

## Homework 3

due: Tuesday, October 14, in class

**Problem 1:** The state of Illinois, desperate for cash, is considering new ways of raising revenue (ultimately to finance the U of I).

- a) One possibility under consideration is a tariff on car imports (into IL). Suppose IL is a “small country”. Show how the tariff affects domestic price and quantities (produced/consumed/imported) and how it affects different domestic groups as well as the state as a whole.
- b) How would your answers from a) change if IL was a “large country”. First show how the imposition of the tariff changes the outside price of a car. Then repeat a). Finally, explain how to find the optimal tariff that maximizes IL welfare.
- c) Having exhausted possibilities on the import side, the state governor turns to the export side. Analyze how an export tax on corn affects IL welfare? Should he consider an export subsidy?

### **Problem 2:**

- a) Depict/explain the prisoners’ dilemma inherent in tit-for-tat protection. How does this provide a *raison d’être* for the GATT/WTO process?
- b) Research the latest round of trade negotiations, the so-called Doha round. List at least three policy areas under discussion and identify the opposing views of different (groups of) countries on each of these issues.
- c) Explain the trade creation and trade diversion effects of regional trade agreements (feel free to use diagrams to make your point). Why is there a tension between these regional agreements and the basic principles of the GATT/WTO?