International Trade

- tariff (tax on imports)
- quota (limit on imports)

Underlying Assumption

★ Small Domestic Economy / Country ★

→ whatever it does does not affect the world
i.e. how much it buys or sells does not affect the world price.

→ world supply curve is horizontal
i.e. the world can supply the good at p_{world} as much as the small country wants to buy.

International Trade Diagram (importing country)

since $P^{dom} > P^{world}$ the country is not good at making the good

domestic sellers cannot compete against foreign sellers so they sell a little

domestic buyers buy a lot due to cheap P^{w}.

P

domest. P

P^{world}

$S^{domestic}$

S^{world}

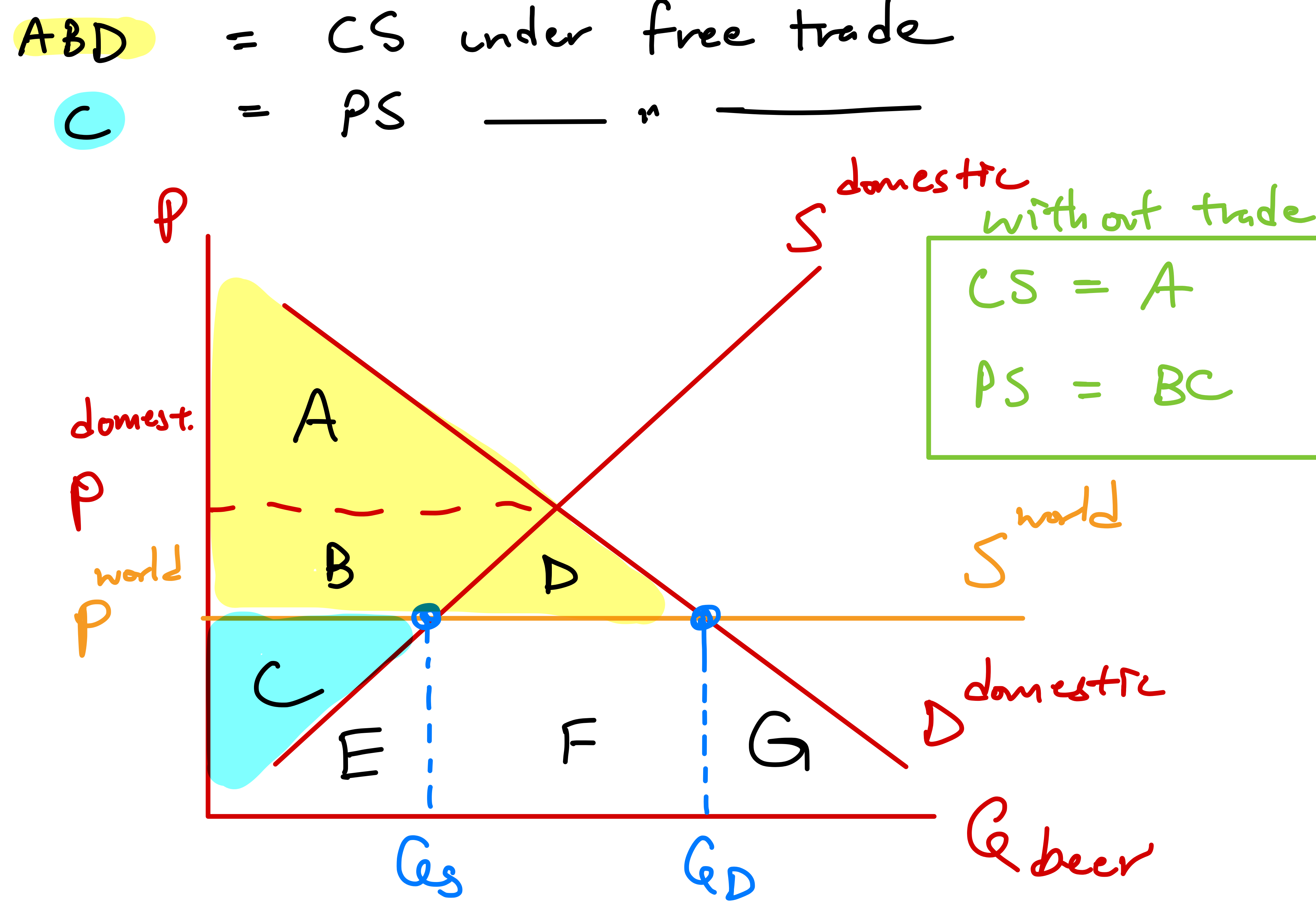
$D^{domestic}$

import from abroad

Q_S

Q_D

Q beer

ABD = CS under free trade
C = PS " "
P
S domestic
without trade
CS = A
PS = BC
domest. P
A
B
D
world P
S world
C
E
F
G
D domestic
Q beer
Qs
QD

Tariffs increase the import price, shifting the S^{world} upwards. This allows more domestic producers to compete against foreign producers.

P

$S^{domestic}$

domest. P

$P^{w}+t$

world S + tariff

I tariff /unit

S^{world}

P_{world}

original import

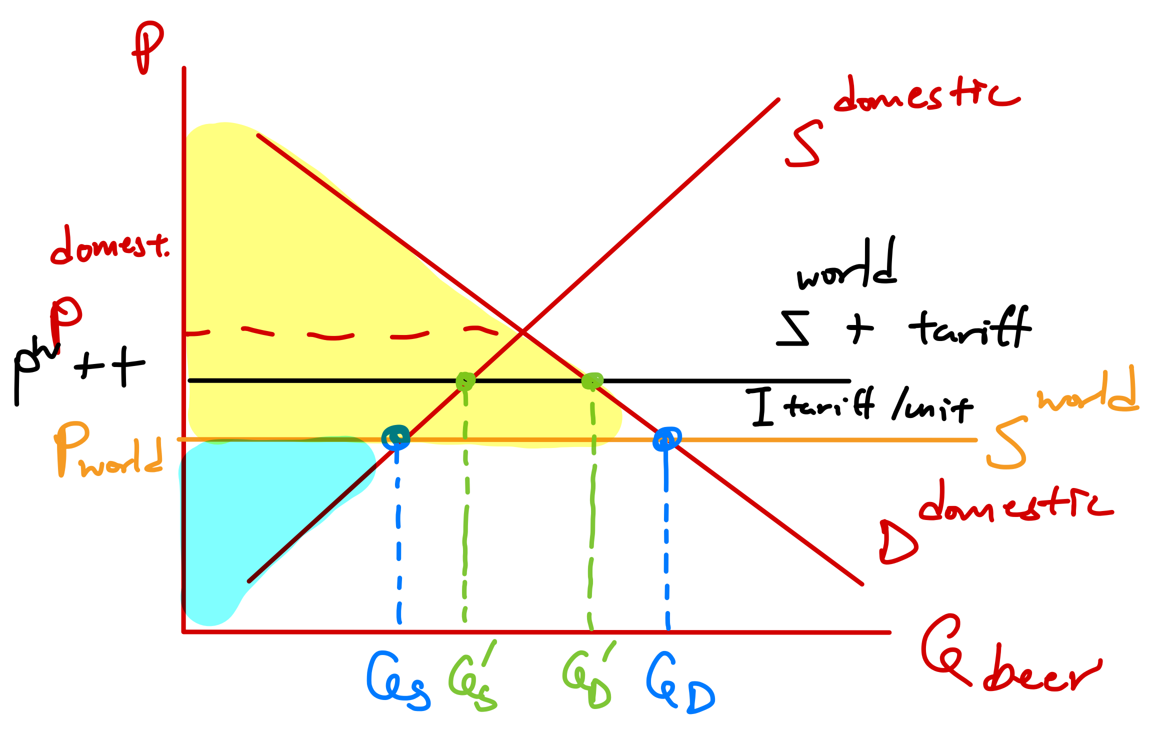
$D^{domestic}$

Q_S Q_S' Q_D' Q_D

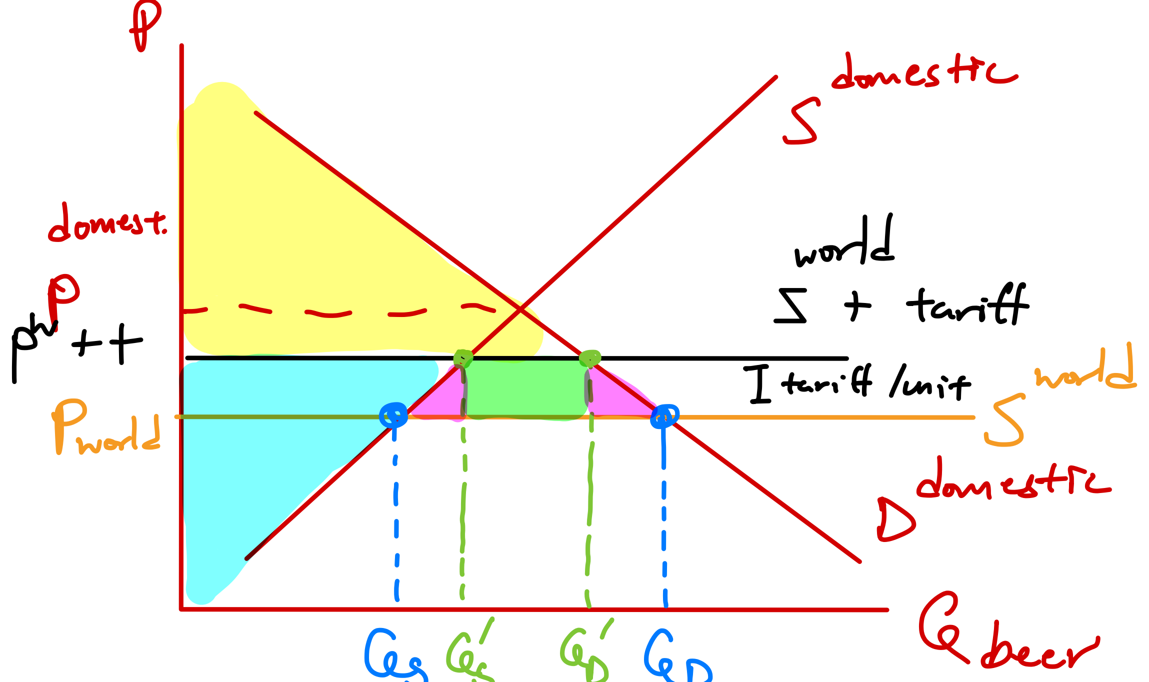
Q beer

new import after tariffs.

No Tariffs



With Tariffs



Consumers pay more so they buy less (CS↓)

Producers sell at higher price, so they produce more (PS↑)

Govt gets tariffs revenue of [green area] (new import × tariff/unit)

[pink area] [pink area] are DWL

Quota : limit on imports

1) govt sets a limit of how much can be imported

2) govt issues "import licences" to firms, usually foreign firms.

3) these licences allows the holders to buy goods abroad at Pworld & sell them in the domestic mkt at higher price, making money.

P

$S^{dom.}$

$S^{dom.}$ + Quota

quota

P^{dom}

P_{Quota}

P^W

S^W

$D^{dom.}$

Q

Q_S Q_S' Q_D' Q_D

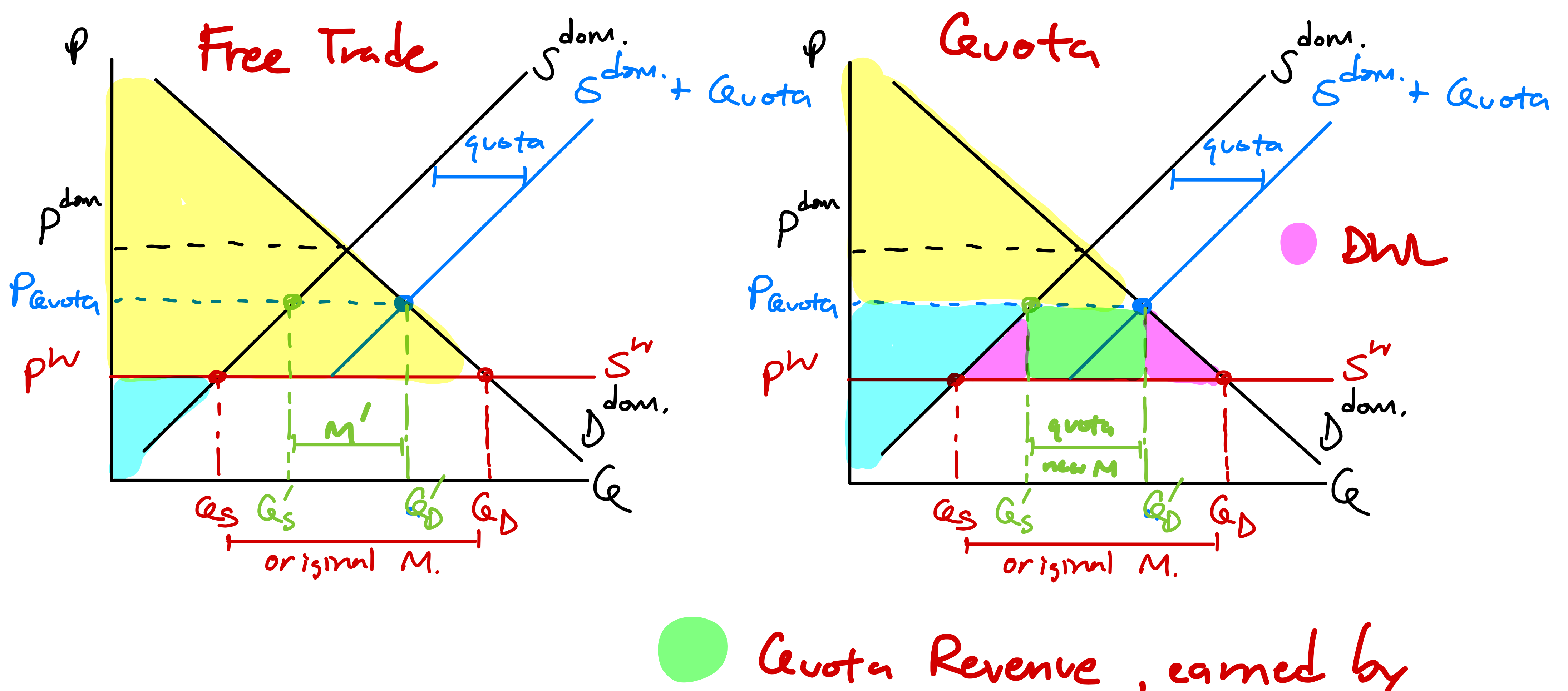
new M = quota

original M.

Quota limits amount of goods to be brought into domestic economy. Then govt allows ppl to trade according mkt force which increase the price to P_{Quota}.

At P_{Quota}, domestic producers produce at Q_S', while domestic consumers buy at Q_D'.

Thus, $Q_D' = Q_S' + \text{Quota}$.



Quota Revenue, earned by licence holders who buy goods at P_w and sell at P_{quota}

→ Quota Revenue may become DWL if licence holders are foreign firms.