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The Macroeconomic Effects of Trade Tariffs: Revisiting the Lerner Symmetry Result

by Jesper Lindé and Andrea Pescatori

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I N T E R N A T I O N A L M O N E T A R Y F U N D

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Western Hemisphere Department

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Abstract

We study the robustness of the Lerner symmetry result in an open economy New Keynesian model with price rigidities. While the Lerner symmetry result of no real effects of a combined import tariff and export subsidy holds up approximately for a number of alternative assumptions, we obtain quantitatively important long-term deviations under complete international asset markets. Direct pass-through of tariffs and subsidies to prices and slow exchange rate adjustment can also generate significant short-term deviations from Lerner. Finally, we quantify the macroeconomic costs of a trade war and find that they can be substantial, with permanently lower income and trade volumes. However, a fully symmetric retaliation to a unilaterally imposed border adjustment tax can prevent any real or nominal effects.

JEL Classification Numbers: E52, E58.

Keywords: Import Tariffs; Export Subsidies; Lerner Condition, Incomplete Markets; Complete Markets, Border Adjustment Tax, Trade War, New Keynesian open-economy model.

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