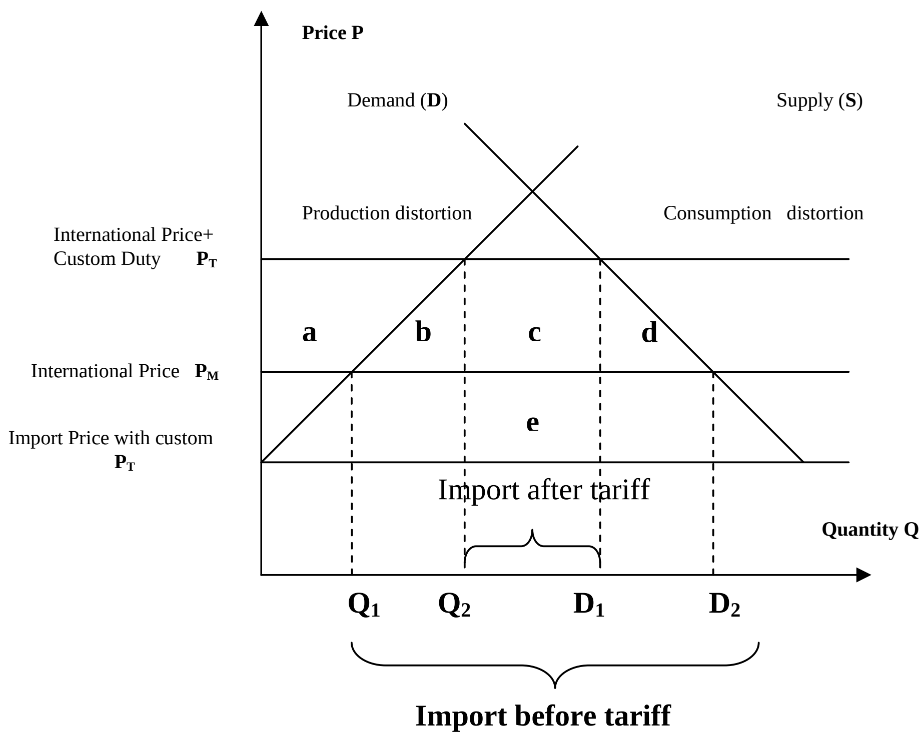
COMMERCIAL POLICY SCIENCE

1. **Free Trade Case**
2. **Protectionism (Protective Tariff) Case**

1. Free Trade Case

a.) The incidence of the custom duty



A custom duty increases domestic production from Q_1 to Q_2, encouraging the producer, while the domestic consumption is decreasing from D_2 to D_1, disadvantaging the consumer. There is also a third player, the government, which gains from the collecting of custom duties.

What is the sold?

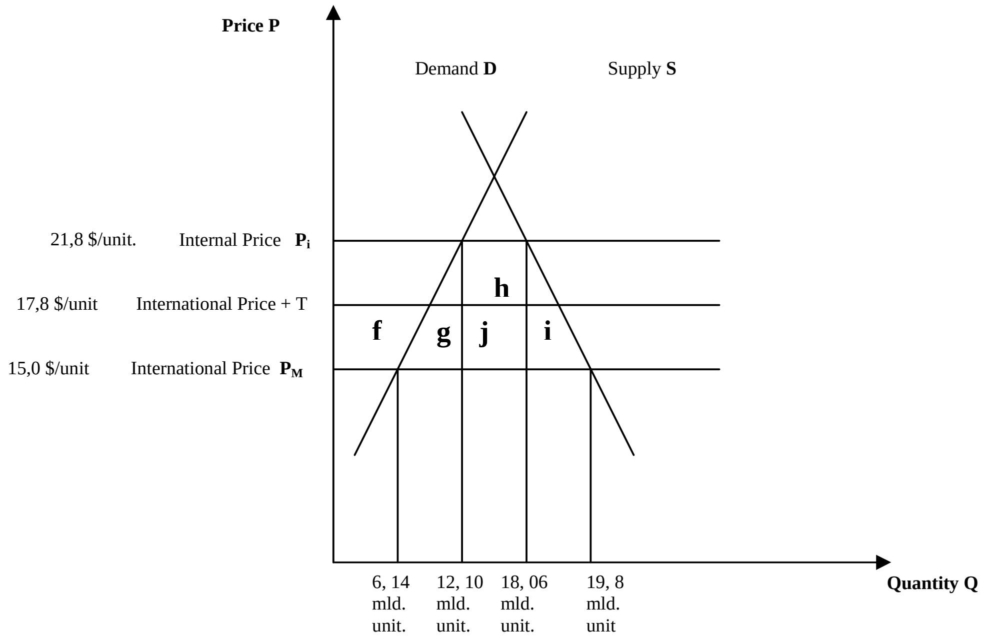
Producer gain= a+b+c+d;

Consumer loss= a;

Government revenue/income= c+e;

Net cost of the tariff = Producer gain - Consumer loss - Government revenue = a+b+c+d - a – (c+e) = b + d = e

b.) ***The incidence of the quantitative restriction***



A quantitative restriction (an import contingent) limits import to a certain quantity or value. In general lines, it has the same effects as a custom duty.

In the previous example, the internal price of the import country (P_i) is bigger then the international price (P_M).

The effect of the introduction of the quantitative restriction is illustrated by 5 areas.

Producer gain = f

Consumer loss = f + g + h + i + j

Government gain = f, because of the collection of custom duty

Net effect of the quantitative restriction introduction is a loss = (f + g + h + i + j) – f – i = j + h

Import contingent increases production and internal prices and generates supplementary revenues for foreigners that gain the right to export in the country that had introduced the contingent.

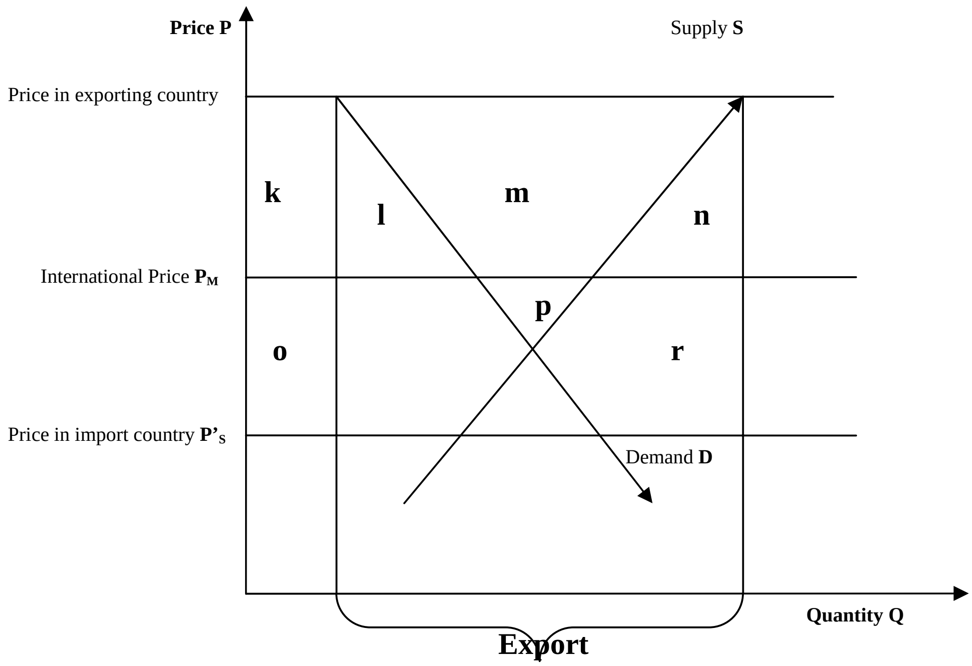
A free trade brings supplementary *advantages*:

- a free trade allows concentration of production in big plants, with big serial productions;

- a free trade offers entrepreneurs the stimulant of competing for exports and with imports, to learn and innovate, especially when trade is “directional”, when state enforces the structure of imports and exports.

- the third advantage is a general one, offering government the possibility of making a distinction between the interests of persons, promoting an equity chance policy for everybody, while in conditions of protection, it can be itself prisoner of some groups of interests.

c.) ***The incidence of the subsidy***



When governs give subsidiaries, producers will export products until internal price overtakes external price with the volume of subsidiaries. The effects of an export subsidy over prices are opposite the ones generated by the custom duty.

Price in export country increases from P_M to P'_S, but because in import country the price decreases from P_M to P_S, price increase is smaller then the subsidy.

Export country:
- Consumer loss: k, l;
- Producer gain: k, l, m;
- Govern subsidy: k, l, m, n, o, p, r;
- Net effect: l + n + o + p + r

An export subsidy brings costs that overtake the benefices.

2. Protectionism (Protective Tariff) Case

a.) **Position of monopoly** - optimal tariff
- commercial war

b.) **Market Failures** - young industries
- dual economies
- external factors

c.) Social Wellness Function - redistribution of incomes;
- incomes gathering

d.) **Economic Instability**