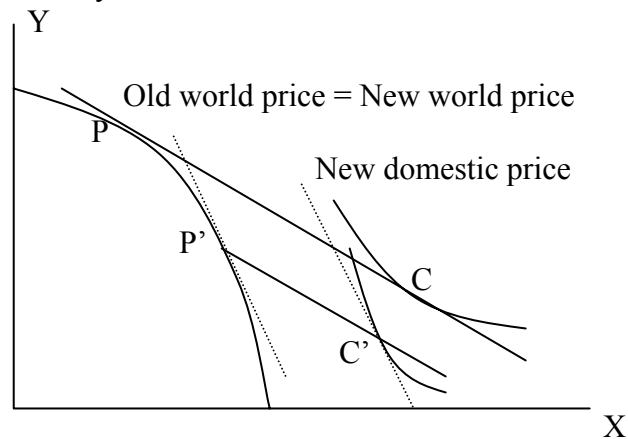


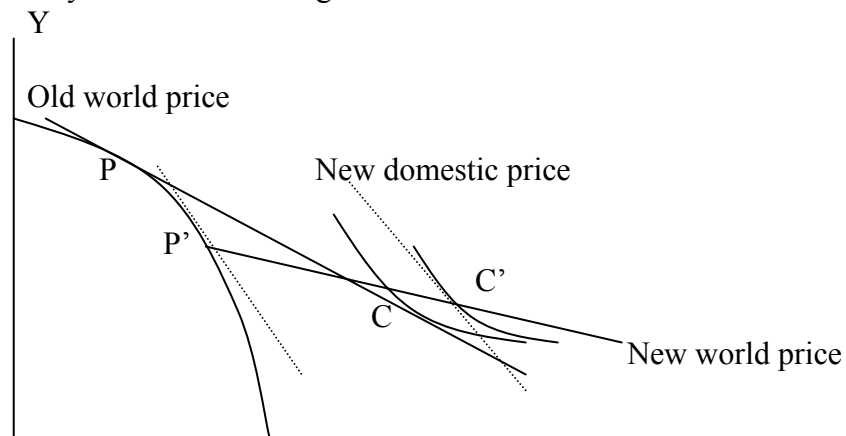
SECTION 4
February 6, 2003

• **General equilibrium presentation of tariff protection**

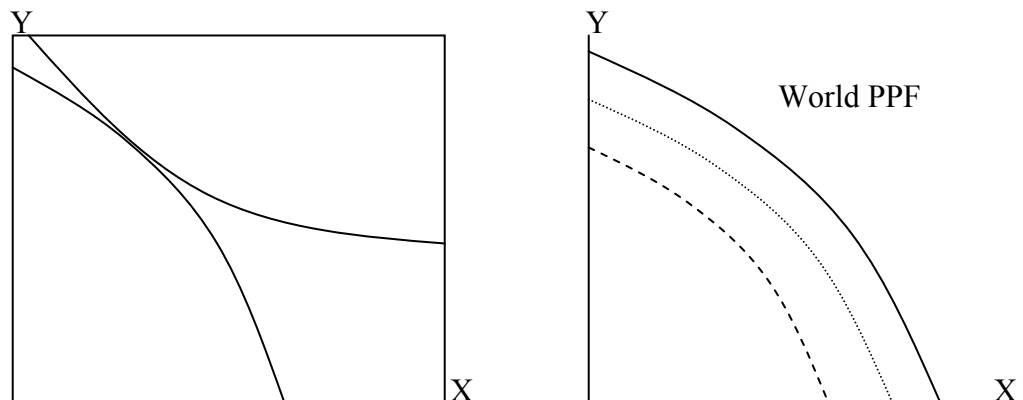
(i) Small country



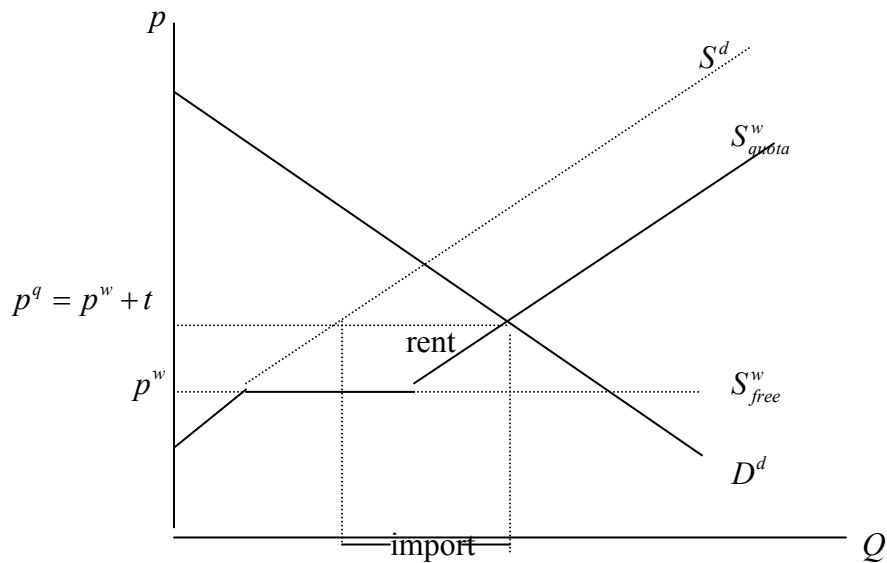
(ii) Big country – Terms-of-trade gain



(iii) Trade war – World PPF shrinks.



- **Tariff-and-quota equivalence theory** (Partial equilibrium representation)

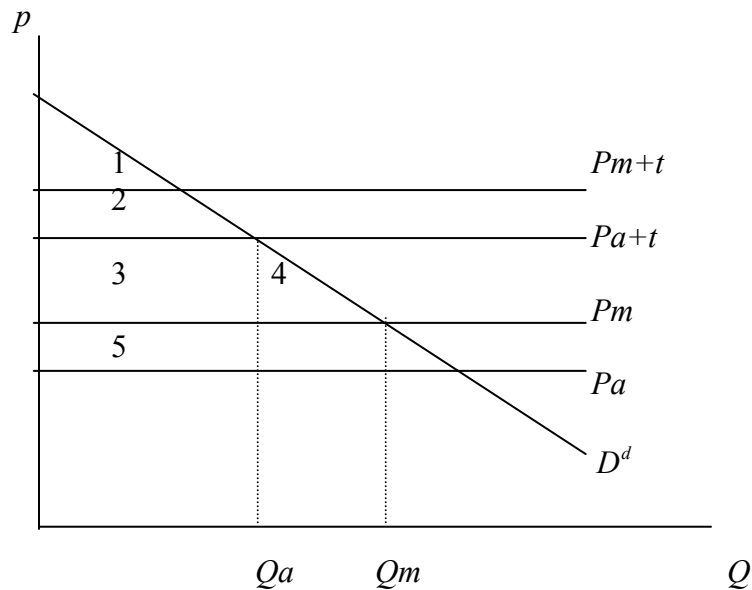


Assumption: Technology is constant-return-to-scale.

- (i) Tariff revenue = Quota rent
- (ii) Domestic price under quota = Domestic price under tariff

- **Welfare analysis of free trade area**

Home country = the U.S. , m = Mexico, a = Argentina



- **Welfare comparison -**

	Pre-NAFTA	Post-NAFTA
CS	area 1+2	area 1+2+3+4
Tariff revenue	area 3+5	zero

Welfare change = 4 – 5

“Trade creation” = 4 vs. 5 = “Trade diversion”