

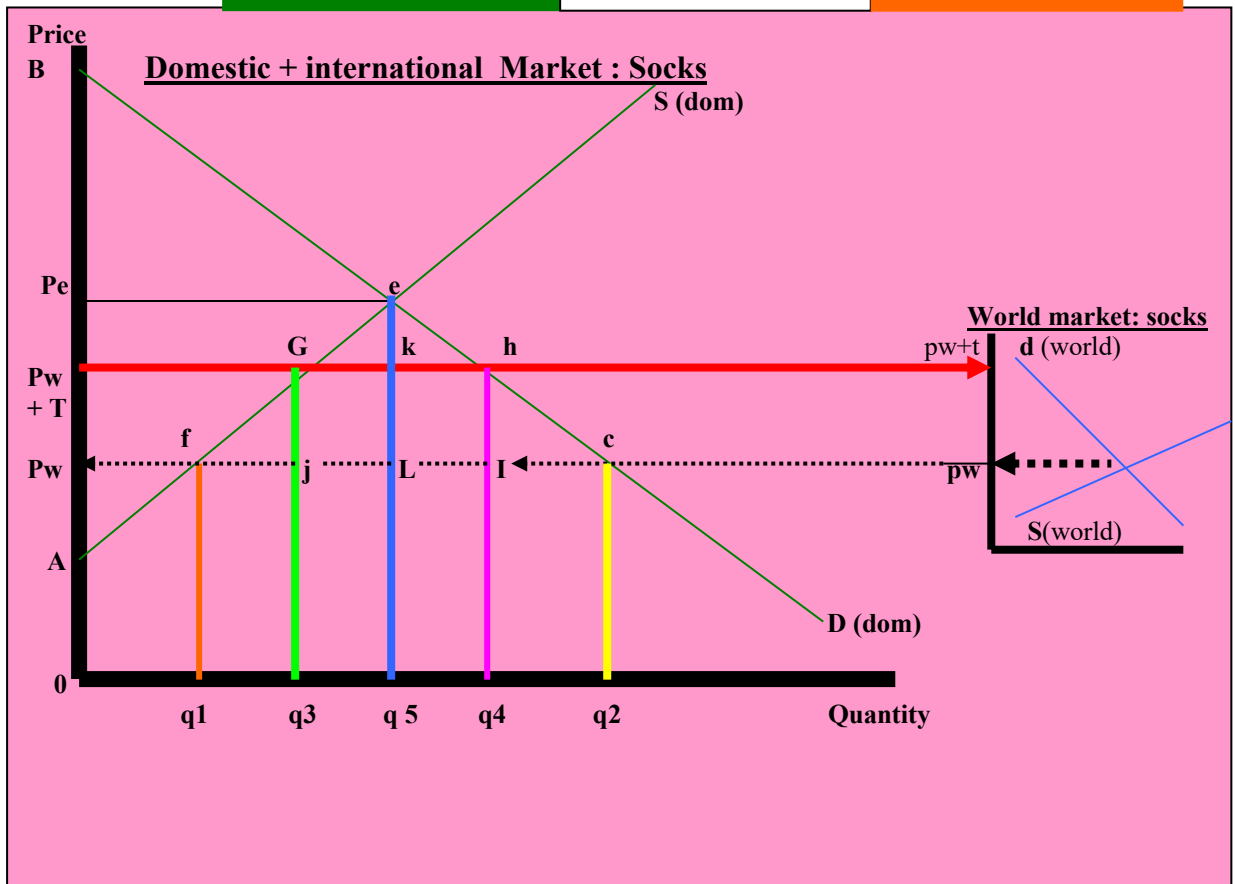
Syllabus Reference 4.2¹ Syllabus Reference 197-207

Grade weight = 4

Example i: The welfare implications of a tariff in a Closed, Protected and Free Trade

Source: Rees + Smith Economic Development pp 121-122

Type of economy:	Closed economy	Protected economy	Free Trade
Equilibrium P + Q			
Domestic consumer Surplus			
Domestic producer Surplus			
'Green' gain			
Gain for society			
Government revenue			



Note: 'green gain' refers to a better use of the resources in the World i.e. better resource allocation

1. Equilibrium P + Q
2. Domestic consumer Surplus
3. Domestic producer Surplus
4. 'Green' gain
5. Gain for society
6. Government revenue

- Task1: For each of the above (1-6) show the area for a closed economy.
- Task2: For each of the above (1-6) show the area for a protected economy.
- Task3: For each of the above (1-6) show the area for a free trade economy.
- Task 4: Show how employment increases as a result of tariff protection.
- Task 5: Show a 'deadweight loss' = loss to society, as a result of the tariff.

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Example ii: The welfare implications of a Free Trade Economy

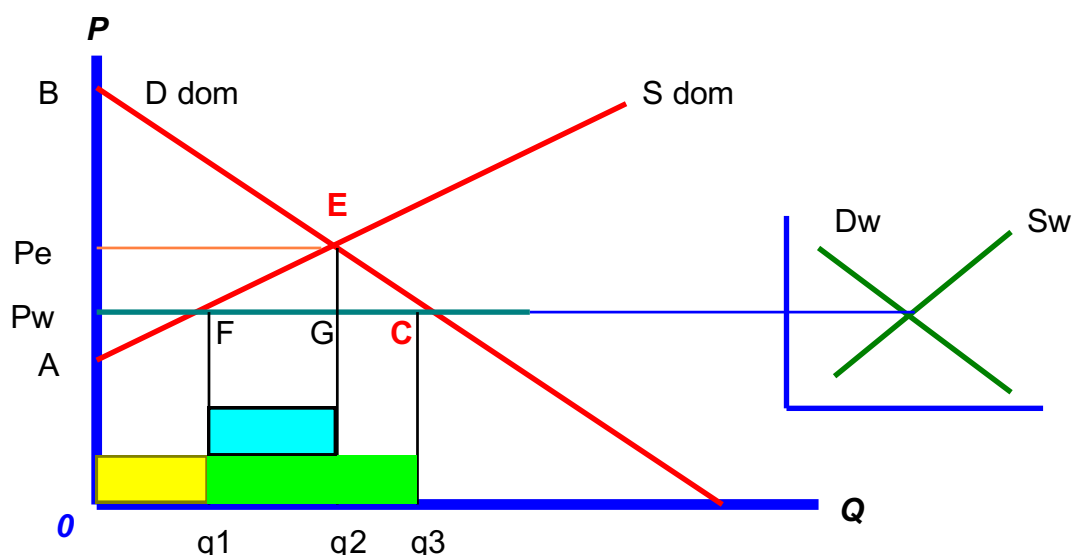
Key:

- S_{dom} = supply in the domestic market without competition from imports
- D_{dom} = domestic demand curve
- P_e = Equilibrium in the domestic market without imports
- P_w = world supply curve at world price i.e. free trade
- D_w = world demand curve
- S_w = world supply curve in the world market

Points to Note:

1. World price (P_w) is lower than P_{dom} / P_e on the assumption that the foreign

Market for socks in a LDC



producers are more efficient over some but not all of the domestic producers. This would most probably be an economies of scale problem for some domestic producers in an LDC

2. Horizontal supply curve in the domestic market as a result of the imports – see P_w S_w – suggests that the LDC is a ‘price taker’ and cannot produce quantities to influence the world price
3. The domestic producers face a serious threat as the world market can satisfy the entire domestic demand
4. Producer Surplus falls from AP_eE to AP_wF
5. Consumer Surplus rises from $PeBE$ to P_wBC
6. Wider selection of goods in domestic market and standard of living has improved because of the price fall and the selection of socks.
7. The end result is that P_w acts as a ceiling price and therefore efficiency is a must if domestic producers are to survive.ⁱ Unemployment occurs in LDC as a result of loss of production /output $q_1 - q_2$.

ⁱ $FEG = CS$ due to transfer of production abroad. $GEC =$ no win no loss area, socks are cheaper and Q_d has increased