INT'L TRADE
FEENSTRA X TAYLOR
CHAP. 7
nos 1, 5, 13.

1) Key provisions of the GATT

a) According to the MFN principle, the tariff applied to other countries should not be higher. And if another country has a lower tariff, then the MFN principle is violated.

The MFN principle is respected with a uniform tariff applied to all countries.

b) The creation of a free-trade area or customs union will by definition lead to lower tariffs applied between members than non-members. It thus violates the MFN principle.

c) Article XI clearly prohibits the use of import quotas.

An exception has been the Multi-Fiber Arrangement instituted in 1974 to be phased out in 2005. The MFA was meant to protect textile and apparel producers in developed countries like Canada and the USA.

5) a) The optimal tariff t^* is given by the following formula:

$$t^* = \frac{1}{E_X^*}$$

where E_X^* is the "elasticity of foreign export supply". We thus have:

$$\lim_{E_X^* \to +\infty} t^* = 0 .$$

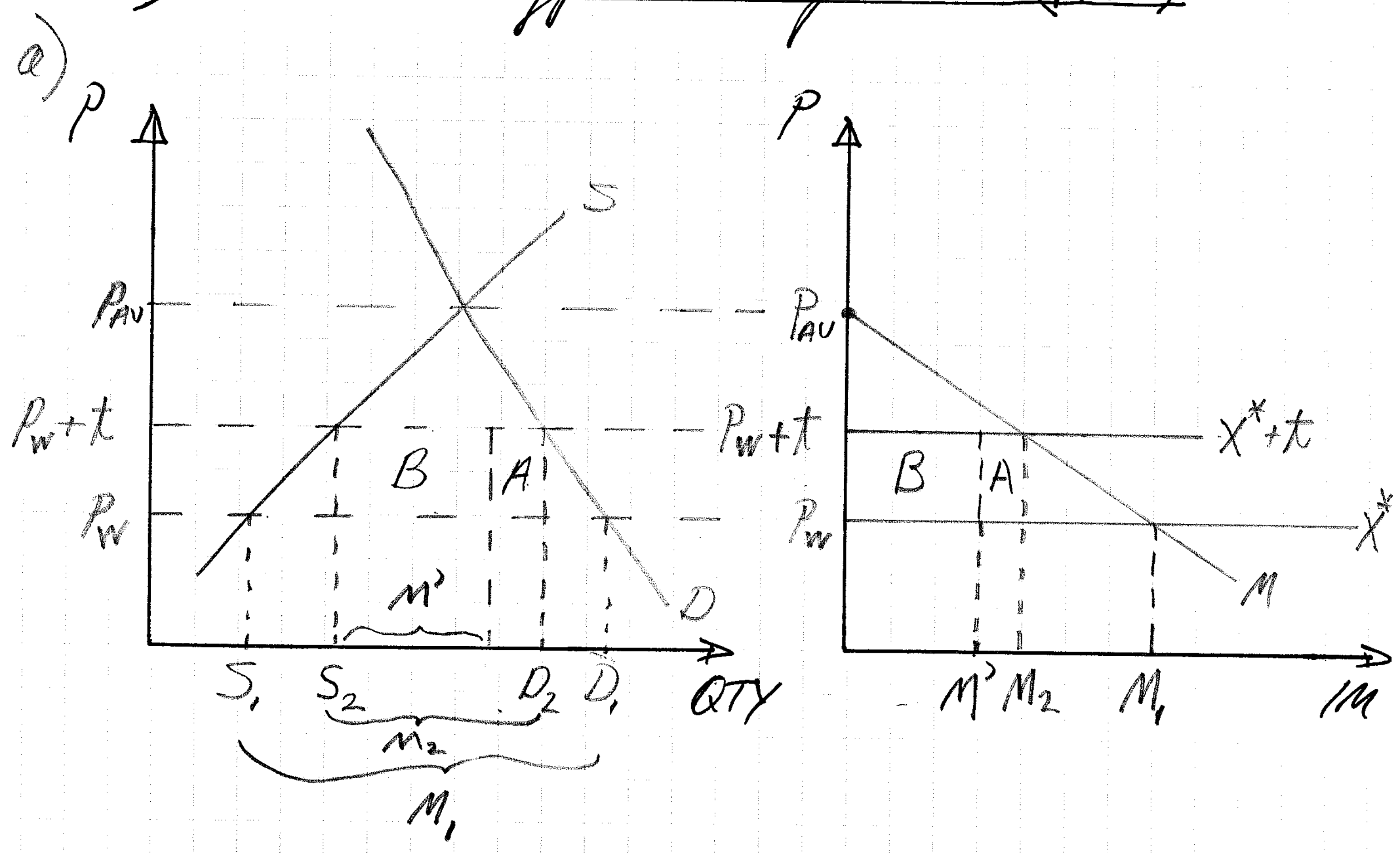
This result is due to the fact that when $E_X^* \to +\infty$, there is no terms-of-trade gain that stems from the imposition of a tariff, i.e. we are in the "small-country" framework.

b) The formula is given above.

c) If $t > t^*$, then welfare will be lower than the maximum at t^*. If t is much larger than t^*, then the welfare level will eventually fall below the free-trade level. It could eventually completely shut down imports of the good in question.

13) The "tariff-rate quota" (TRQ):

a)



We assume that the tariff level t is such that $M_2 > M'$, which means that the demand for imports is still positive once the quota has been satisfied.

The tariff revenue collected is given by rectangle A which equals $(M_2 - M') \cdot t$.

The rectangle of quota rents is given by rectangle $B = t \cdot M'$.

In this scenario, quota rents are effectively transferring some of the tax revenues to whoever holds the quota.

b) The effect on Home welfare depends on who holds the quota.

If the quota is given to some Home importers, then they will collect the quota rents at Home and the Home welfare effect is identical to the standard tariff case. The same applies if quotas are auctioned off to Home firms.

If the quotas are simply imposed on Foreign producers, who can then sell at Home at a higher price, then Foreign firms collect the quota rents and Home welfare is lower than under the standard tariff case.

A third possibility is that quotas are given to Home firms but their value is dissipated by rent seeking activities. In that case, Home welfare is again lower with the TRQ than a standard tariff.

c) The TRQ offers a way to <u>share the rents</u> from a higher price between the Home country and the Foreign producers, assuming that Foreign producers collect the quota rents. This sharing may make it more politically acceptable to Foreign countries.