Mobile Capital, Optimal Tariff, and Welfare Loss from Tariff Competition

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Abstract

In an intra-industry trade model with mobile capital, we examine the characteristics of optimal tariff and welfare loss from tariff competition. The results are two-fold. First, when capital intensity in the differentiated-good sector is sufficiently high, the optimal tariff rate is a decreasing function of the country size and the trade openness of the foreign country, which is contrastive to the Gros' (1987) case without mobile capital. Furthermore, the optimal tariff rate is always lower than that in Gros (1987). Second, in a tariff competition between two symmetric countries, a rise in capital intensity lowers the equilibrium tariff rate and the welfare-loss ratio. In other words, higher intensity of capital plays a role of alleviating excessive tariff competition.

Key words: Intra-industry trade, Tariff, Mobile capital, Welfare loss.

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