

LECTURE XII

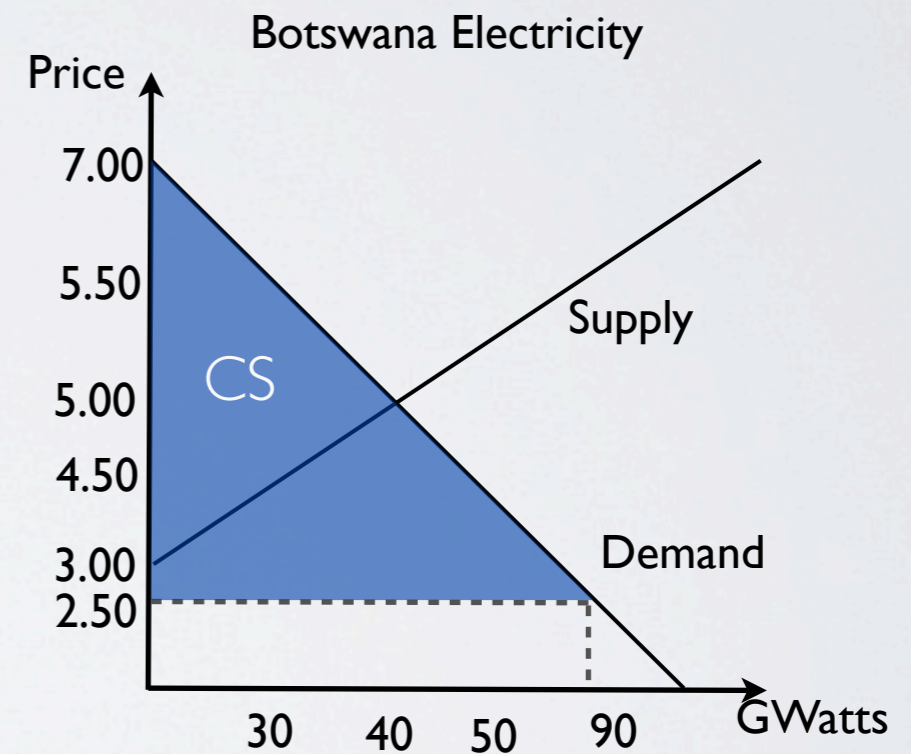
10 April 2012

TOPIC 13 (CONT.)

Small Country Trade Model

TRADE: CASE 3

- Suppose the South African price taken is now \$2.50 / GWatt
 - $PS = 0$
 - $CS = .5 * (7 - 2.50) * 90 = 202.50$
- Now electricity is so cheap, domestic producers cannot afford to produce
 - Even though suppliers are unable to produce, total welfare is still higher
 - This might be a chance for firms or laborers to lobby for **trade barriers**



JUSTIFICATIONS FOR BARRIERS

- What are some reasons we might sacrifice a greater national welfare and introduce trade barriers?
 1. Jobs: Imports reduce jobs in that industry (as we saw), but other opportunities might be created in industries that are now exporting
 2. National-security (Hamilton): Some industries might produce resources necessary for national security (oil?), but the interdependence might be exaggerated
 3. Infant-industry (also Hamilton, among others): Young industries need time to become efficient and compete, but protection can also hinder efficiencies

JUSTIFICATIONS FOR BARRIERS

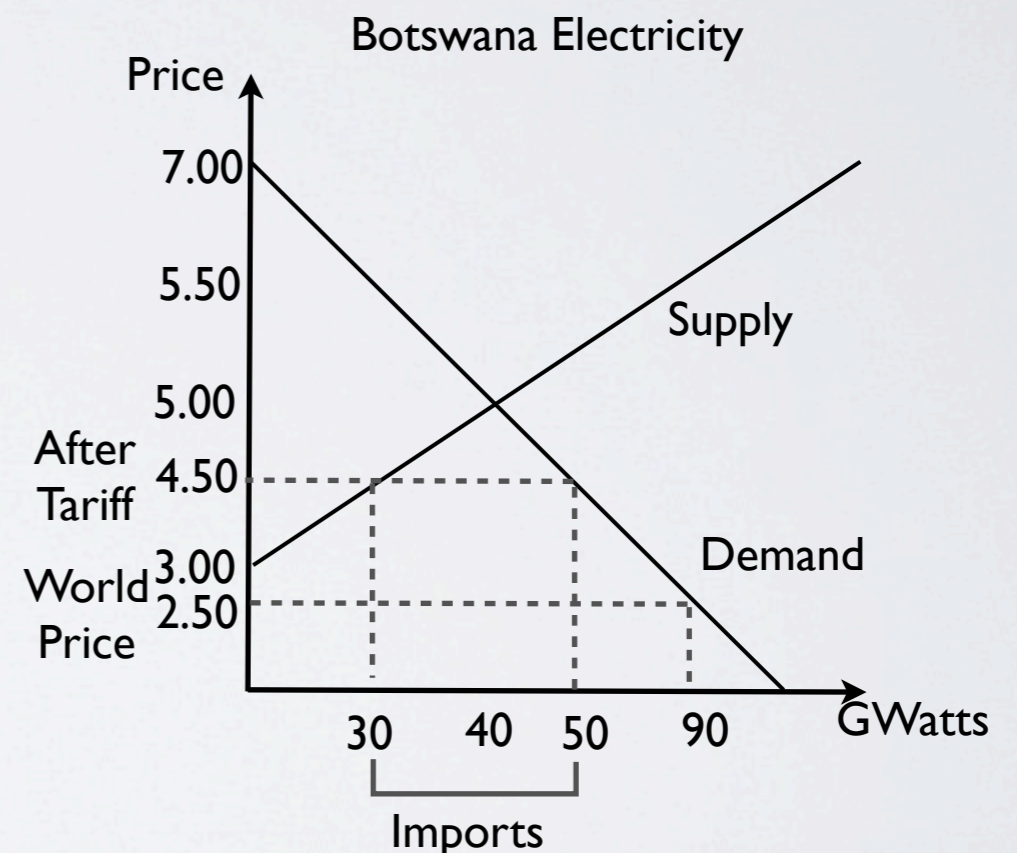
4. Unfair competition: perhaps firms in this country face more regulations in another or production is subsidized elsewhere, but consumers gain from lower prices
5. Bargaining chip: reducing own protection can be used in negotiations for others to lower theirs
6. Efficiency v. Equality: although general welfare increases because of trade, there are distributional effects

TYPES OF A BARRIERS

- What are different types of trade barriers?
 - **Tariffs:** a tax imposed on an imported good
 - Revenue tariff: tariff designed to produce income (used to be the only way to raise revenue)
 - Protective: designed to shield domestic producers from foreign competition
 - **Import Quota:** Limit imposed on the quantity or value over a certain period of time for some good imported
 - **Non-tariff barrier:** none of the above; e.g. voluntary export restricts - firms voluntarily limit exports to another country, which raises prices on that good

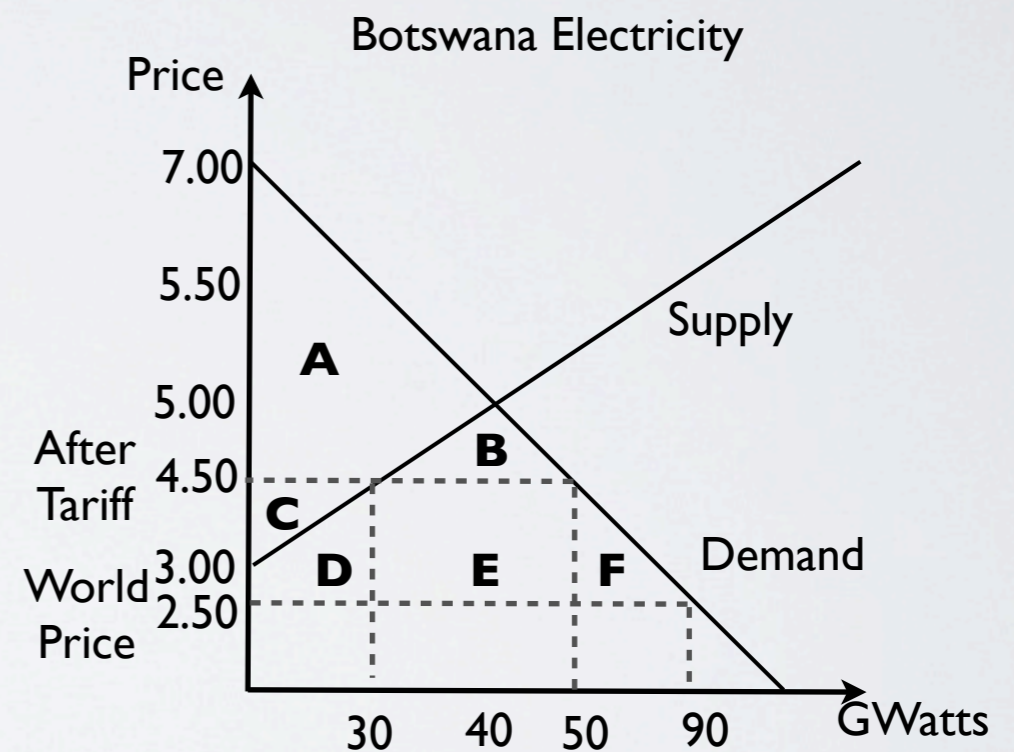
BARRIER: BOTSWANA

- Suppose world price is \$2.50 / Gwatt so to help producers, Botswana introduces a tariff of \$2.00 / Gwatt
- New price is World Price + Tariff = \$4.50
- For S and D, we've seen at price \$4.50, supply is 30 and demand is 50
- So imports are 20



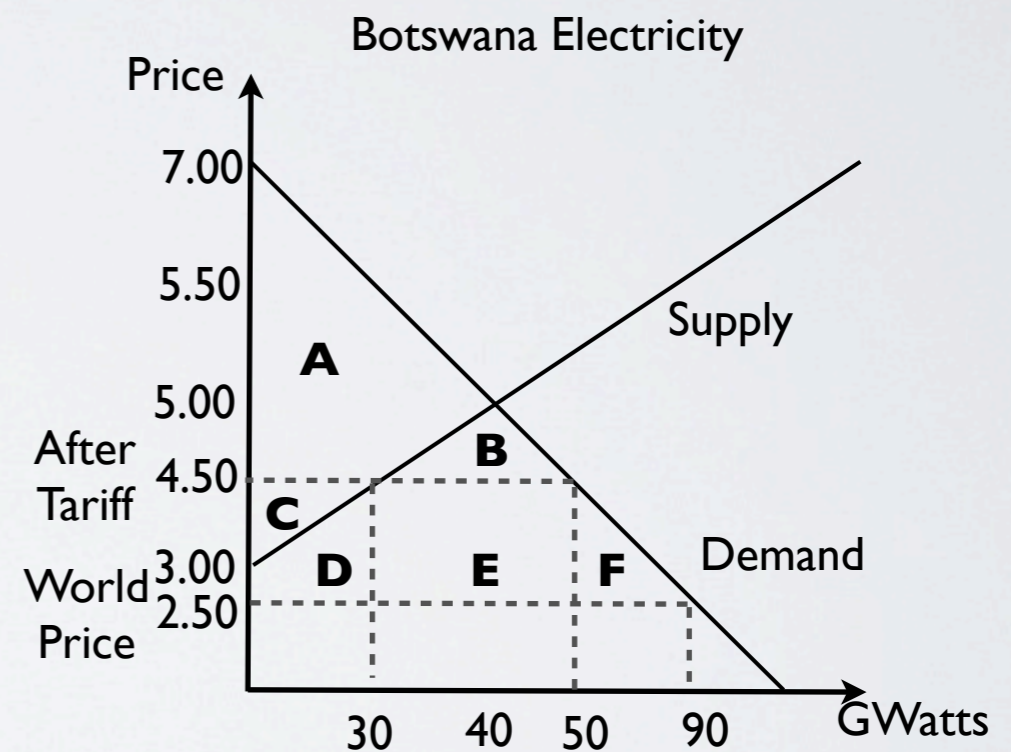
BARRIER: BOTSWANA

- Welfare Analysis
 - Before the tariff, recall total surplus = CS = A + B + C + D + E + F
 - Now we have a new actor, the government that benefits
 - Government benefits in the form of *tariff revenue*, which is the tariff times the quantity imported, here \$40



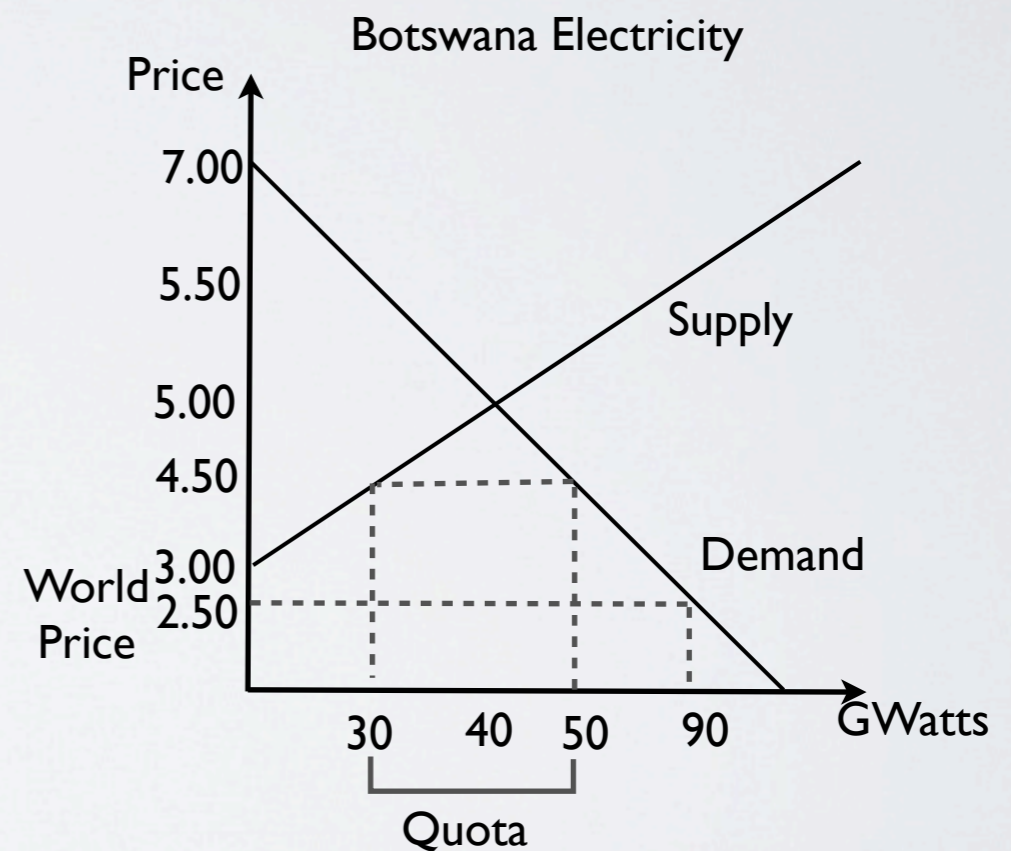
BARRIER: BOTSWANA

- Welfare Analysis
 - After the tariff, then $GS = E$
 - $CS = A + B$, $PS = C$
 - So $TS = CS + PS + GS = A + B + C + E$
 - Notice this is a loss of D and F
 - Numerically, we found before that $PS + CS = 85$, now $+ 40$ so $TS = 125$, lower than free trade 202.50
- The loss from interference in the efficient market (free trade) is **deadweight loss**



OTHER BARRIERS

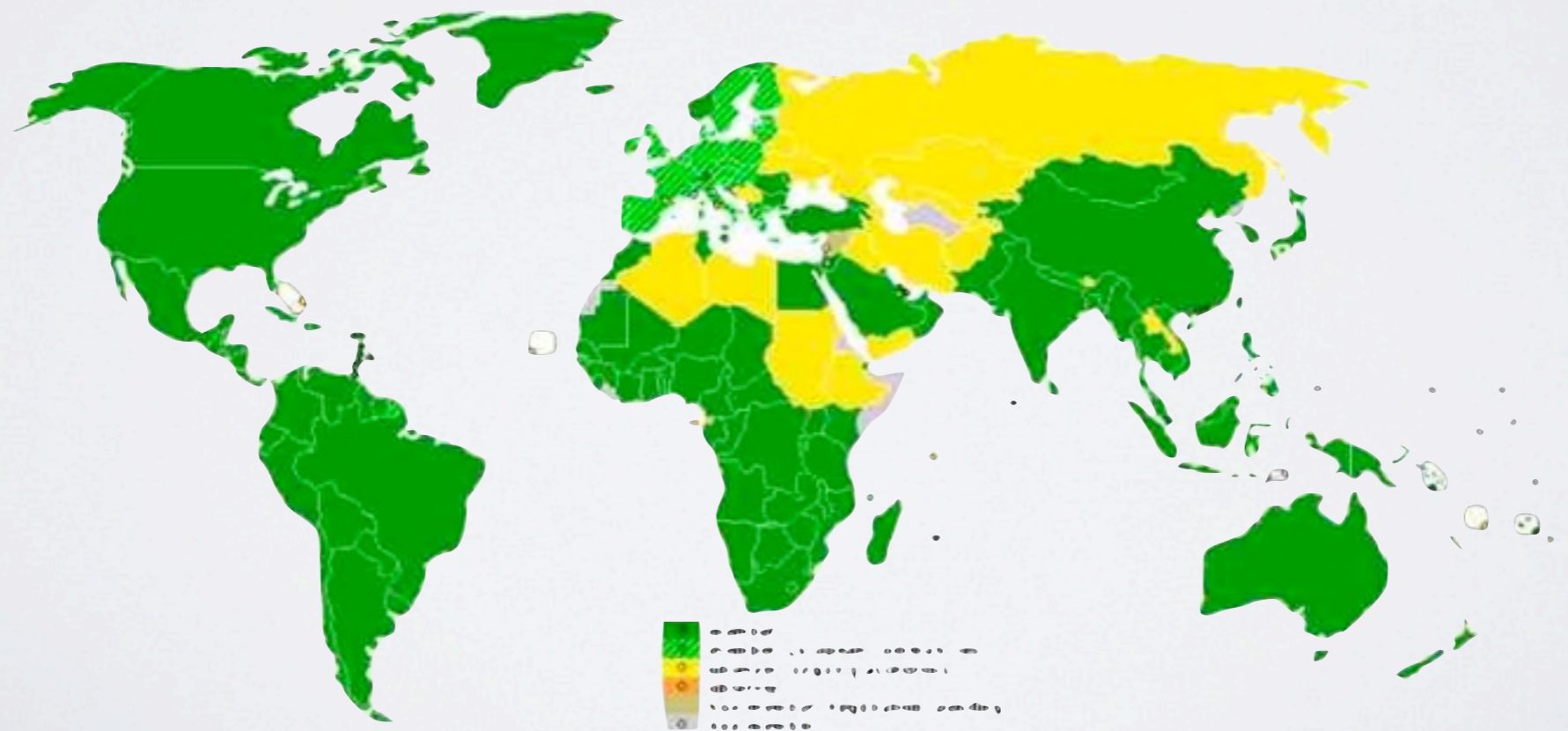
- Quotas can be looked at similarly
 - Here a quota of 20 Gwatts would ensure a price of \$4.50
 - The quota acts as a maximum wedge between supply and demand (the maximum difference is exactly the most we could possibly import)
 - Quotas can be distributed differently than tariffs and may not be gained in the form of government revenue



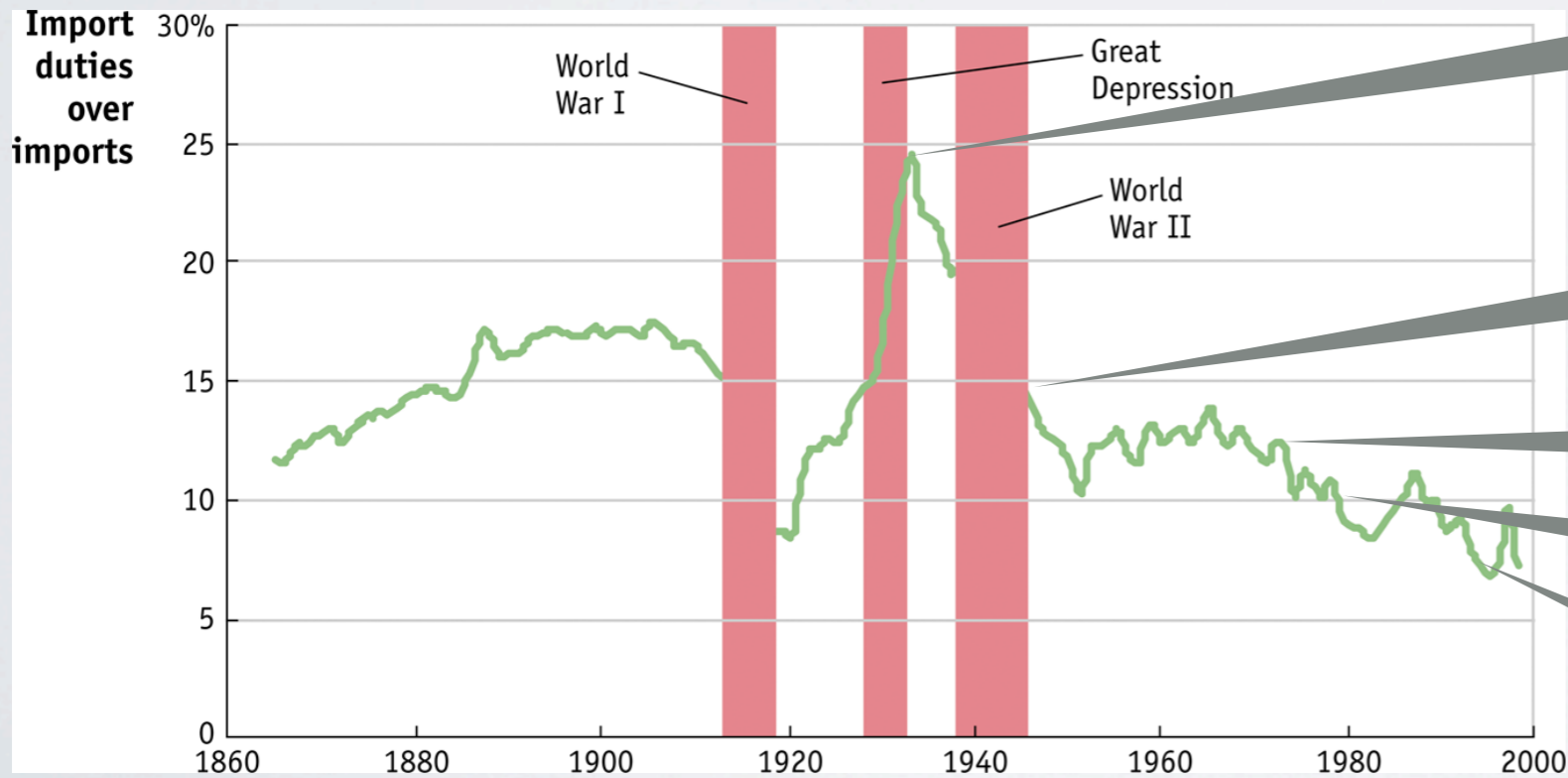
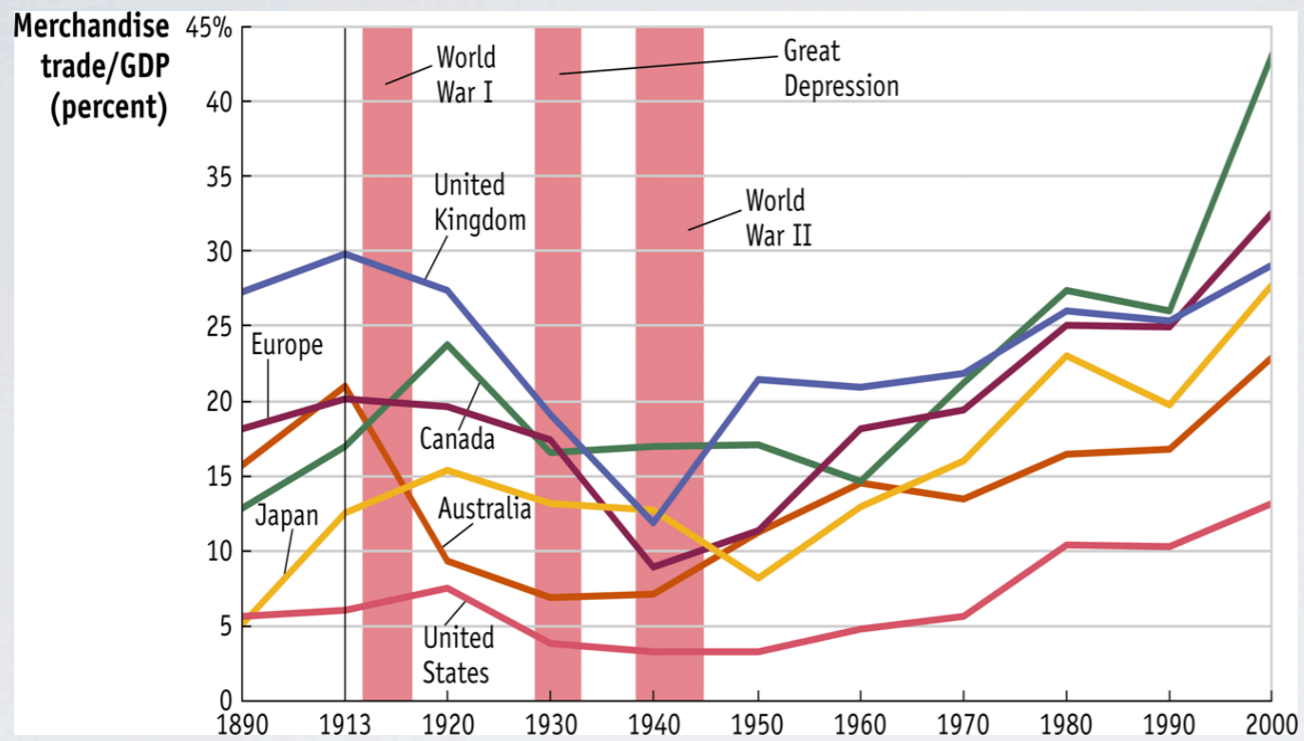
EFFECTS OF BARRIERS

- Barriers help some and hurt some and overall negative (by what metric?)
- E.g. Effects of a tariff:
 - Decline in imports
 - + Tariff Revenue
 - + Increase in production for domestic market
 - Decline in exports in case of retaliatory foreign tariffs
 - Decline in consumption
 - Higher costs by efficiency losses
 - Decreased variety of goods

REMOVING BARRIERS



WTO Members (2006)



Smoot Hawley, 1930

GATT, 1946

Kennedy Round, 1967

Tokyo Round, 1979

Uruguay Round, 1994

© 2008 Worth Publishers
International Trade
Feenstra/Taylor

HISTORY OF REMOVING BARRIERS

- Post WWII, 23 countries met in Geneva to create an international trade organization; failed but created a **General Agreement on Tariffs on Trade (GATT)**
- GATT provided opportunity for members to negotiate reduction of tariffs and other trade barriers
- Through “rounds” of discussion, tariffs among member states have continuously declined for the past 50 years

WORLD TRADE ORGANIZATION

- After the 1994 Uruguay rounds ended, the member states (100+) agreed to the creation of the **World Trade Organization (WTO)**
- Conditions of membership: non-discrimination in trade practice
 - Most Favored Nation - trade conditions (barriers) offered to one member country must be offered to all
 - Exception is for free trade areas (NAFTA, EU) that are allowed to decrease barriers among members more than the WTO agreed-upon levels
 - National Treatment - foreign goods cannot be subject to requirements (health, etc.) different from domestic goods
- Problems occur, typically with the second condition; e.g. environmental considerations and health considerations are typically used as a form of trade barrier

WORLD TRADE ORGANIZATION

- Unique component of WTO is the court system:
 - In case of a trade dispute, one country can take another to the WTO court
 - If guilty, the offender must pay compensation and repeal the offending law
 - Sometimes seen as a way for wealthier countries to take advantage of poorer countries (US has much better trade lawyers than Antigua)
- Unlike many international organizations, the decision of the courts are binding

CURRENT EVENTS: WTO

- Only one round has begun since the WTO was created
 - Doha rounds began in 2001
 - Still ongoing and many believe will not be successful
 - Current dispute based on lower income countries that want wealthier countries to eliminate subsidies to agricultural production
 - Also want reform of the WTO system to give smaller countries more of a voice in the system

COSTS OF FREE TRADE

- Free trade improves overall welfare but there are segments that lose
- Opposition to low wages internationally, poor work standards, child labor
- WTO makes no judgment on these standards, environmental, health, etc.



Doha Round, Seattle Protests

COSTS OF FREE TRADE

- Protestors typically stand for moral position or in interests of developing country
- From WTO perspective, economic growth is the best way to achieve living standards and eventually improve environmental conditions

REVIEW

- Small countries are typically defined by their inability to affect world prices
- Trade unambiguously improves national welfare but there are winners and losers
- These segments of society typically lobby government to induce trade protections, usually in the form of tariffs or quotas
- Since the introduction of the GATT, tariff barriers have been on the decline among member nations, though other barriers still exist to control trade flows