Globalization with Capital Integration

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Can tariffs be good?

Politicians

"Tariffs are the greatest thing ever invented."

— Donald Trump

"It opens our mines; it erects our machine shops, our furnaces, and factories."

— William McKinley

"We did it anyway. And we got over 1,000 American jobs back, right here in the United States."

— Barack Obama

Economists

"It does protect; it protects the consumer very well against one thing. It protects the consumer against low prices."

— Milton Friedman

"The fact that trade protection hurts the economy of the country that imposes it is one of the oldest but still most startling insights economics has to offer."

— Jagdish Bhagwati

"The first thing to say is that, in general, protectionism is bad."

— Paul Krugman

Approach and answer

- **Approach:** Extend Melitz (2003)–Chaney (2008)–Caliendo et al. (2023) with freely mobile capital.
- **Answer:** Unilateral tariff ↑ → capital inflow → firm entry ↑
  - Home expenditure shifts toward Home firms → expected profits ↑ → firm entry ↑ ?
  - **Without capital mobility:** Domestic factor prices ↑ → entry costs ↑ → expected profit gains fully offset → no additional entry.
  - **With capital mobility:** Capital inflows ↑ → factor cost increases mitigated → expected profit gains not fully offset → additional firm entry.
- **Answer continue:**
  - Capital inflow → labor income ↑
  - Firm entry ↑ → dampened price-index increase
  - Potential welfare ↑

Summary of counterfactual results

- 2018 Tariff Policy (in a model calibrated to 51 U.S. regions and China)
  - Model-predicted firm entry is positively associated with the observed change in the number of establishments
  - Pure wage earners: welfare ↑ in all U.S. regions.
  - Households: welfare ↑ in most U.S. regions.
  - Model-predicted household welfare gains are positively associated with the change in Republican vote share (2012–2016).
    - The 2016 Republican campaign placed substantial emphasis on trade policy toward China.
    - Voters are more likely to support policies that they expect to benefit from.

Related Literature

- Trade policy and international factor mobility
  - ◇ Mundell (1957); Kemp (1966); Jones (1967); Wong (1986)
  - ◇ Johnson (1953); Bagwell and Staiger (1999)
- Trade protection and firm location

  Venables (1985); Bagwell and Staiger (2012); Melitz and Ottaviano (2008)
- Tariff-jumping FDI

  Brainard (1993); Horstmann and Markusen (1992); Motta and Norman (1992)
- Trade shocks and welfare

  Fajgelbaum et al. (2020); Caliendo and Parro (2021); Autor et al. (2013); Caliendo et al. (2019); Galle et al. (2023)
- Trade policy and political outcomes

  Grossman and Helpman (1994); Autor et al. (2020)

Two Country Model Setup

- Two symmetric countries {H,F}
- Three inputs: labor, intermediate input and capital
  - Households earn both labor and rental income
  - Intermediate inputs use the same CES aggregate as final consumption.
- Capital is internationally mobile
- Labor can not move across country borders

Households

- Utility

$$U_n = Q_n^c = \int_{\omega \in \Omega_n} (q_n(\omega))^{\frac{\sigma-1}{\sigma}})^{\frac{\sigma}{\sigma-1}}$$

- Budget Constraint

$$\int_{\omega \in \Omega_n} p_n(\omega) q_n(\omega) d\omega \leq w_n L_n + r K_n$$

  - $K_n = \gamma_n K_0$
  - Total capital endowment, K_0, endowment share, γ_n, and total population, L_n are exogenous

- Households Demand

$$\boxed{q_n^c(\omega) = \frac{p_n(\omega)^{-\sigma}}{P_n^{1-\sigma}} (r K_n + W_n L_n)}$$

  - $P_n = \left(\int_{\omega \in \Omega_n} p_n(\omega)^{1-\sigma} \, d\omega \right)^{\frac{1}{1-\sigma}}$.

Firm

- Production function:

$$Y(\omega) = Z\left(\frac{L}{\xi}\right)^{\xi}\left(\frac{E}{\phi(1-\xi)}\right)^{\phi(1-\xi)}\left(\frac{K}{(1-\phi)(1-\xi)}\right)^{(1-\phi)(1-\xi)}$$

- Productivity follows a Pareto distribution:

$$\Pr(Z \geq z) = \left(\frac{\underline{z}}{z}\right)^{\alpha}, \qquad z \geq \underline{z}, \qquad \alpha > \sigma - 1$$

- Unit input cost:

$$c_s = {W_s}^{\xi}\left(P_s^{\phi} r^{1-\phi}\right)^{1-\xi}$$

- Cost minimization yields factor demand:
  - ◇ intermediate inputs: $q_n^p(\omega) = \frac{p_n(\omega)^{-\sigma}}{P_n^{\sigma-1}} M_n$

- Constant markup pricing:

$$p_{sn}(z) = \frac{\sigma}{\sigma - 1}\frac{c_s}{z}(1 + \tau_{sn})$$

Firm Selection and Aggregate Trade Values

- Firms serve market n if variable profits cover fixed costs, yielding the productivity cutoff:

$$z_{\min}^{sn} = \left(\frac{F_{sn}}{B_n}\right)^{\frac{1}{\sigma-1}} c_s^{\frac{\sigma}{\sigma-1}} (1+\tau_{sn})$$

- Market size of destination n:

$$B_n = \frac{W_n L_n + r K_n}{P_n^{1-\sigma}} \left(\frac{1}{\sigma}\right)^{\sigma} \left(\frac{1}{\sigma-1}\right)^{1-\sigma}$$

- Aggregate trade value:

$$V_{sn} = \frac{\sigma \alpha \underline{z}^{\alpha}}{\alpha+1-\sigma} N_s c_s^{1-\frac{\sigma\alpha}{\sigma-1}} B_n^{\frac{\alpha}{\sigma-1}} F_{sn}^{1-\frac{\alpha}{\sigma-1}} (1+\tau_{sn})^{-\alpha}$$

- Aggregate profits net of fixed costs:

$$\tilde{\pi}_{sn} = \frac{\sigma-1}{\sigma\alpha} V_{sn}$$

Equilibrium Conditions

- Free entry:

$$\frac{\sigma - 1}{\sigma \alpha} \sum_n V_{sn} = N_s F_s^E c_s$$

- Labor-market clearing:

$$W_s L_s = \xi \sum_n V_{sn}$$

- Global capital-market clearing:

$$rK_0 = (1 - \xi)(1 - \phi) \sum_{s,n} V_{sn}$$

Intermediate-input expenditure:

$$P_s E_s = \phi(1 - \xi) \sum_n V_{sn}$$

- Trade balance in country H:

$$W_H L_H + \gamma r K_0 + P_H E_H = V_{HH} + V_{FH}$$

Wage-Entry Linkage

- Free entry and labor-market clearing imply:

$$N_s = \frac{L_s}{\xi F_s^E} \frac{\sigma - 1}{\sigma \alpha} \left(\frac{W_s}{P_s^{\phi} r^{1-\phi}} \right)^{1-\xi}$$

- With labor and intermediate inputs ($\phi = 1$):

$$N_s \propto \left(\frac{W_s}{P_s} \right)^{1-\xi}$$

  - ◇ Entry moves with real wages, reinforcing the welfare effect of trade policy.

- With labor and mobile capital ($\phi = 0$):

$$N_s \propto \left(\frac{W_s}{r} \right)^{1-\xi}$$

  - ◇ Entry moves with nominal wages (rental rate as numeraire), can move in the opposite direction from welfare.

Comparative Statics: labor and intermediate inputs only ($\phi = 1$)

- Caliendo et al. (2023) setup
- When intermediate-input propagation is convergent, the qualitative effect of trade policy is standard:
  - The tariff shock propagates through prices and production costs not like snowballing
  - Tariff $\uparrow \rightarrow$ welfare $\downarrow$
  - This holds for both **bilateral** and **unilateral** tariffs

Comparative Statics: Labor and mobile capital only ($\phi = 0$)

- Let λ denote the export share.
- Bilateral tariff increase:

$$\hat{\tau}_{HF} = \hat{\tau}_{FH} = \hat{\tau} > 0$$

- Wage response:

$$\hat{W}_H = \hat{W}_F = 0$$

- Price-index response:

$$\hat{P}_H = \hat{P}_F = \lambda\hat{\tau}$$

- Welfare response: $-\lambda\hat{\tau}$
  - Same as the standard Melitz (2003)–Chaney (2008) benchmark, consistent with the sufficient-statistics result of Arkolakis et al. (2012).

Comparative Statics: Labor and mobile capital only ($\phi = 0$)

- Unilateral tariff increase:

$$\hat{\tau}_{HF} = 0, \qquad \hat{\tau}_{FH} = \hat{\tau} > 0$$

- Home wage response:

$$\hat{W}_H = \frac{\alpha\lambda(1-\lambda)}{A}\,\hat{\tau}$$

Proposition

A unilateral increase in the Home tariff raises the nominal wage in Home and lowers the nominal wage in Foreign by the same magnitude:

$$\hat{W}_H = -\hat{W}_F > 0.$$

Comparative Statics: $\phi = 1$

- Price-index response to a unilateral tariff:

$$\hat{P}_H = \underbrace{\left[\epsilon(1-\lambda)\left(1+2\lambda-\frac{1}{\sigma}\right)\xi+2\lambda^2\right]\frac{\lambda\hat{\tau}}{A}}_{\substack{\text{Conventional}\\ \text{price effect}}} - \underbrace{\frac{\lambda\hat{N}_H}{\alpha(1-\lambda)}}_{\text{Entry effect}}$$

$$\hat{N}_H = (1-\xi)\hat{W}_H$$

Proposition

There exists a unique $\xi^* \in (0,1)$ such that

$$\hat{P}_H \begin{cases} < 0, & \xi < \xi^*, \\ = 0, & \xi = \xi^*, \\ > 0, & \xi > \xi^*. \end{cases}$$

proposition

Comparative Statics: $\phi = 1$

- welfare change:

$$\widehat{\text{welfare}} = \frac{W_H L_H}{W_H L_H + r K_H} \hat{W}_H - \hat{P}_H = \xi \hat{W}_H - \hat{P}_H$$

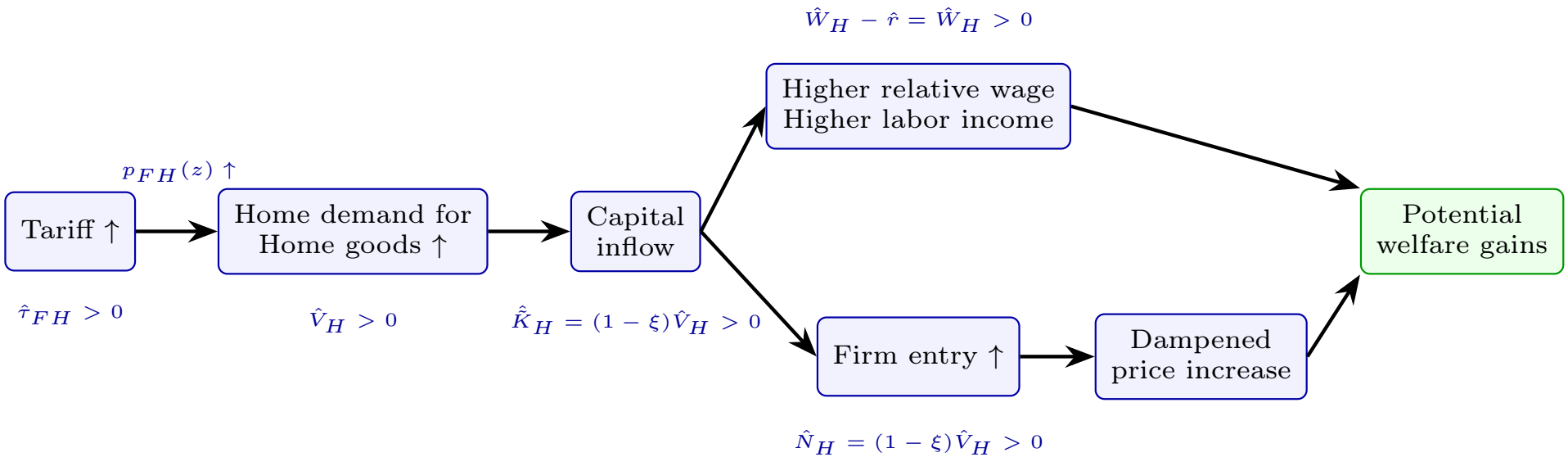
Corollary

A welfare gain from a unilateral increase in trade costs requires a weaker condition on ξ than a decline in the Home price index. There exists a unique $\xi^{**} > \xi^{*}$ such that

$$\hat{P}_H \begin{cases} < \xi \hat{W}_H, & \xi < \xi^{**}, \\ = \xi \hat{W}_H, & \xi = \xi^{**}, \\ > \xi \hat{W}_H, & \xi > \xi^{**}. \end{cases}$$

Hence, for $\xi \in (\xi^{*}, \xi^{**})$, household welfare rises even though the Home price index rises.

Summary



$$\hat{P}_H = \underbrace{\left[\epsilon(1-\lambda)\left(1+2\lambda-\frac{1}{\sigma}\right)\xi+2\lambda^2\right]\frac{\lambda\hat{\tau}}{A}}_{\text{conventional price effect}} - \underbrace{\frac{\lambda\hat{N}_H}{\alpha(1-\lambda)}}_{\text{entry effect}}$$

Multi-Region Model: Exact Hat Algebra

- Extend the model to 51 U.S. regions and China. Define $\hat{X} \equiv X'/X$.
- Bilateral trade values:

$$\hat{V}_{sn} = \hat{N}_s \hat{B}_n^{\frac{\alpha}{\sigma-1}} \left(\hat{W}_s^{\xi} \hat{P}_s^{(1-\xi)\phi} \right)^{1-\epsilon} \widehat{(1+\tau_{sn})}^{-\alpha}$$

- Equilibrium firm entry:

$$\hat{N}_s = \hat{W}_s^{1-\xi} \hat{P}_s^{-\phi(1-\xi)}$$

- Solve for regional wages and price indices:

$$\hat{\boldsymbol{W}},\ \hat{\boldsymbol{P}} \in \mathbb{R}^{52}$$

- Equilibrium conditions:

$$\text{Labor markets:} \quad \sum_n V_{sn} \hat{W}_s = \sum_n V_{sn} \hat{V}_{sn}$$

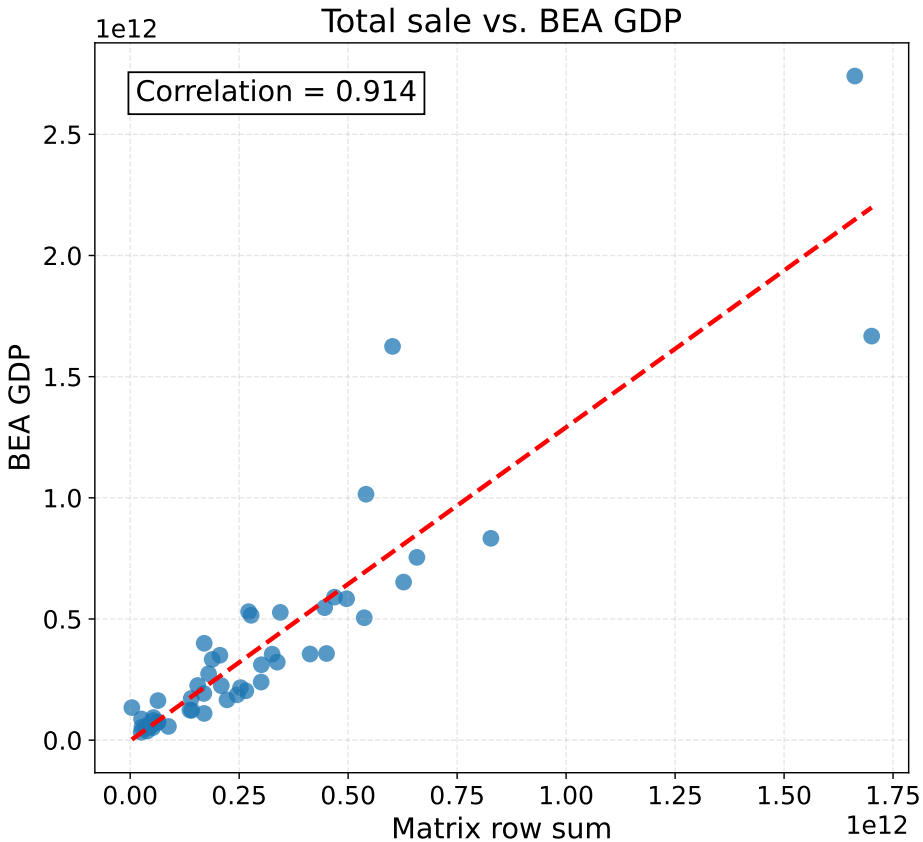
$$\text{Expenditure balance:} \quad (\xi + \phi(1-\xi)) \sum_n V_{sn} \hat{W}_s + \gamma_s r K_0 = \sum_k V_{ks} \hat{V}_{ks}$$

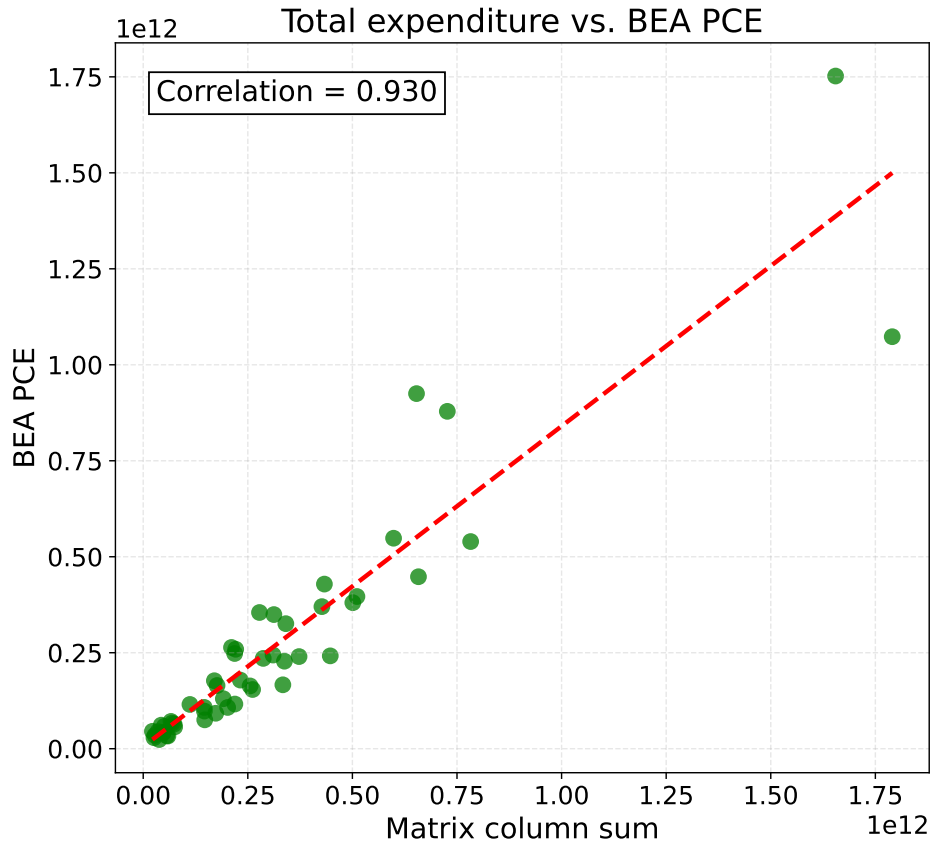
$$\text{Global capital market:} \quad r K_0 = (1-\xi)(1-\phi) \sum_s \sum_n V_{sn} \hat{W}_s$$

Multi-Region Calibration

- Assume that the world has 52 regions
  - 50 U.S states + Washingtong D.C + China
- Construct a 52 by 52 trade matrix V:
  - Freight Analysis Framework provides 2017 state-to-state trade data
  - USATrade online provides 2017 state-wise import and export data
  - Impute Chinese domestic sales using the GDP ratio between the U.S. and China
- Trade matrix moments:
  - Row sums (total sales): Benchmarked against regional GDP
  - Column sums (total purchases): Benchmarked against regional PCE

Constructed matrix moments versus BEA-reported regional values (2017)





include China

Calibration Strategy

- **Parameters**

Parameter	Value	Source
Elasticity of substitution, σ	4	Melitz and Redding (2015)
Pareto shape, α	4.25	Melitz and Redding (2015)
Labor share, ξ	0.31	U.S. Bureau of Economic Analysis (2017)
Intermediate-input share, ϕ	0.64	U.S. Bureau of Economic Analysis (2017)

- **Capital ownership shares** from equilibrium conditions:

$$\gamma_S = \frac{\text{Total purchase} - (\xi + \phi(1-\xi))\text{Total sale}}{(1-\xi)(1-\phi)\text{World total sale}}. \tag{1}$$

- **2018 tariff shocks** (2017 WITS tariffs: U.S. 3%, China 8%)

$$\widehat{1+\tau}_{\text{US,CHN}} = \frac{1.21}{1.03} \approx 1.17, \qquad \widehat{1+\tau}_{\text{CHN,US}} = \frac{1.19}{1.08} \approx 1.1.$$

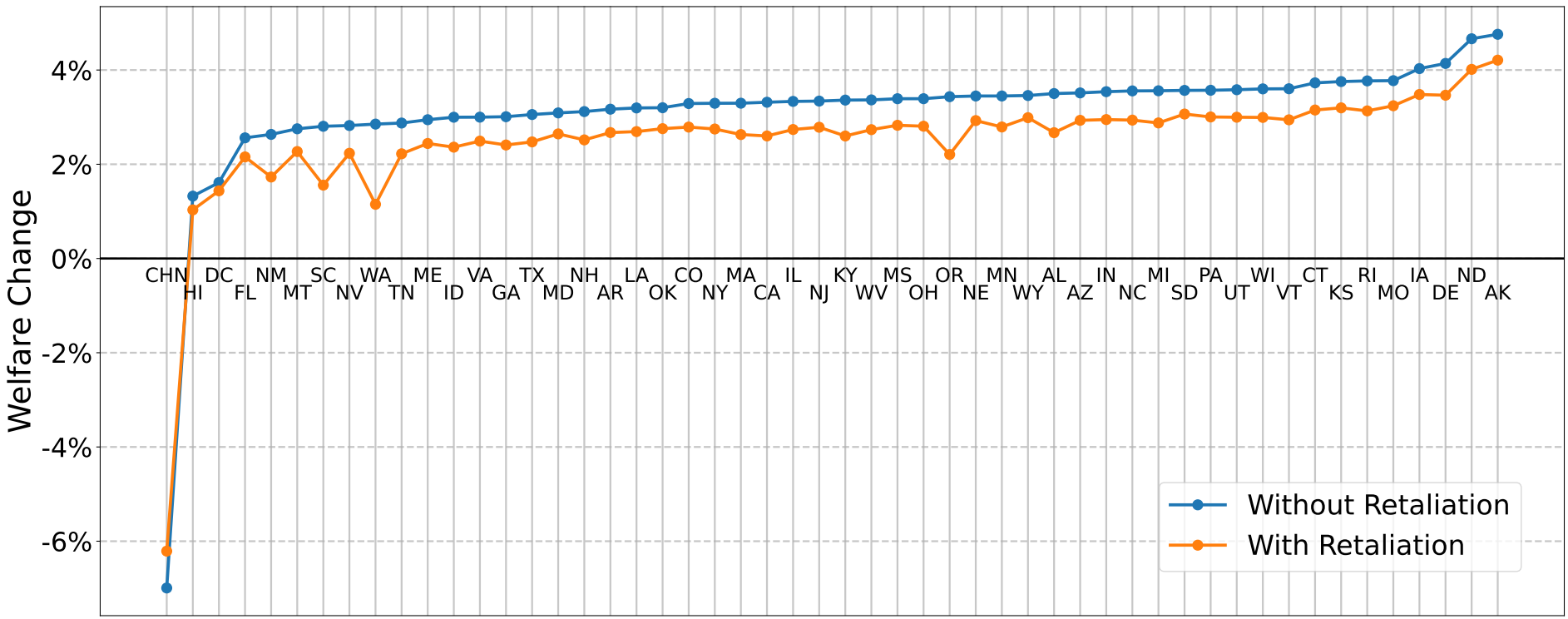
Model-Predicted Firm Entry and Establishment Growth

- $\hat{N}_{yr} = \dfrac{N_{yr} - N_{2017}}{N_{2017}} \times 100$ (CBP data). $\hat{N}_{\text{model}} = (\hat{N} - 1) \times 100$.

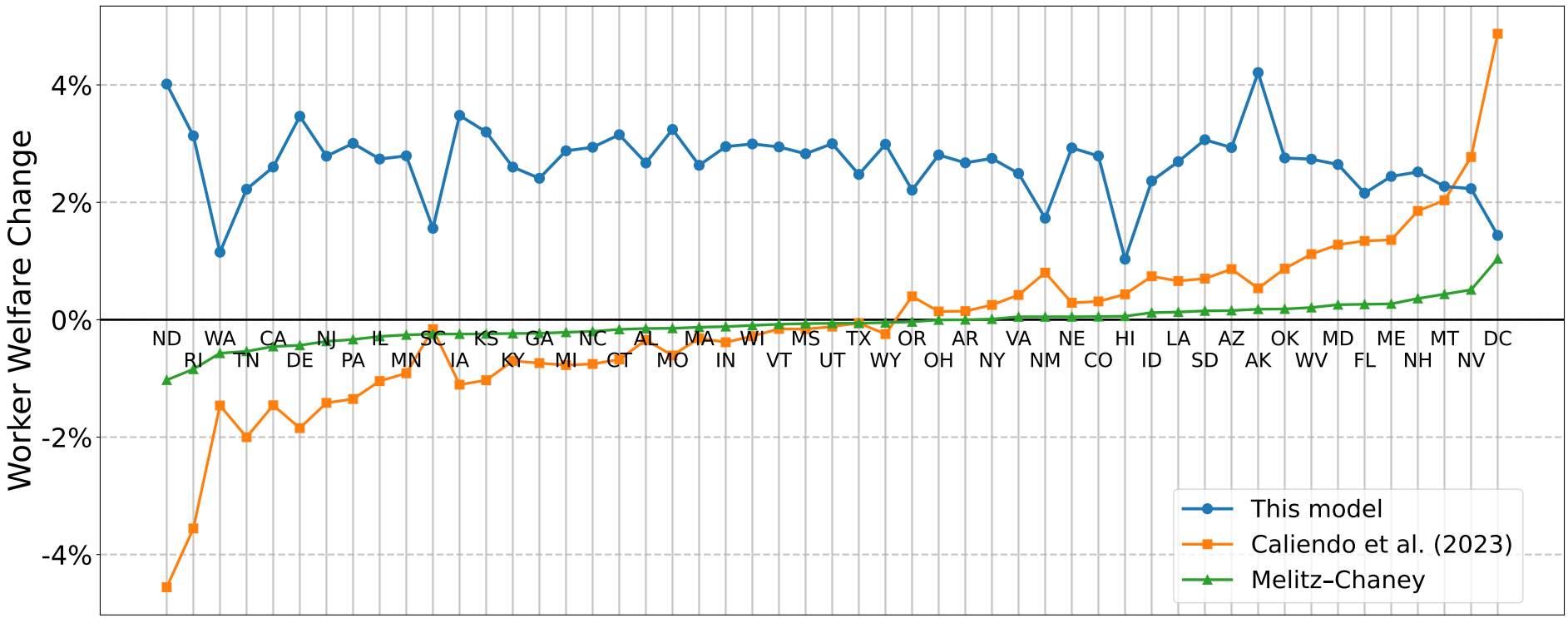
	(1) $\hat{N}_{2018}$	(2) $\hat{N}_{2019}$	(3) $\hat{N}_{2020}$	(4) $\hat{N}_{2021}$	(5) $\hat{N}_{2022}$
$\hat{N}_{\text{model}}$	0.121	0.279*	0.682	1.316**	1.732*
	(0.167)	(0.168)	(0.550)	(0.646)	(0.916)
Population growth	0.328	0.289	0.529***	0.854***	0.996***
	(0.311)	(0.227)	(0.200)	(0.182)	(0.193)
Pre-trend	0.196***	0.370***	0.567***	0.637***	0.621***
	(0.054)	(0.056)	(0.105)	(0.139)	(0.206)
Constant	-0.828**	-1.605***	-3.498***	-4.224***	-4.090*
	(0.363)	(0.425)	(1.309)	(1.578)	(2.380)
Observations	51	51	51	51	51
R-squared	0.699	0.824	0.793	0.823	0.841

Controls Comparison

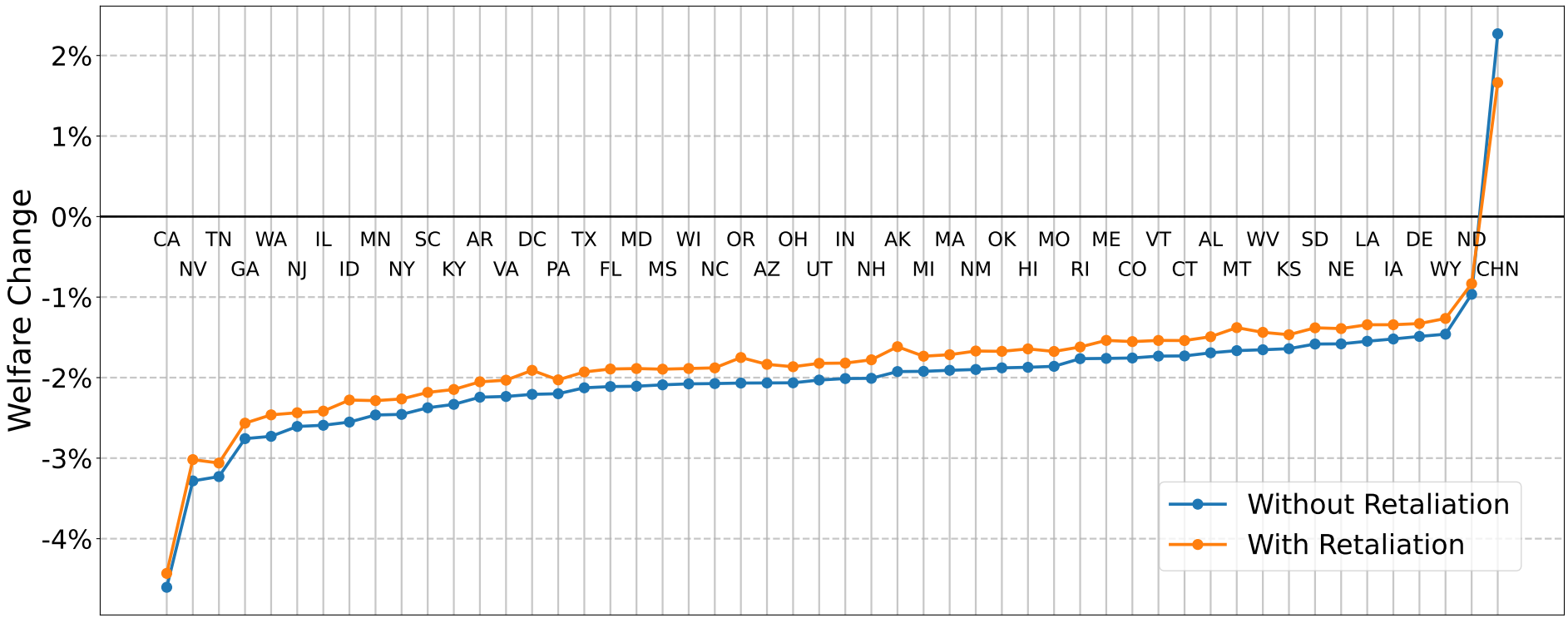
Workers' welfare effects of 2018 tariff policy.



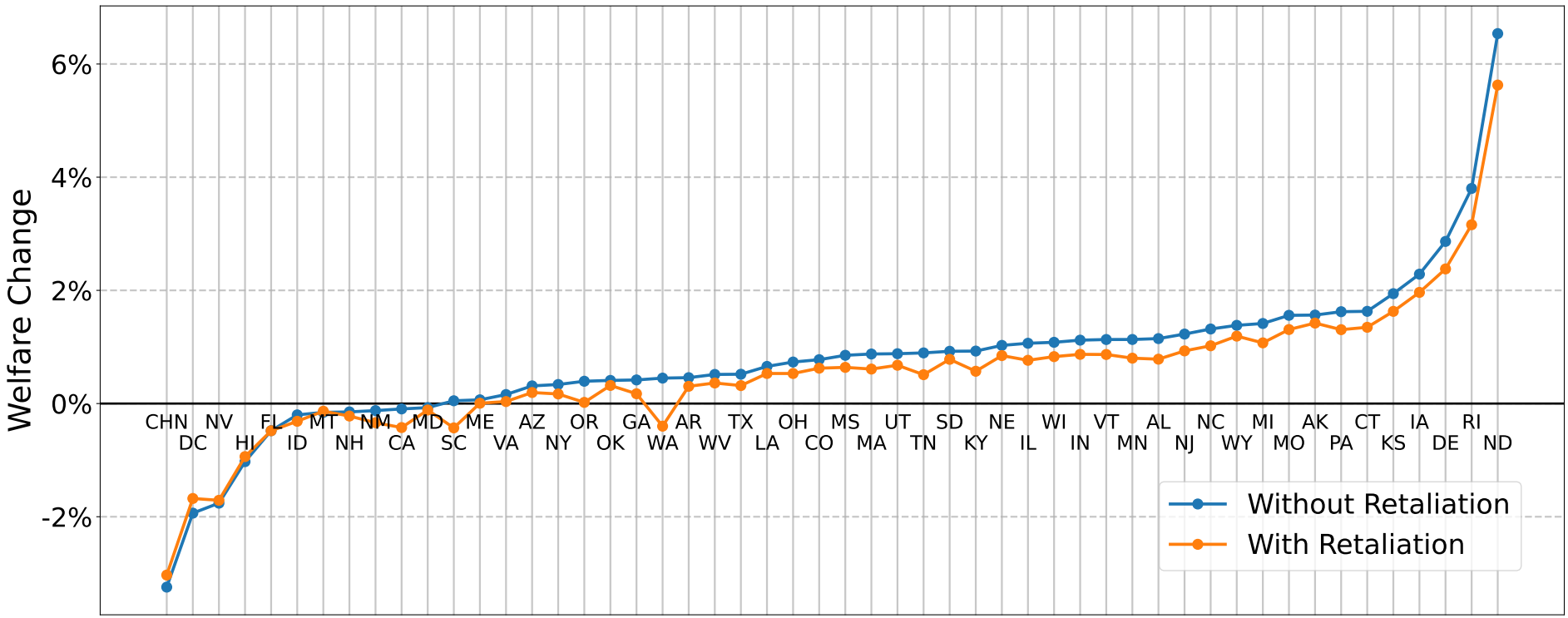
Workers' welfare effects of 2018 tariff policy: compare with Caliendo et al (2023) and Melitz-Chaney setup



Capital Holders' Welfare Effects of the 2018 Tariff Policy



Household Welfare Effects of the 2018 Tariff Policy



target

Republican Vote Share Change (2016–2012) vs. Model-Predicted State Welfare

	(1)	(2)	(3)	(4)	(5)	(6)
%Δ HH welfare	0.876***					
	(0.228)					
%Δ HH welfare (retaliation)		1.028***				
		(0.259)				
$\phi = 1$: %Δ Worker welfare			-0.156*			
			(0.085)			
$\phi = 1$: %Δ Worker welfare (retaliation)				-0.461		
				(0.281)		
$\phi = 0$: %Δ HH welfare					2.632***	
					(0.871)	
$\phi = 0$: %Δ HH welfare (retaliation)						3.118***
						(1.051)
Constant	-1.351*	-1.234*	-0.588	-0.659	0.378	0.273
	(0.706)	(0.683)	(0.678)	(0.676)	(0.752)	(0.760)
Observations	51	51	51	51	51	51
R-squared	0.054	0.059	0.022	0.020	0.053	0.054

Notes: Robust standard errors in parentheses, computed using the HC3 estimator.

$^{*}p < 0.10$, $^{**}p < 0.05$, $^{***}p < 0.01$.

2020-2016 2024-2020

Conclusion

- Trade protection help countries compete for the mobile factor
  - more mobile productive factors expand the resources available for domestic production and encourage firm entry.
- The mechanism extends beyond tariffs: any policy that induces factor inflows can generate similar effects.
- The mobile factor need not be capital.
  - With labor mobility, inflows bring both productive capacity and consumption demand, potentially amplifying the effects found here with capital mobility.

Literature Review: why tariff usually lower welfare before

- GE trade model (immobile factor):
  - ↑ Tariff $\Longrightarrow$ varieties ↓ ($\equiv$ ↑ price index $\equiv$ welfare ↓)
  - Armington (1969)
- GE trade model with mobile factor:
  - ↑ tariff $\Longrightarrow$ capital inflow $\Longrightarrow$ domestic production ↑ (intensive margin)
  - Domestic price index ↑↑ due to greater access to foreign varieties.
  - Welfare ↓
  - (Boulhol 2009) (Kleinman et al. 2023)
- GE trade model with heterogeneous firms:
  - ↑ tariff $\Longrightarrow$ ↓ welfare through ↓ varieties ($\equiv$ ↑ price index)
  - Extra cost: ↓ average productivity for firms
  - (Melitz 2003) (Chaney 2008) (Bernard, Redding & Schott 2007)
- This paper: Added **extensive margin** channel
  - Asymmetric tariff ↑ $\Longrightarrow$ capital inflow
  - Average cost of firm entry ↓ $\Longrightarrow$ firms enter $\Longrightarrow$ domestic variety ↑

Back

Production with labor and intermediate inputs only ($\phi = 1$)

- Let λ denote the import expenditure share.
- Home wage as numeraire:

$$\widehat{\text{Welfare}}_H = -\hat{P}_H$$

- Bilateral tariff increase:

$$\hat{\tau}_{HF} = \hat{\tau}_{FH} = \hat{\tau} > 0$$

- Price-index response:

$$\hat{P}_H = \lambda\hat{\tau} + \underbrace{\frac{\sigma}{\sigma - 1}(1 - \xi)}_{\beta} \hat{P}_H = \frac{\lambda\hat{\tau}}{1 - \beta}$$

Proposition

If the intermediate-input feedback is convergent, $\beta < 1$, then a bilateral tariff increase raises the domestic price index and thus decreases welfare.

Back

Comparative Statics: Labor and intermediate inputs only ($\phi = 1$)

- Unilateral tariff increase:

$$\hat{\tau}_{HF} = 0, \qquad \hat{\tau}_{FH} = \hat{\tau} > 0$$

- Price-index response:

$$\hat{P}_H = \frac{1}{1-\beta}\frac{B}{A}\lambda\hat{\tau}$$

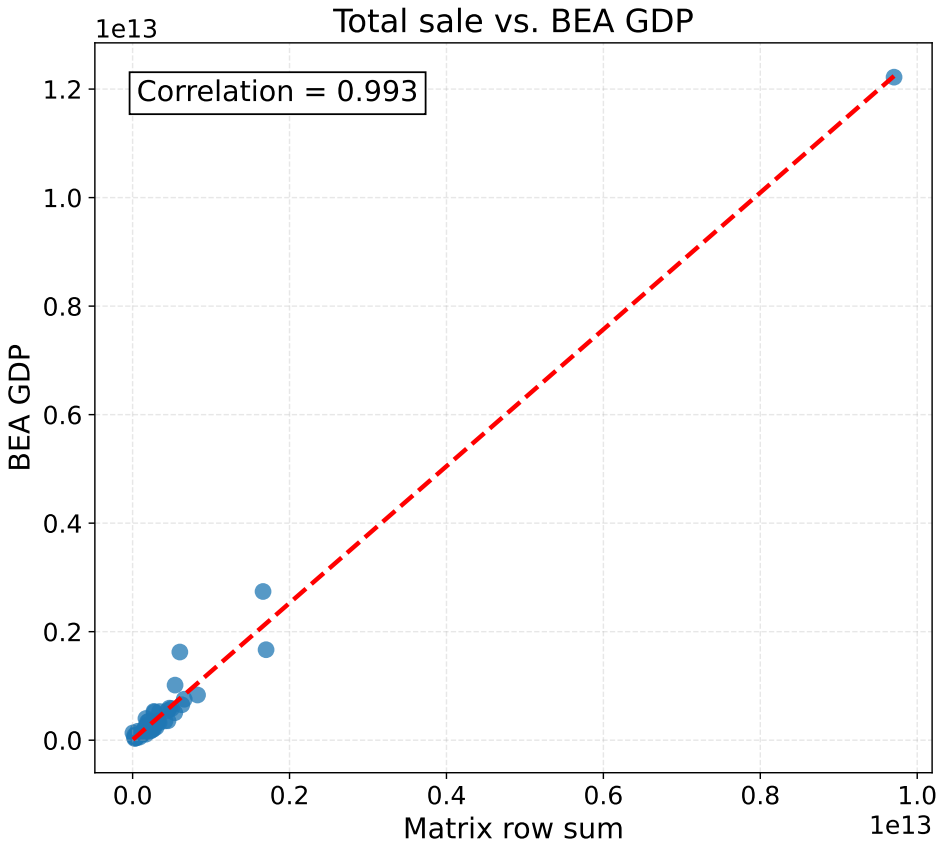
$$A = (\sigma-1)(1-\beta)\Big[\frac{\sigma\alpha}{\sigma-1}2(1-\lambda)-1\Big] + 2\lambda(\sigma-1)$$

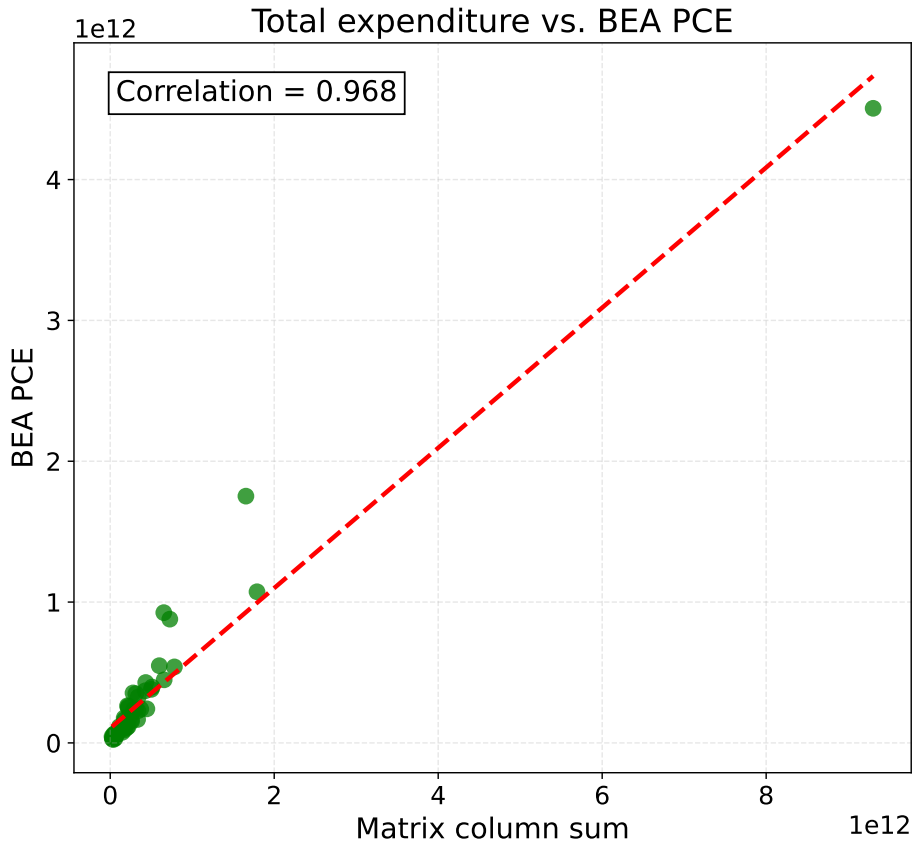
$$B = \frac{\sigma\alpha}{\sigma-1}(1-\lambda)(\sigma-1)(1-\beta) + (\sigma-1)\lambda$$

Proposition

If the intermediate-input feedback is convergent, $\beta < 1$, then a unilateral tariff increase raises the domestic price index and thereby reduces welfare.

Constructed matrix - implied versus BEA-reported regional values (2017)





Back

Trump's 2018 tariff policy -controls

- Population change control

$$\widehat{\text{pop}}_t = \frac{\text{pop}_t - \text{pop}_{2017}}{\text{pop}_{2017}} \times 100, \qquad t = 2018, \ldots, 2022.$$

- Pre-trend control

$$\text{compound_est_grw_1317} = \frac{N_{2017} - N_{2013}}{N_{2013}} \times 100$$

Back

Trump's 2018 tariff policy - comparison

- $\phi = 1$: Production with only labor and intermediate input

Table: $\phi = 1$ Model-Predicted Firm Entry and Establishment Growth

	(1) 2018	(2) 2019	(3) 2020	(4) 2021	(5) 2022
$\hat{N}_{\phi=1}$	-0.003	-0.023	-0.005	-0.044	-0.082
	(0.024)	(0.028)	(0.079)	(0.099)	(0.136)
Population growth	0.312	0.271	0.542***	0.862***	1.000***
	(0.320)	(0.245)	(0.191)	(0.203)	(0.226)
Pre-trend	0.196***	0.373***	0.544***	0.606***	0.588**
	(0.058)	(0.066)	(0.111)	(0.163)	(0.240)
Constant	-0.539***	-0.951***	-1.839***	-1.057**	0.057
	(0.169)	(0.161)	(0.288)	(0.416)	(0.563)
Observations	51	51	51	51	51
R-squared	0.697	0.821	0.786	0.810	0.827

Notes: Robust standard errors in parentheses, computed using the HC3 estimator.
$^{*}p < 0.10$, $^{**}p < 0.05$, $^{***}p < 0.01$.

Trump's 2018 tariff policy - comparison

- $\phi = 0$: Production with only labor and mobile capital

Table: $\phi = 0$ Model-Predicted Firm Entry and Establishment Growth

	(1) $\hat{N}_{2018}$	(2) $\hat{N}_{2019}$	(3) $\hat{N}_{2020}$	(4) $\hat{N}_{2021}$	(5) $\hat{N}_{2022}$
$\hat{N}_{\phi=0}$	0.564	1.099	2.790	5.342**	7.760**
	(0.616)	(0.854)	(1.795)	(2.433)	(3.537)
Population growth	0.352	0.317	0.571***	0.926***	1.077***
	(0.326)	(0.238)	(0.202)	(0.172)	(0.156)
Pre-trend	0.188***	0.350***	0.522***	0.545***	0.492***
	(0.059)	(0.058)	(0.106)	(0.126)	(0.150)
Constant	-1.129*	-2.087**	-4.783**	-6.648**	-8.044**
	(0.602)	(0.936)	(1.901)	(2.615)	(3.904)
Observations	51	51	51	51	51
R-squared	0.701	0.825	0.796	0.826	0.849

Notes: Robust standard errors in parentheses, computed using the HC3 estimator.

$^{*}p < 0.10$, $^{**}p < 0.05$, $^{***}p < 0.01$.

Back

Republican Vote Share change (2020–2016) vs. Model-Predicted State Welfare Consequences

	(1)	(2)	(3)	(4)	(5)	(6)
%Δ HH welfare	-0.2143					
	(0.3395)					
%Δ HH welfare with retaliation		-0.2485				
		(0.3814)				
$\phi = 1$ %Δ Worker welfare			0.0312			
			(0.0452)			
$\phi = 1$ %Δ Worker welfare with retaliation				0.0808		
				(0.1423)		
$\phi = 0$ %Δ HH welfare					-0.8561	
					(0.7584)	
$\phi = 0$ %Δ HH welfare with retaliation						-1.0084
						(0.8545)
Constant	1.0045***	0.9739***	0.8192***	0.8325***	0.5008	0.5365
	(0.3886)	(0.3543)	(0.3154)	(0.3150)	(0.4547)	(0.4300)
Observations	51	51	51	51	51	51
R-squared	0.0152	0.0161	0.0041	0.0028	0.0264	0.0268

Notes: Robust standard errors in parentheses, computed using the HC3 estimator.

$^{*}p < 0.10$, $^{**}p < 0.05$, $^{***}p < 0.01$.

Back

Republican Vote Share change (2024–2020) vs. Model-Predicted State Welfare Consequences

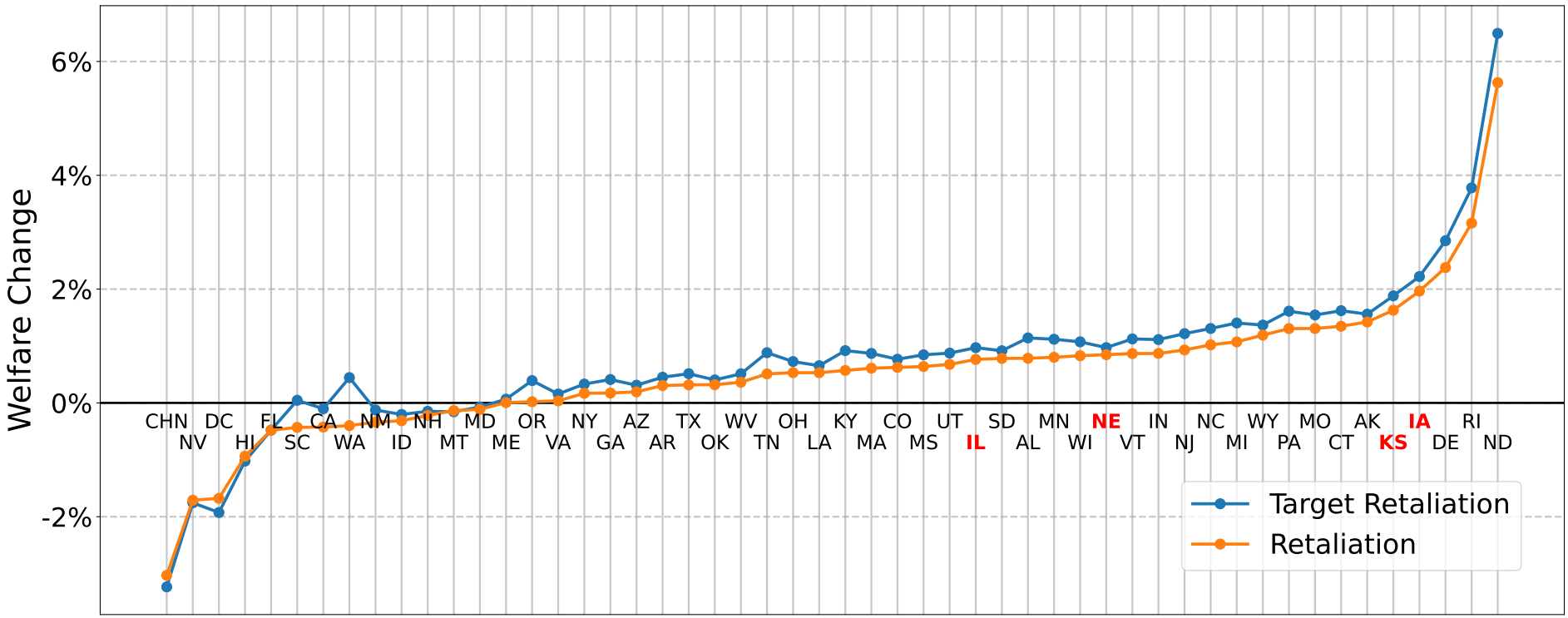
	(1)	(2)	(3)	(4)	(5)	(6)
%Δ HH welfare	-0.1002					
	(0.1045)					
%Δ HH welfare with retaliation		-0.1133				
		(0.1178)				
$\phi = 1$ %Δ Worker welfare			-0.0217			
			(0.0329)			
$\phi = 1$ %Δ Worker welfare with retaliation				-0.0748		
				(0.1039)		
$\phi = 0$ %Δ HH welfare					-0.3716	
					(0.3911)	
$\phi = 0$ %Δ HH welfare with retaliation						-0.4871
						(0.4537)
Constant	2.3048***	2.2887***	2.2262***	2.2154***	2.0801***	2.0815***
	(0.2080)	(0.1997)	(0.1659)	(0.1659)	(0.1832)	(0.1701)
Observations	51	51	51	51	51	51
R-squared	0.0121	0.0122	0.0073	0.0089	0.0181	0.0228

Notes: Robust standard errors in parentheses, computed using the HC3 estimator.

$^{*}p < 0.10$, $^{**}p < 0.05$, $^{***}p < 0.01$.

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Households' welfare effect when China retaliate vs retaliate with a target



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Comparative Statics: $\phi = 1$

- Price index response:

$$\hat{P}_H = \frac{\lambda}{A}\hat{\tau}F$$

$$F = \left[\epsilon(1-\lambda)\left(1+2\lambda-\frac{1}{\sigma}\right)+\lambda\right]\xi + \lambda(2\lambda-1)$$

Proposition

The sign of the Home price-index response to a unilateral increase in trade costs is determined by a strictly increasing function of ξ. There exists a unique $\xi^* \in (0,1)$ such that

$$\hat{P}_H \begin{cases} < 0, & \xi < \xi^*, \\ = 0, & \xi = \xi^*, \\ > 0, & \xi > \xi^*. \end{cases}$$

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