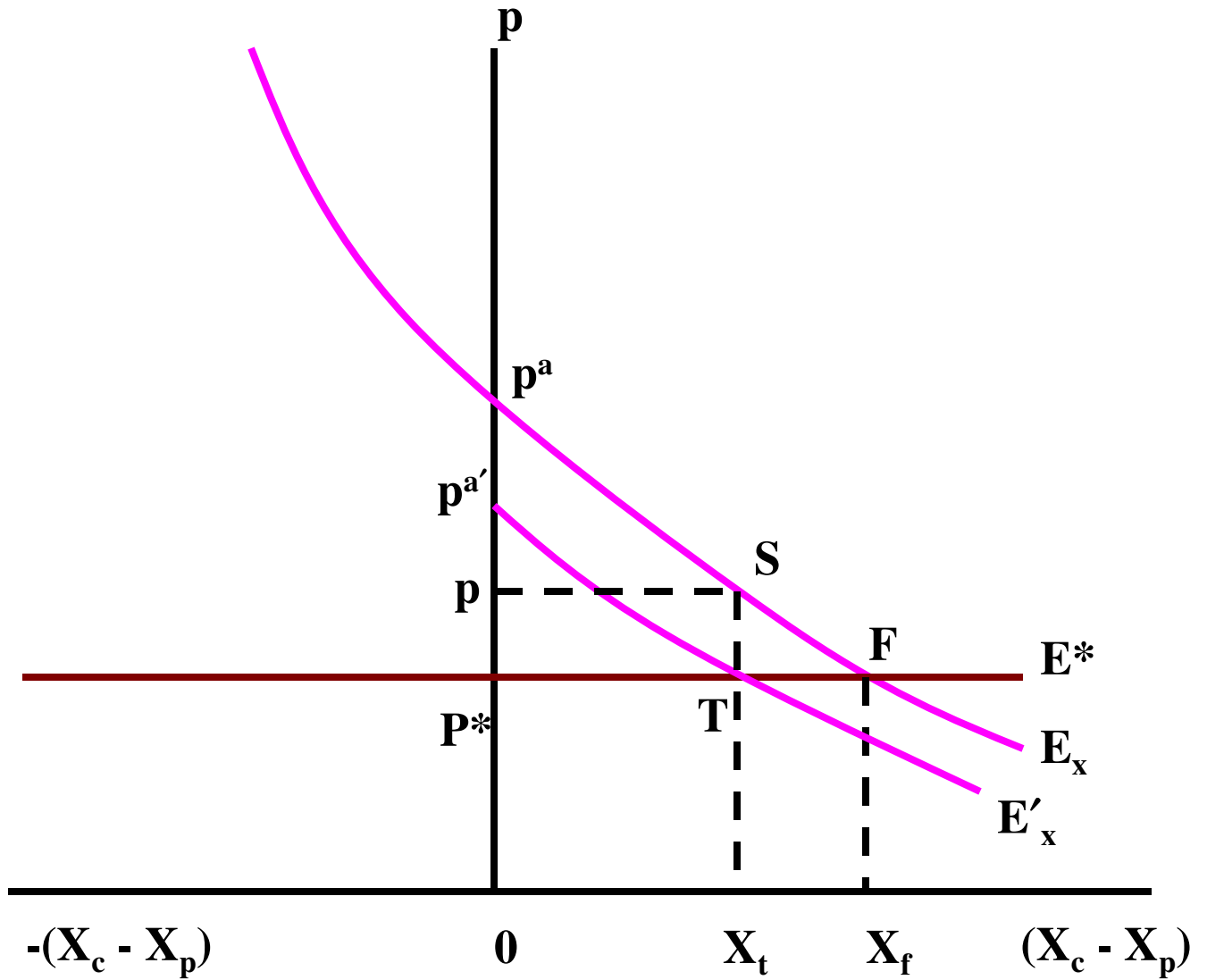
FIGURE 1: IMPORT TARIFF IN A SMALL ECONOMY



$$\text{MRS} = \text{MRT} = p = p^*(1+t) > p^* \quad (1)$$

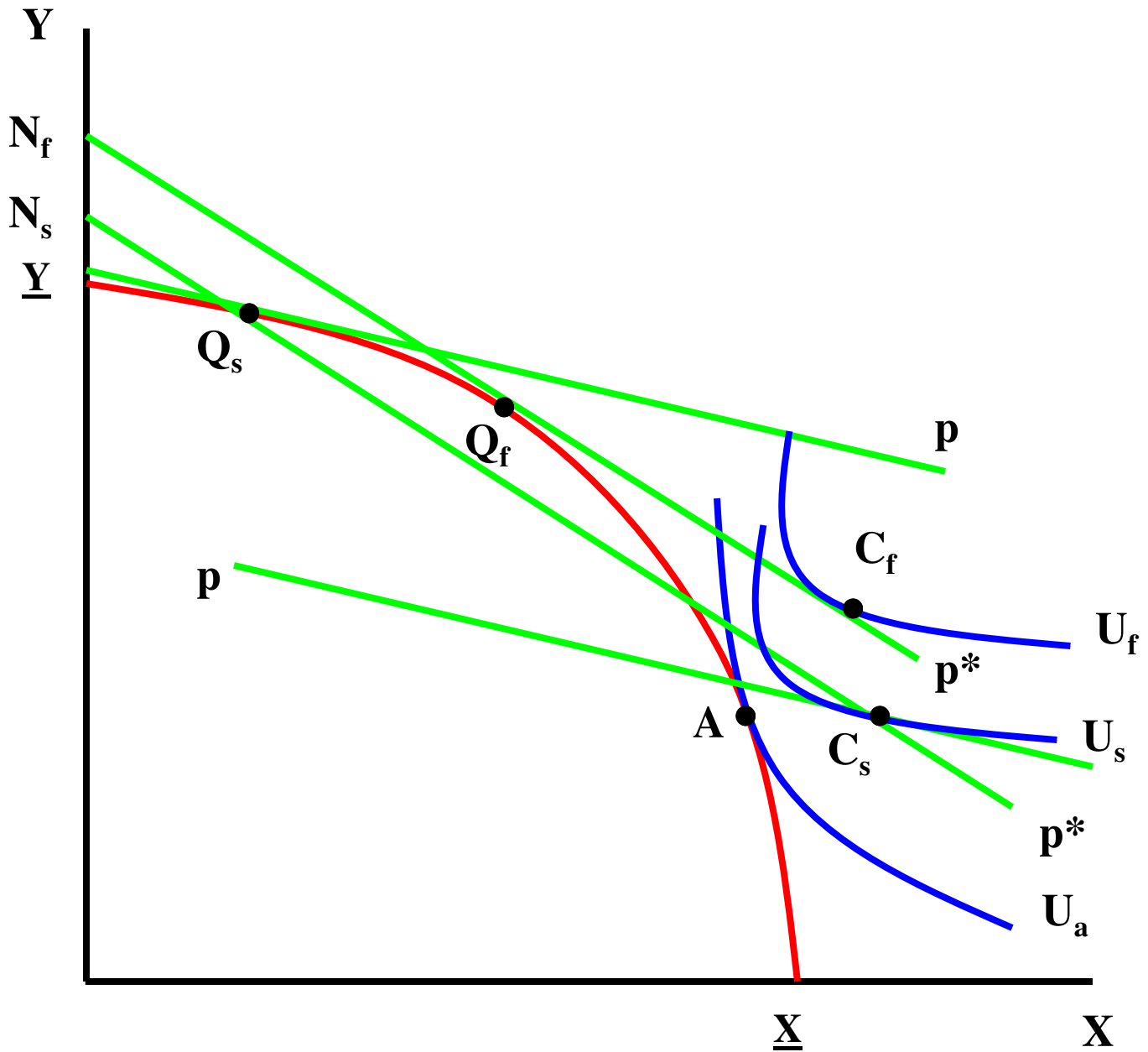
$$p_x^*(X_c - X_p) + p_y^*(Y_c - Y_p) = 0 \quad (2)$$

FIGURE 2: EXCESS DEMAND AND IMPORT TARIFFS



Tariff revenue = $pp^* TS$

FIGURE 3: EXPORT SUBSIDY IN A SMALL ECONOMY



$$\text{MRS} = \text{MRT} = p = p^*/(1+s) < p^* \quad (3)$$

$$p_x^*(X_c - X_p) + p_y^*(Y_c - Y_p) = 0 \quad (2)$$

FIGURE 4: IMPORT QUOTA IN A SMALL ECONOMY

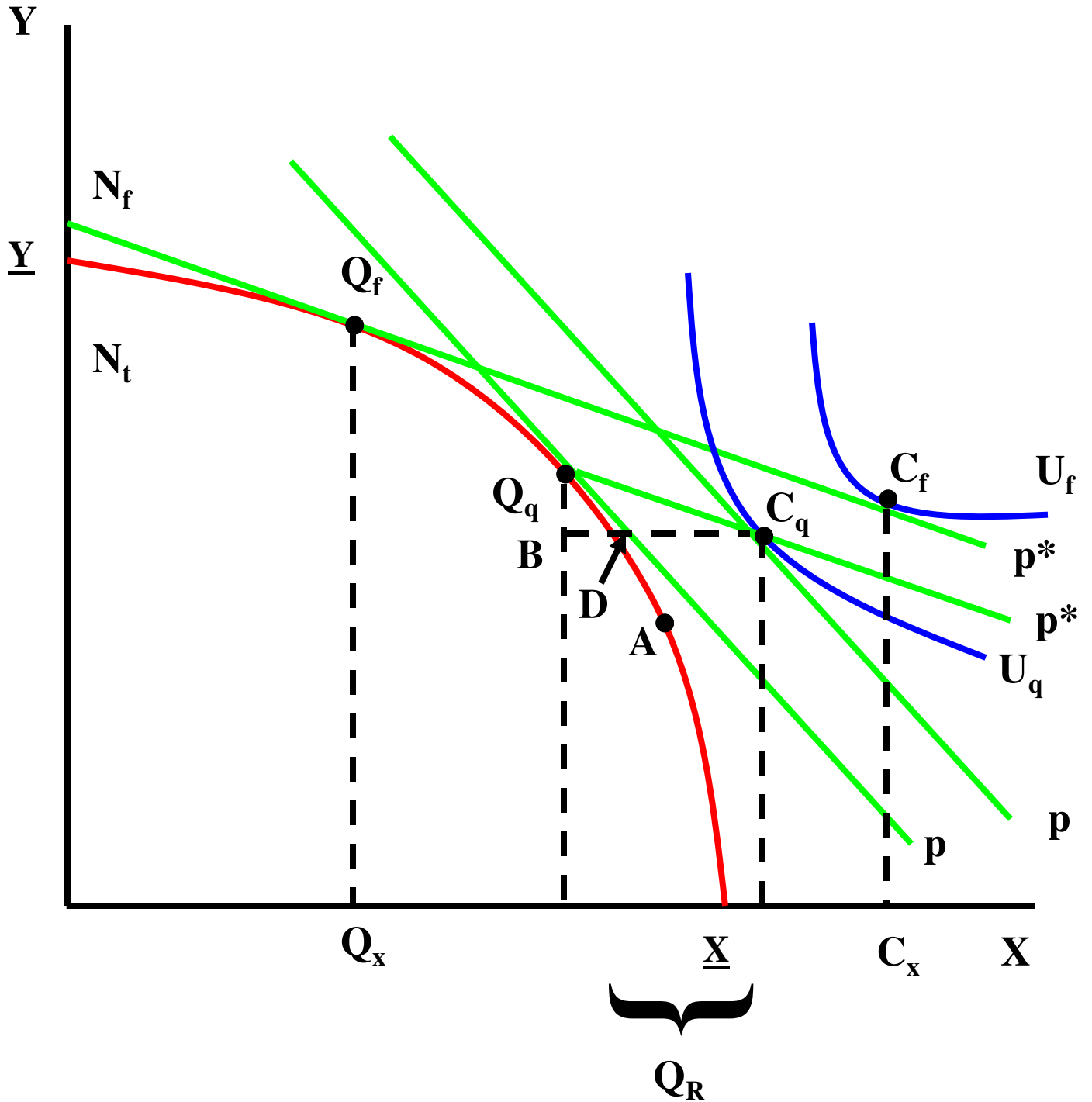


FIGURE 5: EXCESS DEMAND QUOTAS vs. TARIFFS

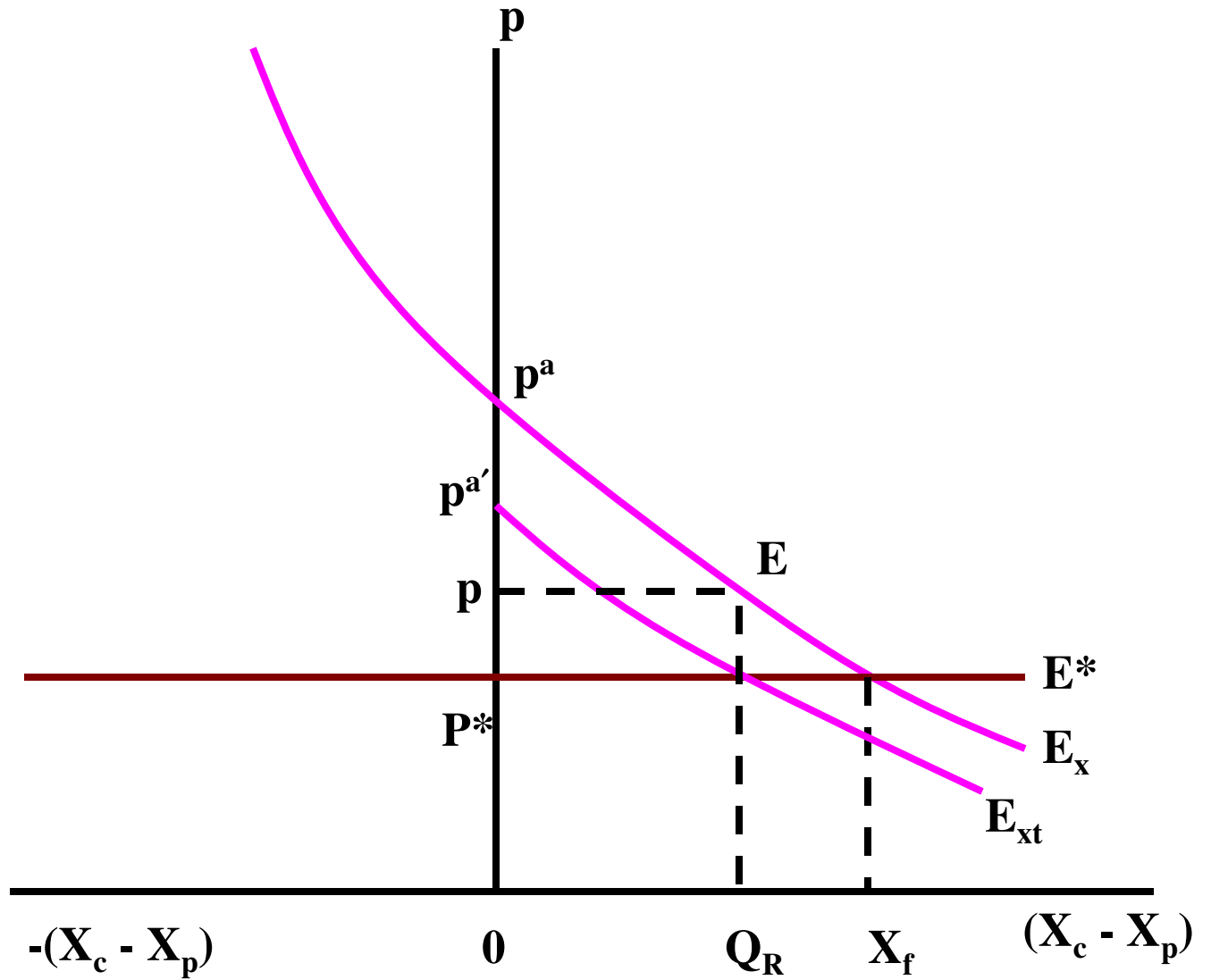


FIGURE 6: LOSSES FROM DISTORTIONS

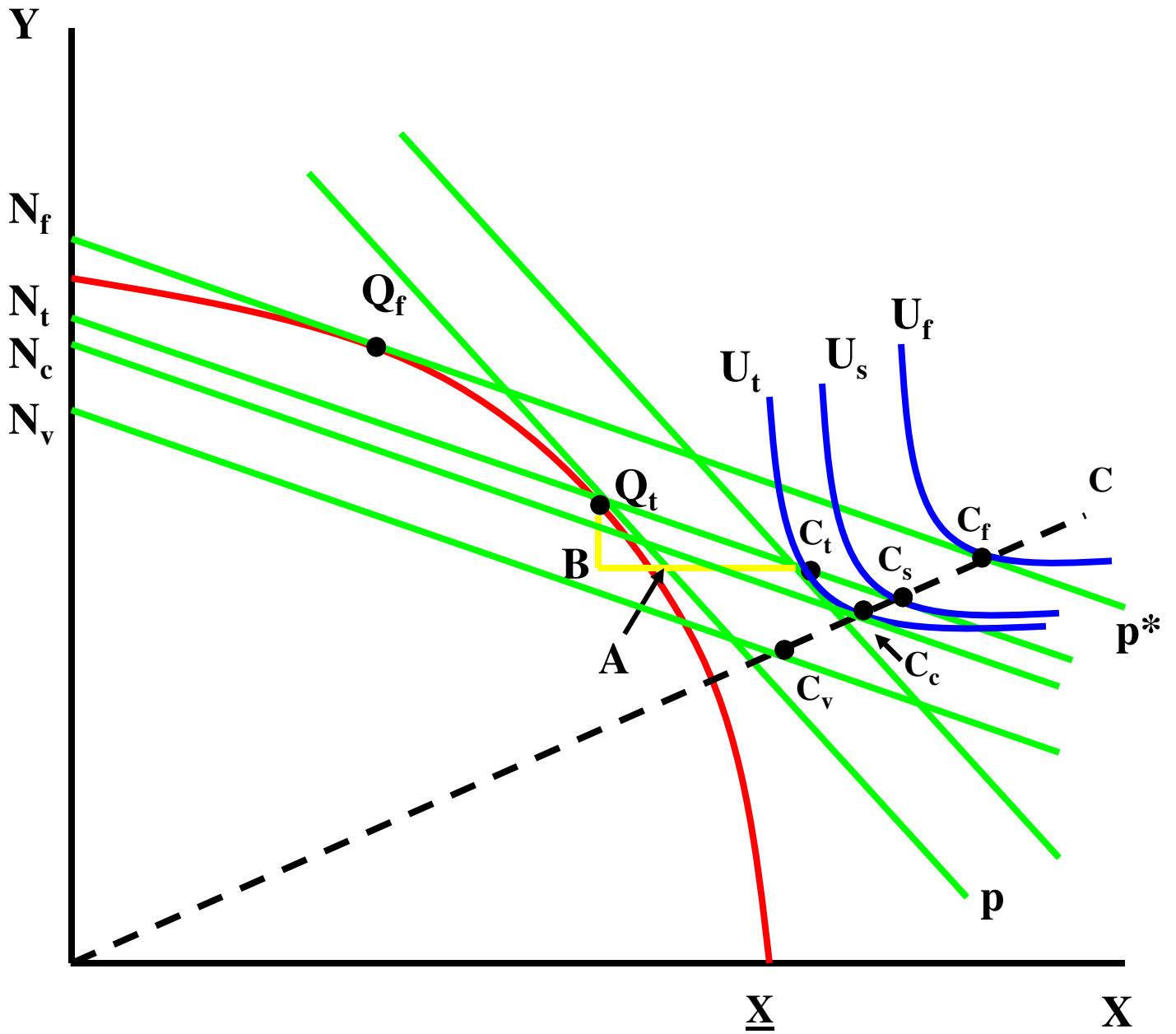
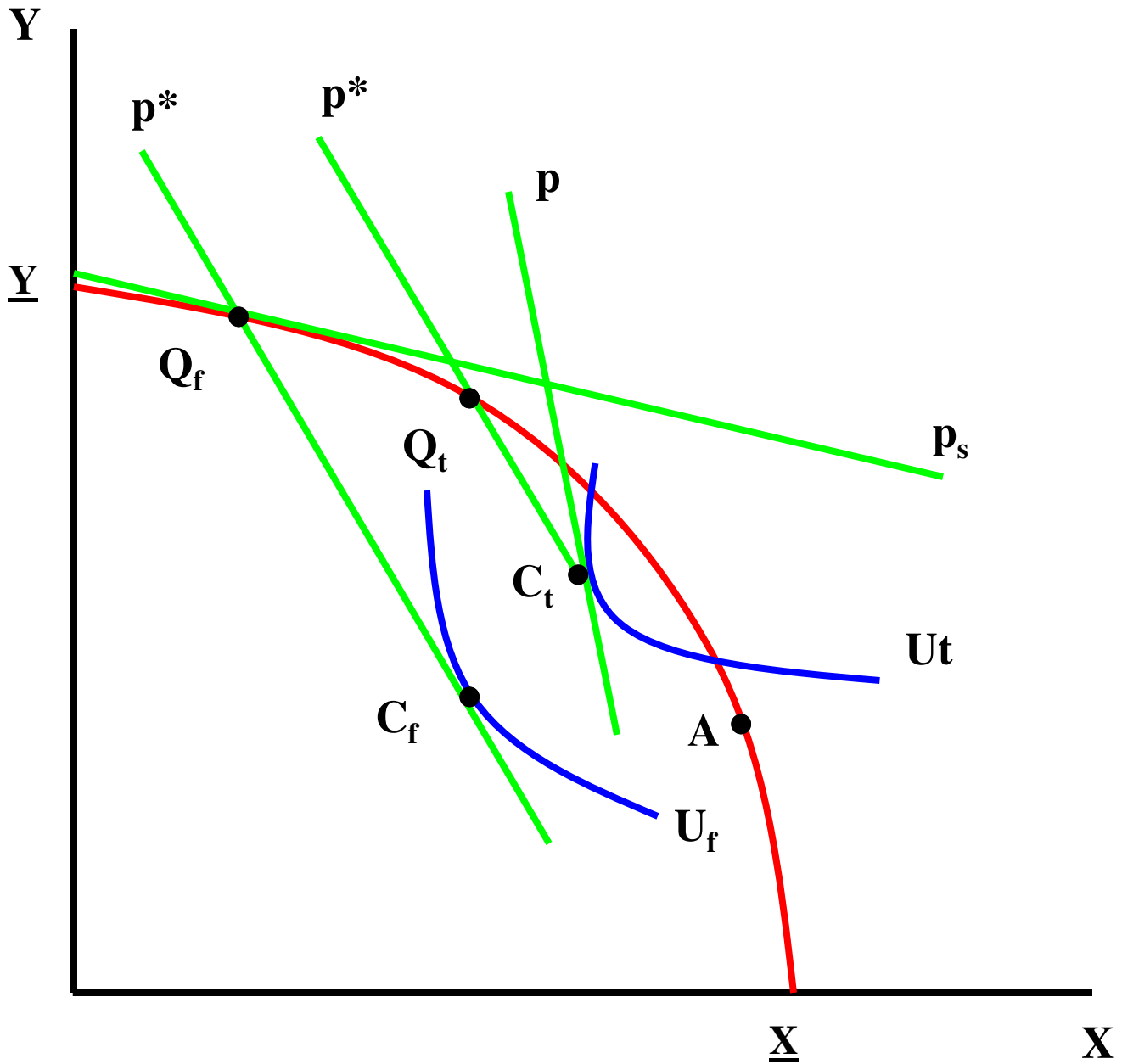


FIGURE 7: TARIFFS AND DISTORTIONS



In presence of a distortion, i.e., a subsidy, *second-best* to introduce another distortion, i.e., a tariff

- If a country is large, it can influence its *terms of trade* when it opens up to trade, i.e., the price of its exports falls as it exports more, and the price of its imports rises as it imports more
- It may be optimal for a country to exploit its monopoly power in this case to alter its terms of trade by imposing a tariff on its exports/imports (Figure 8)
- This, however, worsens the terms of trade for the foreign country, so it will likely *retaliate* with its own tariffs, resulting in a “trade war”
- Also possible, that as a large country grows, it actually loses from trade - *immiserizing growth* (Figure 9)
- This happens though only if the exporting country fails to adopt an optimal tariff on exports/imports in order to influence its terms of trade

FIGURE 8: OPTIMAL TARIFFS AND MONOPOLY

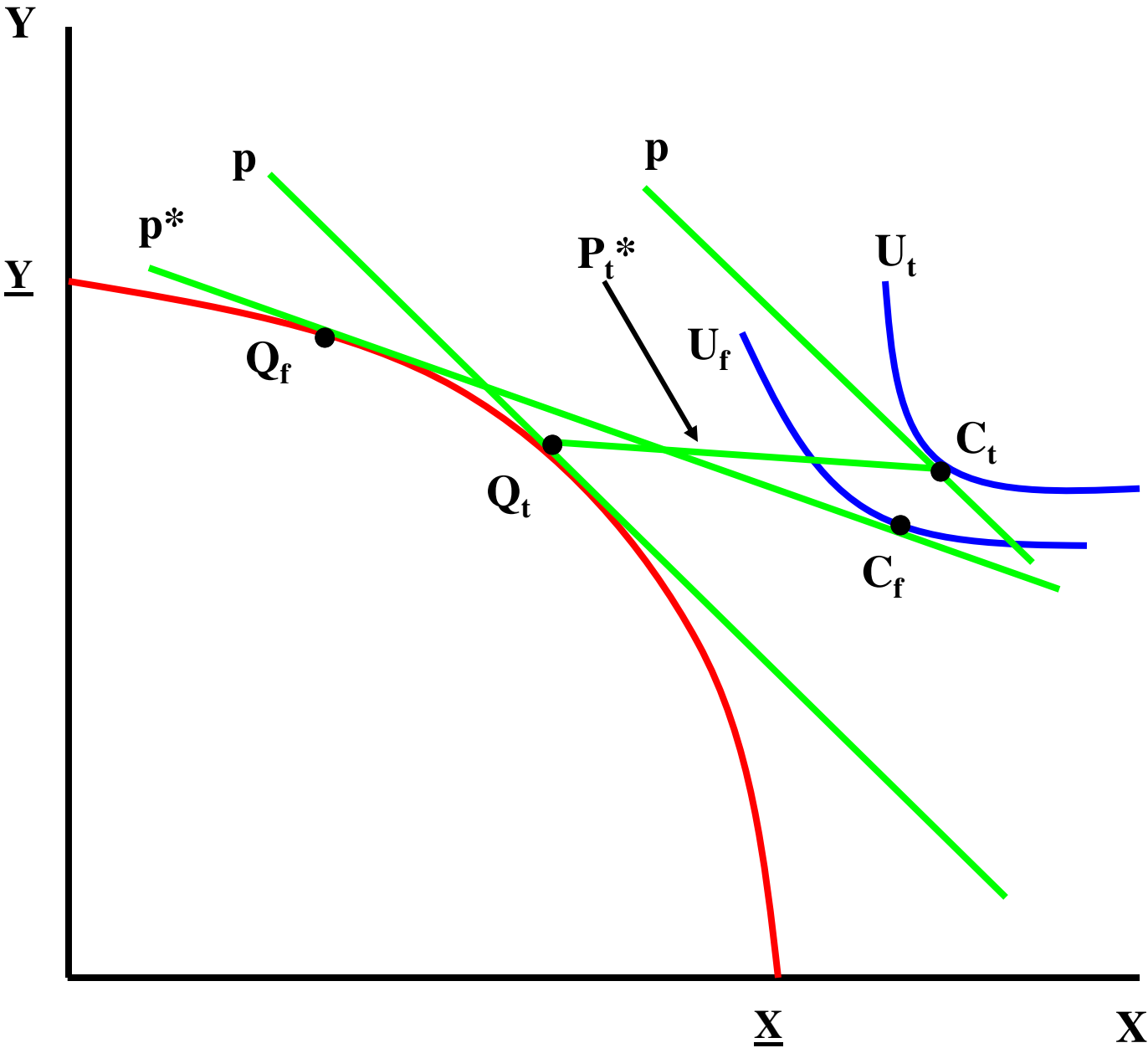


FIGURE 9: IMMISERIZING GROWTH

