International Trade

L15

Trade Policies

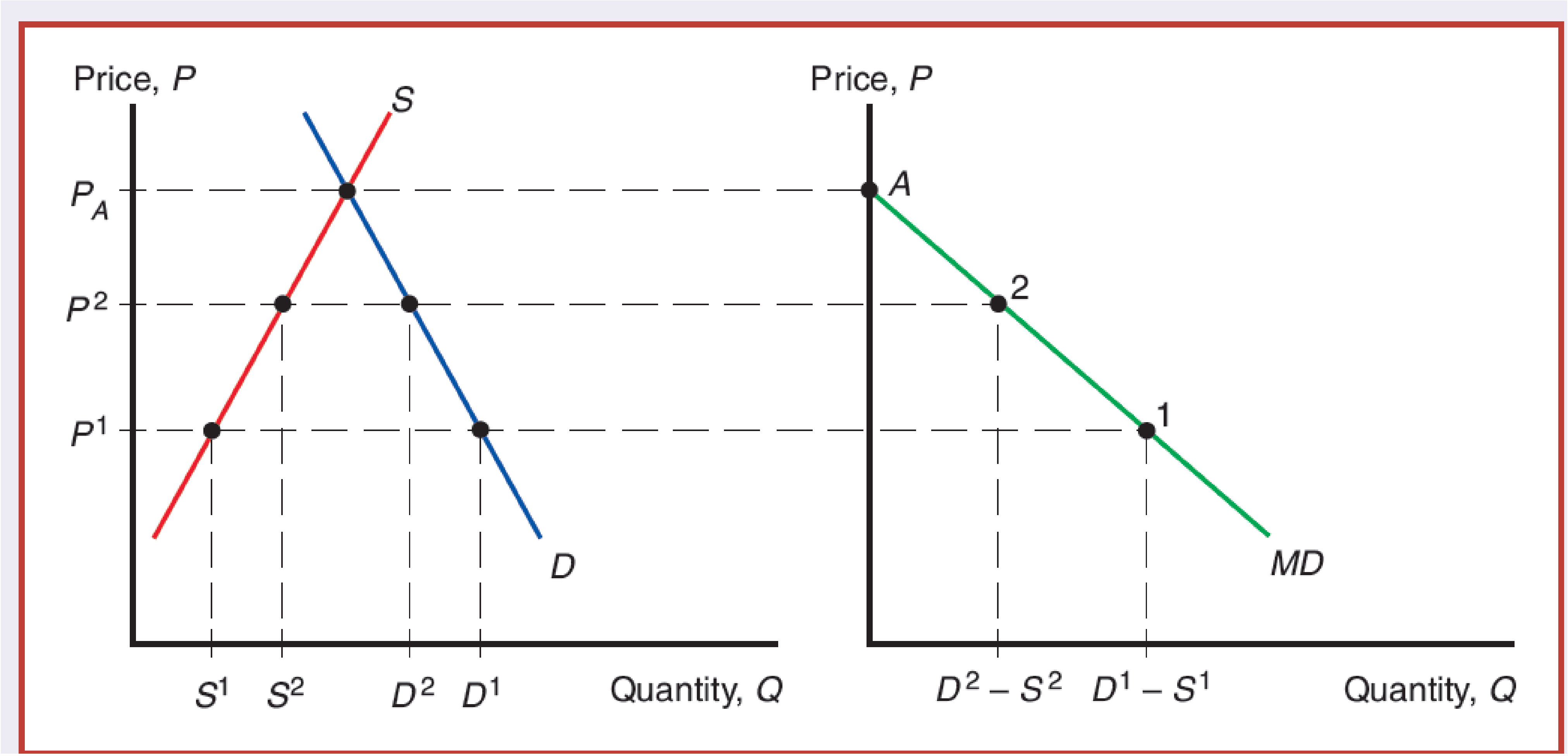
- It refers to a set of practices- regulations, agreement, laws that govern international trade
- Tariff policies are set by countries mainly for two purposes
- -a) Increase tax revenue
- b) Protect domestic Industries
- Earliest – UK (protect agriculture form M competition)
- Trade policies- protectionist policies
- Ex: France, Sweden, Italy, Germany developed through trade protectionist policies
- Recent times-US, Canada, Australia- trade protectionism

Trade Policies

- Tariffs
- Non-tariff barriers: Import quotas and export restraints

Trade in a single industry: Supply and Demand

- 2 countries- Home and Foreign
- Both countries consume and produce wheat
- Wheat-represent competitive market- price taker-implies supply and demand in respective domestic markets depends on?
- w/o tariff- wheat costless transported between countries if?

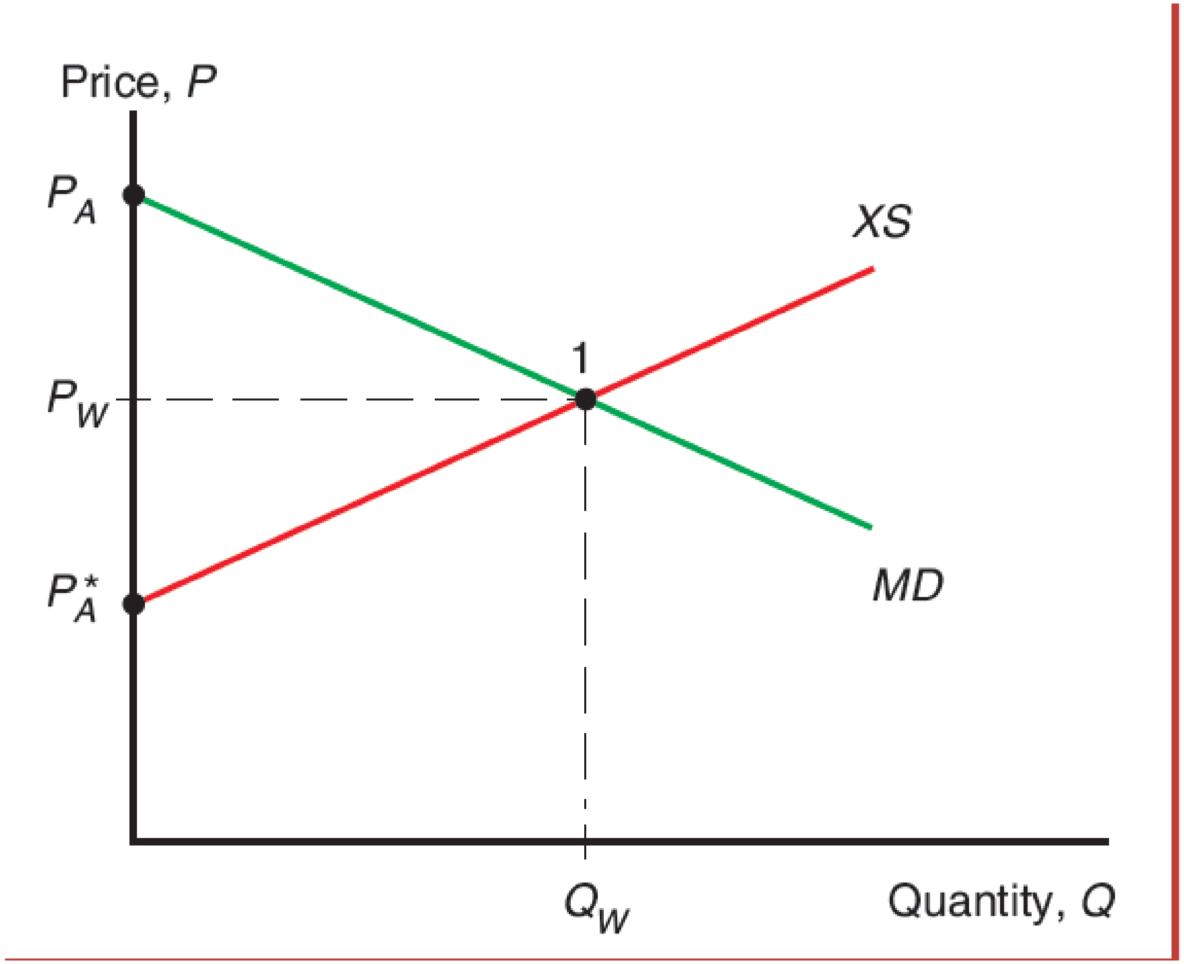


Home’s Import demand Curve

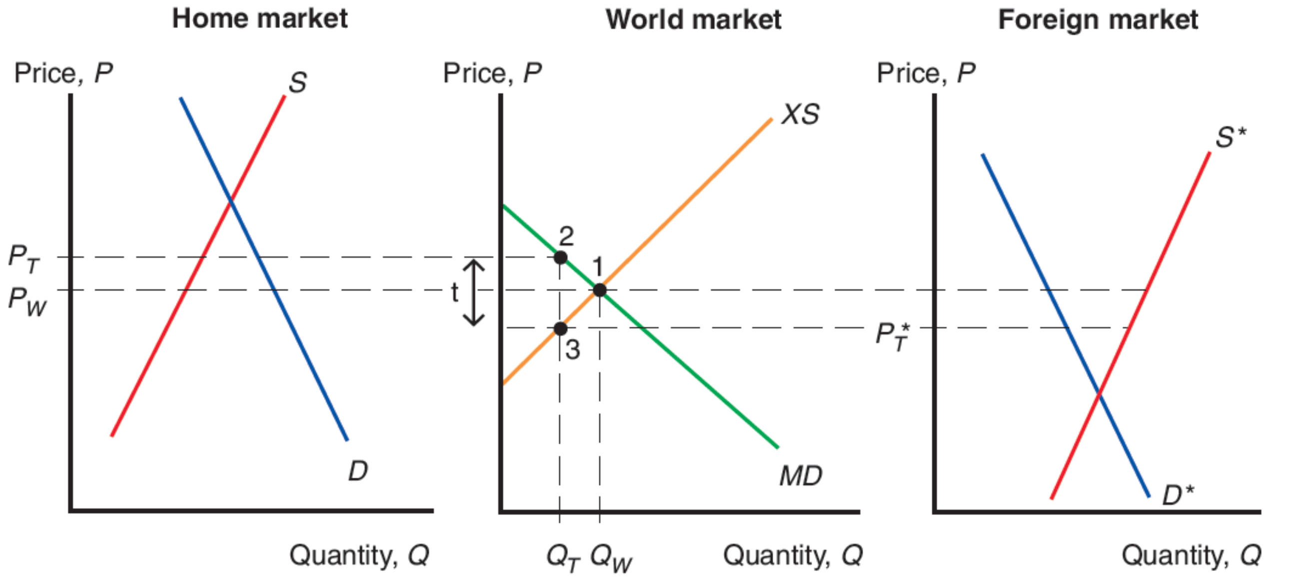
Foreign's export Supply curve

Trade equilibrium

- World equilibrium occurs when Home import demand equals Foreign export supply
- . At the price *PW* where the two curves cross, world supply equals world demand.



Effects of tariff



Effects of tariff

- With the tariff in place, however, shippers are not willing to move wheat from Foreign to Home unless the Home price exceeds the Foreign price by at least *t*.
- If no wheat is being shipped, however, there will be an excess demand for wheat in Home and an excess supply in Foreign.
- Thus, the price in Home will rise and that in Foreign will fall until the price difference is *t*.
- Introducing a tariff, then, drives a wedge between the prices in the two markets.
- The tariff raises the price in Home to *PT* and lowers the price in Foreign to $PT^* = PT - t$.
- In Home, producers supply more at the higher price, while consumers demand less, so that fewer imports are demanded (1 to 2 in MD curve)

Effects of tariff

- In Foreign, the lower price leads to reduced supply and increased demand, and thus a smaller export supply (as seen in the move from point 1 to point 3 on the *XS* curve)
- . Thus, **the volume of wheat traded declines** from *QW*, the free trade volume, to *QT*, the volume with a tariff. At the trade volume *QT*, Home import demand equals Foreign export supply when $PT - PT^* = t$.
- The **increase in the price in Home**, from *PW* to *PT*, **is less than the amount of the tariff because part of the tariff is reflected in a decline in Foreign's export price and thus is not passed on to Home consumers**. This is the normal result of a tariff and of any trade policy that limits imports.

Effects of tariff-Small country

- The size of the effect on the exporters' price, however, is often very small in practice. When a small country imposes a tariff, its share of the world market for the goods it imports is usually minor to begin with, so that its import reduction has very little effect on the world (foreign export) price.

Tariff in a small country

- In the "small country" case : a small country cannot affect foreign export prices.
- In this case, a tariff raises the price of the imported good in the country imposing the tariff by the full amount of the tariff, from *PW* to *PW* + *t*.
- Production of the imported good rises from *S*1 to *S*2, while consumption of the good falls from *D*1 to *D*2. As a result of the tariff, then, imports fall in the country imposing the tariff.