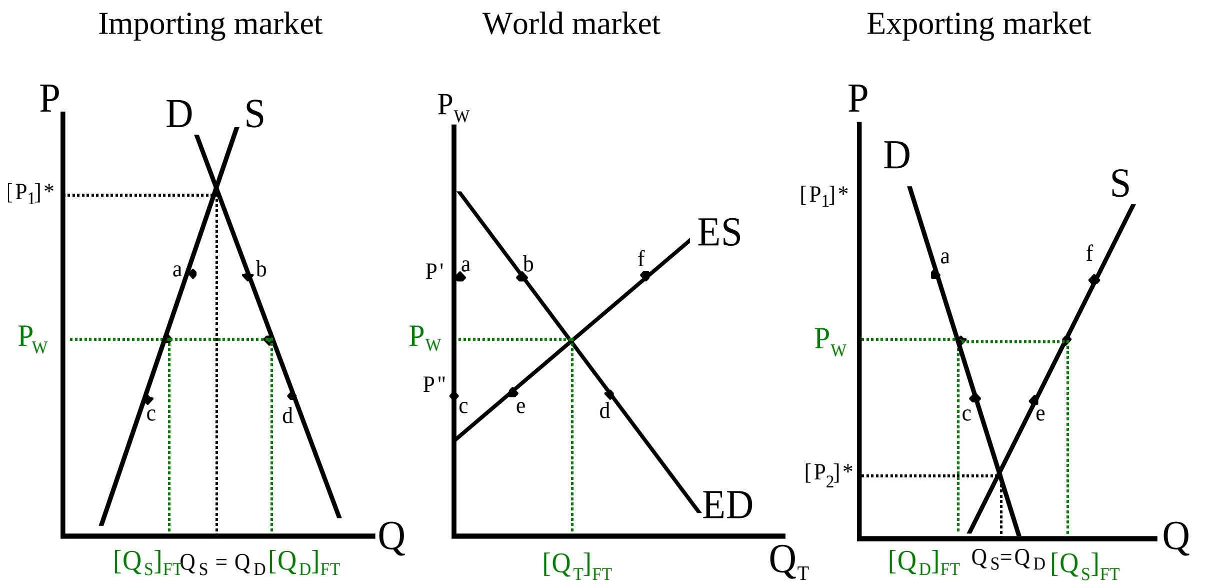
Review session: Trade and trade policy analysis

<u>Free trade:</u>

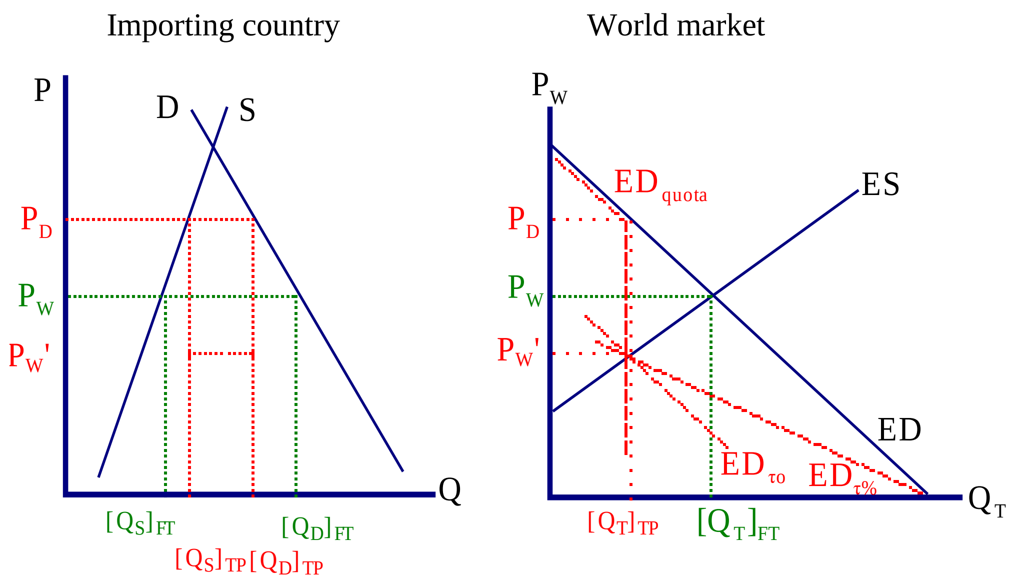
Free trade of identical goods in the absence of government intervention, non-competitive markets, and transactions or transport costs

Determining the willingness to import (ED) and export (ES) at all relevant prices involves identifying the importing and exporting country, respectively. For the importer, ED = D – S in that market. For the exporter, ES = S – D in that market. Setting ED = ES results in a price, P_W, that brings all markets into equilibrium, where the quantity trade is equal to the quantity imported and exported, i.e., $Q_T = Q_X = Q_M$.



<u>Trade policy analysis:</u>

Restrictions on imports are a shock to the importer's willingness to import, i.e. a shock to the ED curve. Three different policy instruments are shown each having the same restrictive effect on the volume of imports: (1) the ad valorem import tariff ($ED_{\tau\%}$), (2) the specific import tariff ($ED_{\tau o}$), and (3) the import quota (ED_{quota}).



A policy that targets exports (an export tax, quota or subsidy) will be a shock to the ES curve. It would be policy implemented by the exporting country's government.