Discussion of

Redistributing the Gains From Trade through Progressive Taxation

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Motivation

• Trade is a positive productivity shock
  — better global allocation results in aggregate gains from trade
  — comparative advantage is sufficient for this result
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  — of industries
  — of occupations and skills
  — of firms
  — of geographies
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- Heterogeneity can be in the:
  - Short run (transitory)
  - Long run steady state (permanent)
  - Long run stationary equilibrium (permanent volatility)
Dynamic DFS model with:

1. spacial production and mobility costs
2. incomplete asset markets (as in Bewley-Aiyagari model)
   - natural benchmark: complete markets and mobility costs
3. dynamics of (idiosyncratic) comparative advantage
   - allows to study ADH identification strategy
4. cross-section income inequality and a redistributive tax system
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- Very large state space!
  - Each location (island) \( \omega \) characterized by productivity \( p_w(\omega)z_h(\omega) \), number of workers \( \mu_h(\omega) \) and distribution of their wealth \( \lambda(a; \omega) \)
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- Comparison across steady states with different trade costs
  — Long-run gains for everyone, but with more volatility (Cosar, Guner and Tybaut 16)
  — Less terms-of-trade insurance in the open economy (Stiglitz 82, Spector 01, Rodrik 98, Epifani and Gancia 08)
  — Transitory inequality and permanent losses from misallocation (Hopenhayn and Rogerson 93, Hornstein, Krusell and Violante 11)
Goal of the paper

- Study the optimal degree of progressivity of the tax system
  - insurance benefit vs misallocation cost
    (reduces incentive to reallocate towards high productivity islands)
  - the model designed to have a small intensive margin response
    question: why at all?

- Redistribution is not a direct policy instrument
  - creates a tradeoff between equity and efficiency
  - but this tradeoff is not unavoidable

- Indeed, subsidy to mobility cost is a direct policy instrument
  - results in no tradeoff
  - lower trade costs justify a greater subsidy?
  - why this subsidy is not possible? information cost? lack of lump-sum tax to support it?
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1. US has too little redistribution given its trade openness
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② More trade openness would justify more redistribution
   — Different conclusion from papers with long-run heterogenous outcomes and extensive margin of trade (Itskhoki 08, AGI 17)
   — Why? Trade has a direct effect on volatility. Mobility costs create misallocation wedge, which is not very sensitive to trade.
   — Interesting to decompose these effects
Trade and Optimal Progressivity
in Antràs, De Gortari and Itskhoki (2017)

Inequality aversion, $\rho$

Progressivity of taxation, $\phi$

Trade Equilibrium

Autarky
What is not in the model?

1. No non-tradables, housing, local amenities and congestion
   — important for quantitative conclusions
   — partial eqm approach to home production and mobility costs

2. No permanently displaced workers
   — all are ex-ante and long-term identical
   — only transitory losses
   — rest unemployment? (Alvarez and Shimer 2011)

3. No trends in comparative advantage
   — stationary distribution and mean reversion of CA
   — is this the right way to think about the China shock?

4. Technology is not mobile
   — but firms and technology can move

A puzzle of the rust belt!
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What are the islands?

- Islands are an abstraction. Do they correspond to geographies, industries, occupation or firms?

- Comparative advantage $p_w(\omega)z_h(\omega)$ is calibrated to individual income process, and the role of trade is recovered structurally. But one could use direct data on comparative advantage (e.g., Hanson, Lind and Muendler 16)

- Without mobility costs, all agents would go to a single island. How large are the mobility costs relative to CA reversion? Large gross flows and insufficient net flows?