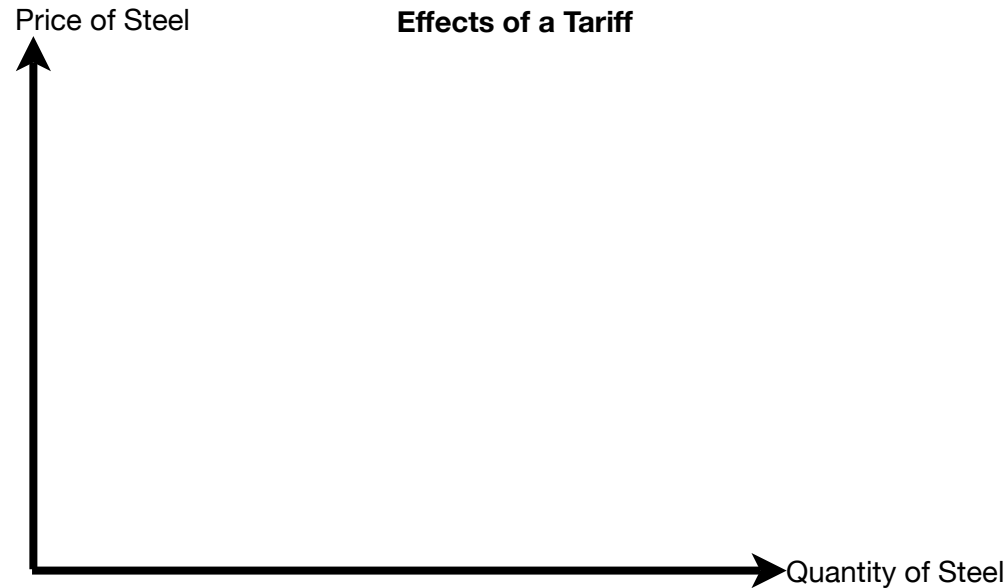


	Before Tariff	After Tariff	Change
CS	A+B+C+D +E-F	A+B	-(C+D+E+F)
PS	G	C+G	+C
Govt. Revenue	None	E	?
Total Surplus	A+B+C+D+E +F+G	A+B+C+E+G	?

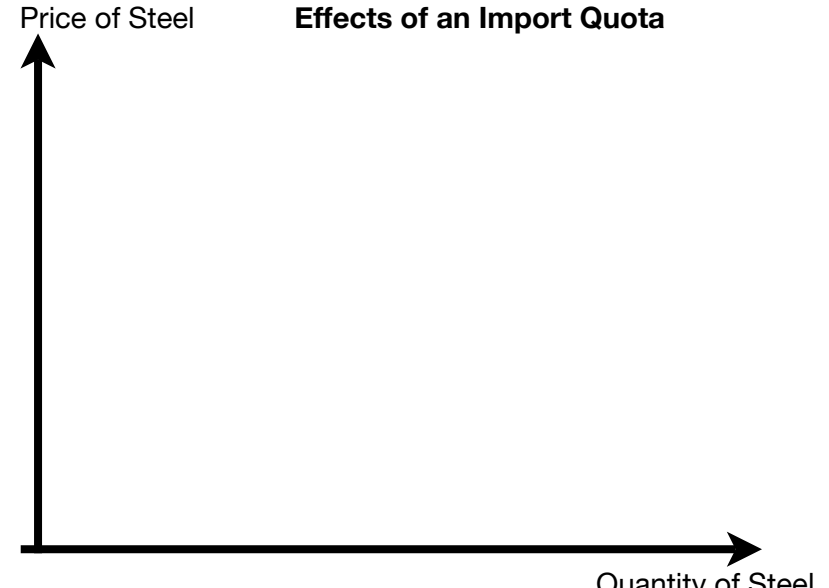
Q1:What is Govt. Revenue?
Q2: What is Change in Total Surplus?

	Before Quota	After Quota	Change
CS	A+B+C+D +E'+E''+F	A+B	-(C+D+E'+E''+F)
PS	G	C+G	+C
License Holder	None	?	+(E'+E'')
Total Surplus	A+B+C+D +E'+E''+F+G	A+B+C +E'+E''+G	?

Q1:What is License Holder Revenue after quota?
Q2: What is Change in Total Surplus?



Effects of a Tariff



Effects of an Import Quota

Definitions { **Trade Creation:** The increase in trade volume caused by union with a lower cost (more efficient) supplier within the trade bloc

Tariff: A tariff is a tax on goods produced abroad and sold domestically.

DWT Loss: the reduction in consumer and producer surplus resulting from restricting output below its efficient level

An **import quota** is a limit on the quantity of a good that can be produced abroad and sold domestically.

Policy Lessons

Lessons for Trade Policy	Benefits of Increased Trade	Arguments Against Trade	Change
Both tariffs and import quotas . . .	Increased variety of goods	Jobs	$-(C+D+E+F)$
raise domestic prices.	Lower costs through economies of scale	National Security	+C
reduce the welfare of domestic consumers.	Increased competition	Infant Industry	?
increase the welfare of domestic producers.	Enhanced flow of ideas	Unfair Competition	?
cause deadweight losses.		Protection-as-a-Bargaining Chip	

Case Study

Definitions	NAFTA	GATT
Both Unilateral: when a country removes its trade restrictions on its own.	The North American Free Trade Agreement (NAFTA) is an example of a multilateral trade agreement.	The General Agreement on Tariffs and Trade (GATT) refers to a continuing series of negotiations among many of the world's countries with a goal of promoting free trade.
Multilateral: a country reduces its trade restrictions while other countries do the same.	In 1993, NAFTA lowered the trade barriers among the United States, Mexico, and Canada.	GATT has successfully reduced the average tariff among member countries from about 40 percent after WWII to about 5 percent today.

Summary

The effects of free trade can be determined by comparing the domestic price without trade to the world price.

A low domestic price indicates that the country has a comparative advantage in producing the good and that the country will become an exporter.

A high domestic price indicates that the rest of the world has a comparative advantage in producing the good and that the country will become an importer.

When a country allows trade and becomes an exporter of a good, producers of the good are better off, and consumers of the good are worse off.

When a country allows trade and becomes an importer of a good, consumers of the good are better off, and producers are worse off.

A tariff—a tax on imports—moves a market closer to the equilibrium than would exist without trade, and therefore reduces the gains from trade.

Import quotas will have effects similar to those of tariffs.