

WTO

Consider a world with two countries, Home and Foreign, and two goods, X and Y.

The demand curve for each good in each country is given by: $Q^D = 50 - P$.

The supply curve for Y in Home and for X in Foreign is given by: $Q^S = P$, while the supply curve for X in Home and for Y in Foreign is given by: $Q^S = 20 + P$.

The equilibrium tariff on good X in Foreign equals 3.5. Similarly, the equilibrium tariff on good Y in Home is 3.5. Under such tariffs, the world price of good X (good Y) is 18.25.

Calculate the free trade price.

Calculate the change in social welfare in each country if we move from free trade to equilibrium tariffs. Illustrate with a diagram.

Given your results, would Home and Foreign prefer to negotiate trade policy, or would they prefer to maintain their sovereignty and discretion by leaving each country to set its trade policy on its own?