

Faculti Summary

<https://faculti.net/two-sided-market-power/>

In 2018, the United States introduced tariffs of 10-50% on various imports, igniting a trade war with key trading partners, which responded with retaliatory tariffs. This video event highlighted a shift towards protectionist trade policies and raised concerns about their impact on consumer prices and welfare. Notably, tariffs imposed during the Trump administration resulted in price increases equating to the rate of the tariffs, meaning consumers suffered the full burden of these costs, contradicting traditional trade theories that suggested incomplete price pass-through.

Research aims to explore why the pass-through from these tariffs was so complete and why conventional theories failed to predict this outcome. The study emphasizes two-sided heterogeneity and market power in global production networks, noting that modern trade primarily involves firm-to-firm transactions rather than direct sales to consumers.

A novel theoretical framework is presented, focusing on price-setting dynamics in firm-to-firm relationships, where firms have substantial market power on both sides of the transaction. This video approach leads to two main predictions: (1) bilateral markups vary significantly across relationships, and (2) the pass-through of tariffs may be complete for smaller importers while being incomplete for larger ones due to the dynamics of demand and marginal costs.

The research utilizes detailed data on firm-to-firm transactions, particularly in the context of Trump tariffs, to empirically test the model's predictions. Results indicate that US importers generally exhibit greater bargaining power compared to foreign exporters, a departure from conventional assumptions, and that foreign exporters' marginal costs are responsive to output changes.

Lastly, the study concludes that the overall pass-through from Trump tariffs was around 40%, attributed mainly to adjustments in foreign exporters' marginal costs. This video finding questions previous work suggesting higher pass-through rates and highlights the significance of analyzing price dynamics at the firm level to understand broader economic implications. The research contributes to the literature on trade policy and pricing, emphasizing the relevance of global value chains in current international trade scenarios.