The welfare effects of a (partial) tariff reduction under domestic distortion

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Abstract

We use a three-sector specific factor model to examine the welfare effect of a tariff policy when an economy is subject to a domestic distortion. As has been shown in the existing literature, we analytically show that some tariff reforms are always welfare improving. However, the welfare effect of a policy reform is ambiguous in general because there are multiple distortions in the economy in question (the theory of second best). Therefore we resort to numerical analysis to understand how the welfare effect of a policy reform of our interest might be affected by different economic environments.

[**Very preliminary draft: Please do not quote**]