



Trade Problem Set 110 2-1

1. Consider the following trade policy game between two small country governments, Kenya and Ethiopia. The policy choices for each government are to choose either free trade on all imports or to place a 15% tariff on all imports. The national welfare payoffs for each country when both choose free trade are given as (100, 100). The first 100 is Kenya's national welfare, the second is Ethiopia's.

(Kenya, Ethiopia)		Ethiopia	
		Free Trade	15% Tariff
Kenya	Free Trade	(100,100)	(100, 80)
	15% Tariff		

- (2) Based on the tariff analysis for a small importing country and assuming symmetry between the two countries, complete the empty two cells in the table above.
- (1) Based on the numbers you provided in (a), identify which cell corresponds to the Nash (or non-cooperative) equilibrium.
- (1) Which cell corresponds to the cooperative equilibrium?
- Yes or No? Does this game help justify a trade liberalization organization like the WTO?

