

Exercise Sheet 6: Commercial Policy

Exercise 1

If a large open economy can improve its terms of trade by levying a tariff, why is it not always better to keep levying higher and higher tariffs to obtain ever better terms of trade?

Exercise 2

Suppose a country is an exporter of solar panels. The government wants to increase solar panel exports and pays a subsidy on solar panel exports. That is, if firms export solar panels, they receive an additional subsidy from the government, so that the price they receive for the exports is higher than the world price of solar panels.

- a) Show the effect of an export subsidy on consumer surplus, producer surplus, government revenue, and total welfare, assuming the country introducing the subsidy is a small player in the world market for solar panels.
- b) Do the same analysis as in a), but now suppose the country introducing the subsidy is a large player in the market for solar panels. Compare the welfare losses or gains to your answer in a).

Exercise 3

Suppose a country is an exporter of wheat. The government wants to keep the domestic price for wheat below the world price. Show that this can be achieved with an export quota, i.e. a system in which the government limits the total amounts of exports of wheat. Suppose that the firms who are allowed to export can keep all the export revenue. Show the effects of such an export quota on producer surplus, consumer surplus and on total welfare.