Abstract

We extend the two-country strategic trade model by endogenizing the timing of moves by firms in price competition and present the optimal trade policy. In the case of price competition in the third market, a firm with marginal production cost that is higher than other firms enjoys a second-mover advantage in price setting. Thus, governments have a strategic incentive to impose higher export tax to provide their own firms the preferred order of moves in price competition. The game of simultaneous tariff setting has no pure-strategy Nash equilibrium, in which firms try to expand the tariff rate of their rival; once the rate reaches the maximum value, it drops to the minimum value. Moreover, we find that the government can always make its firm obtain a second-mover advantage if the rival government does nothing. These results very different from the well-known results derived from conventional strategic trade theory.