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  - Study endogenous shifts in self categorization triggered by changes in economic conditions or by political opportunism that accentuates racial and ethnic differences
Social Identity

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  - Groups (e.g., social class, religion, ethnicity, nation) are source of pride and self-esteem
  - Self image enhanced by the status of the groups to which people imagine themselves belonging; but also source of cognitive dissonance that arise from differences
  - Self categorization: Individuals choose the set of groups with which they identify (endogenous)

  - No permission needed
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In Economics: Akerlof and Kranton: (QJE, 2000; *Identity Economics*, 2010)
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Grossman and Helpman ( ).
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Recent Events

- In the US there is plenty of evidence about the formation of a White Identity Group that was politicized in the 2016 election.
- Identity groups have also played a large role in the Brexit debate and in the rise of populism (a form of identity politics).
Our Approach

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- We focus on a specific mechanism through which identity affects trade policy
The Environment

- Begin with a simple structure: two skill levels and no ethnic divisions
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Small country, two sectors, two factors, CRS production structure

Goods:
- Z (import-competing and exportable)
- X

Factors:
- h (skilled)
- ` (unskilled)

Normalize the population to equal 1, with fractions

\[ \lambda_h, \lambda`\]

Assume that Z is intensive in unskilled workers

Quasi-linear materialistic utility:

\[ \nu_i = cX_i + v(cZ_i) \]

Two psychosocial components of utility:

Pride and self-esteem from group membership, associated with "status" of group: average material well-being

Dissonance costs of group membership, associated with personal distance from average group member
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If the distributions of ideological preferences are common in different groups, the instrumental policies converge to those that maximize aggregate welfare (otherwise, weighted sum of welfare levels)

- Now “welfare” includes material and psychosocial components
- Add up across individuals; find policy that maximizes this sum
Three potential identity groups: Working Class, Elite, Nationals
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Who identifies as Working Class?

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Three potential identity groups: Working Class, Elite, Nationals

Who identifies as Working Class?

- Less-skilled are homogeneous, so no cost to doing so; all unskilled identify as working class (not necessarily so with ethnic divisions)

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- Skilled are homogeneous, so no cost to doing so; all skilled identify as elite
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Who identifies as Nationals?

- Here it means to identify with broad group of nationals, not only certain “real” nationals

Compare status benefit with dissonance cost ($I_b = 1$ or $0$; $I_{b'} = 1$ or $0$).
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Grossman and Helpman ( ) Identity Politics June, 2019 8 / 21
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The Maximand: Socioeconomic Classes

- World price and domestic price of $X$ equal one; world price of $Z$ equals $q$ and the domestic price is $p = q (1 + t)$
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  \]

- Similar for $\ell$

- Aggregate utility $U(p, q)$ equals:
  \[
  \lambda_h A_h^\varepsilon + \lambda_\ell A_\ell^\omega + (1 + \alpha) \left[ Y(p) + T(p, q) + \Gamma(p) \right] \\
  + \lambda_h I_h^b \left\{ A_h^b + \alpha_b [Y(p) + T(p, q) + \Gamma(p)] - \beta_h^b (1 - \lambda_h)^2 [\delta(p)]^2 \right\} \\
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Equilibrium Policy

- Competition for votes leads parties to choose a tariff that maximizes $U(p, q)$ subject to self-categorization (participation) constraints.
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- Draw $U(p, q)$ for each possible identification regime: $r_0, rh, r_\ell, rh, \ell$.
Equilibrium Policy

- Competition for votes leads parties to choose a tariff that maximizes $U(p, q)$ subject to self-categorization (participation) constraints.
- Draw $U(p, q)$ for each possible identification regime: $r_0, r_h, r_\ell, r_{h, \ell}$.
- Outcome is global max of $U(p, q)$, because self-categorization constraints always satisfied at this point.
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If no one identifies broadly with the nation ... aggregate welfare includes status benefits from identifying (only) with own social class.

Proposition: Suppose that $\beta > 0$ and $\beta` > 0$. If neither skill group identifies with the nation, the equilibrium tariff is zero. Otherwise, it is positive.
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Characterizing Equilibrium Trade Policy

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Proposition

Suppose that $\beta^b_h > 0$ and $\beta^b_\ell > 0$. If neither skill group identifies with the nation, the equilibrium tariff is zero. Otherwise, it is positive.
Comparative Statics: Heightened Sensitivity to Social Differences

Proposition

Suppose that skill group $i$ identifies with the nation in some initial political equilibrium ($I_i^b = 1$) and that an increase in $\beta_i^b$ does not induce a change in the identification regime. Then an increase in $\beta_i^b$ generates an increase in the equilibrium tariff rate.
Comparative Statics: Technical Progress

- Model factor-augmenting technological progress: $\pi_h, \pi_\ell$
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- Despite apparent ambiguity, Hicks-neutral technological progress induces higher tariff rate
Turn now to change in identification regime. Focus on a “populist revolution.”
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Consider a shift in the economic or political environment that induces the working class to identify more narrowly than before

- No longer consider the elites to be “real nationals”
- Could be caused by SBTC, globalization, or shift in the perceived cognitive cost of identification
Initially, everyone identifies broadly with the nation: $r^\circ = r_{h,\ell}$
Initially, everyone identifies broadly with the nation: $r^o = r_{h, \ell}$

Then working class ceases to identify broadly, instead identifies only narrowly with others in the same social class (rise in $\beta^b_\ell$): $r^o \rightarrow r_h$
Populist Revolution: Effects on Trade Policy

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Condition for Rise in Protection

There exists $\lambda^*_h \in (0, 1)$ such that $p_h > p_{h, \ell}$ if and only if $\lambda_h < \lambda^*_h$.
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Condition for Rise in Protection

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- More likely when $\beta_{h}^b$ is high relative to $\beta_{\ell}^b$
- If $\beta_h^b = \beta_{\ell}^b = \beta^b$ and $\alpha = \alpha^b = 0.1$, the tariff rate jumps upward when the elite are less than 7.7% of the population.
Condition for Rise in Protection

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Envy of out-groups

- Social psychology literature suggests that individuals may envy those in out-groups with higher status
- If ceasing to identify with broad nation causes working class to envy the elites, then range of $\lambda_h$ for which tariff jumps upward is larger
Societies have more cleavages: wider menu of identity choices
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We extend the model to allow for an ethnic majority $M$ and an ethnic minority $m$, as well as three skill levels: $h, \ell, k$, where $k$ workers (the least skilled) are employed in nontraded services
Identification Patterns

- Individuals with ethnicity $j$ and skill level $i$ may identify with others of the same ethnicity ($\Pi_{i,j}^j = 1$) or not ($\Pi_{i,j}^j = 0$), they may identify with others in their own social class ($\Pi_{i,i}^j = 1$) or not ($\Pi_{i,i}^j = 0$), and they may identify with the nation ($\Pi_{i,b}^j = 1$) or not ($\Pi_{i,b}^j = 0$).
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- The benefit from identifying with ethnic group $j$ is $\alpha_e \frac{\sum_i \lambda_i^j v_i}{\lambda^j}$, the benefit from identifying with social class $i$ is $\alpha v_i$, the benefit from identifying with the nation is $\alpha_b \sum_i \lambda_i v_i$. 

Dissonance costs now have two components: the first component is proportional to the squared distance in the space of material well-being, as before, given by $\beta (\bar{v}_i - \bar{v}_g)^2$; the second component of psychological cost for individuals with ethnicity $j$ who identify with some group $g$ is $\beta_e \frac{E_j - \bar{E}_g}{\lambda^j}$ (distance in “ethnic space” ; distance in conceptual space).
Individuals with ethnicity $j$ and skill level $i$ may identify with others of the same ethnicity ($\Pi_{i,j}^{j,j} = 1$) or not ($\Pi_{i,j}^{j,j} = 0$), they may identify with others in their own social class ($\Pi_{i,i}^{j,i} = 1$) or not ($\Pi_{i,i}^{j,i} = 0$), and they may identify with the nation ($\Pi_{i,b}^{j,b} = 1$) or not ($\Pi_{i,b}^{j,b} = 0$).

The benefit from identifying with ethnic group $j$ is $\alpha^e \left( \sum_i \lambda_i^{j,v_i} \right) / \lambda^j$, the benefit from identifying with social class $i$ is $\alpha^v_i$, the benefit from identifying with the nation is $\alpha^b \sum_i \lambda_i v_i$.

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Comparative Statics: Ethnic/Racial Salience

Imagine that politicians increase salience of ethnic distance, $\beta_e$ rises

- This affects cost of identification with social class and with broad nation
Imagine that politicians increase salience of ethnic distance, $\beta^e$ rises

- This affects cost of identification with social class and with broad nation
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**Proposition**

Suppose that a change in $\beta^e$ does not induce a change in identification regime. Then the equilibrium tariff rate is not affected.
An increase in $\beta^e$ may lead to narrower identification pattern
Comparative Statics: Ethnic/Racial Salience

- An increase in $\beta^e$ may lead to narrower identification pattern
- Changes in identification will affect preferences over tariffs
An increase in $\beta^e$ may lead to narrower identification pattern

Changes in identification will affect preferences over tariffs

**Proposition**

*Suppose that $\beta^e$ rises and that the import good $Z$ and nontraded services $S$ are gross complements in demand. If the least-skilled workers ($k$) of any ethnicity cease to identify with the nation or with their social class, the rate of protection jumps upwards. If the middle-skilled workers ($\ell$) of any ethnicity cease to identify with the nation and if their wage is at least as great as the economy-wide average, then the rate of protection jumps upward.*
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These are sufficient conditions, not necessary
Concluding Remarks

- Voter preferences and behavior:

People do not always vote their narrow economic interests. Voters have concern for others, but not all others. Social identity theory is consistent with these observations. A model incorporating social identity necessarily requires many specific choices. These choices can be tailored to particular applications. Importantly, we believe that changes in identification (from whatever cause) generate changes in policy preferences, which in turn affect policy outcomes via the political process. This could apply to additional issues: immigration policy? growth-friendly policies? A large question is what determines salient divisions in society (potential identity groups) and characteristics of prototypical members? And what mechanisms can politicians use to shift costs or benefits of various identification patterns?
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Large question: What determines salient divisions in society (potential identity groups) and characteristics of prototypical member?

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