

Strategic Trade Policy Under Firm Heterogeneity

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Abstract

Until recently, the fact of firm heterogeneity has had limited clout in the study of trade policy. However, recent work has made evident the importance of taking firm heterogeneity into consideration. Building on the framework of Costinot, Rodríguez-Clare, and Werning (2016), this work seeks to characterize the optimal policies of two strategic governments with flexible tax instruments, interacting in a Stackelberg setting. This is accomplished by imposing standard functional form assumptions. Of particular interest is whether the Home country's discriminatory optimal tariff provides incentive for the Foreign country to use discriminatory domestic policy to alter the marginal cost schedule that Home sees and responds to.