



Trade Problem Set 110 2-2

2. Suppose the US and Costa Rica (CR) are two countries among many others in the world. The US is a **large** country and thus its import tariffs will lower the price of CR's exports. Costa Rica, however is a small country, so its tariffs do not affect prices in the US. Assume the US government can choose either free trade, optimal tariffs or 20% tariffs. Costa Rica can choose either free trade, 10% tariffs or 20% tariffs on all imports. The national welfare payoffs for each country in five cases are given. The first term is the US national welfare, the second is the CR's.

(US, CR)		Costa Rica		
		Free Trade	10% tariffs	20% tariffs
US	Free Trade	(100, 20)	(100, 19)	(100, 18)
	Optimal Tariffs	(101, 18)		
	20% tariffs (> optimal)	(100, 17)		

- Use the info provided in the table to complete the four empty cells above.
- Among the nine outcomes, which would Costa Rica most prefer?
- Among the nine outcomes, which would the US most prefer?

d. Identify which cell(s) correspond(s) to a Nash (or non-cooperative) equilibrium.

e. Which cell corresponds to the cooperative equilibrium?