Heterogeneous Agent Trade

Michael E. Waugh
Federal Reserve Bank of Minneapolis and NBER
@tradewartracker

September 21, 2022

The views expressed herein are those of the author and not necessarily those of the Federal Reserve Bank of Minneapolis or the Federal Reserve System. This project was developed with research support from the National Science Foundation (NSF Award number 1948800). Thomas Hasenzagl provided excellent research assistance.

What am I doing?

Big picture — these are the questions that interest me...

1. What are distributional consequences of trade?

2. Is there a role for trade policy to improve outcomes?

One mechanism behind **1.** is heterogeneity in expenditure shares on traded goods and **elasticities**.

- Auer, Burstein, Lein, and Vogel (2022) is a nice example. In the context of the 2015 Swiss appreciation, they find that poor households are more price elastic.

Behind **2.** are inefficiencies arising from market incompleteness... so can trade policy help?
This connects with stuff dating back to Bhagwati (1969).

This paper:

GE, heterogenous agent model of trade delivering ABLV-like facts. I work out the implications for aggregate trade, the gains from trade, and the normative implications for trade policy.

How I do it...

Two ingredients:

- Trade as in Armington, but households have random utility over these varieties.
- Standard incomplete markets model with households facing incomplete insurance against idiosyncratic productivity and taste shocks.

Qualitatively I characterize...

- How price elasticities vary at the micro-level and when micro-heterogeneity shapes aggregates.
- The welfare gains from trade at the micro and macro level.
- The efficient allocation and, thus, how market incompleteness shapes these outcomes.

Quantitatively, I compute a 19 country model (the Eaton and Kortum (2002) data) and (today) study the welfare gains (?) to reductions in trade costs.

Model: Production and Trade

M countries. Each country produces a nationally differentiated product as in Armington.

In country i, competitive firms' produce variety i with:

$$Q_i = A_i N_i,$$

where A_i is TFP; N_i are efficiency units of labor supplied by households.

Cross-country trade faces obstacles:

- iceberg trade costs $d_{ij} > 1$ for one unit from supplier j to go to buyer i.

This structure leads to the following prices that households face

$$p_{ij} = \frac{d_{ij} w_j}{A_j}.$$

Model: Households I

Mass of L_i households in each country i.

Household-level preferences:

$$\mathrm{E}\sum_{t=0}^{\infty}\beta^t\ \tilde{u}(\{c_{ijt},\epsilon_{jt}\}_M)$$

$$\text{where}\quad \tilde{u}(c_{ijt},\epsilon_{jt}) = u(c_{ijt}) + \epsilon_{jt}.$$

- ϵ_{jt} is iid (across time and households) taste shocks over national varieties.

Assumptions:

- For most of the analysis, I'll only assume u is well behaved.
- ϵ_{jt}s are distributed Type 1 Extreme Value with dispersion parameter σ_ϵ.

Model: Households II

A household's efficiency units z_t evolve according to a Markov Chain. They face the wage per efficiency unit w_{it}.

Households borrow or accumulate a non-state contingent asset, a, with gross return R_i. Household's face the debt limit

$$a_{t+1} \geq -\phi_i$$

Conditional on a variety choice, a household's budget constraint is

$$p_{ij} c_{ijt} + a_{t+1} \leq R_i a_t + w_{it} z_t.$$

What Households Do...

Focus on a stationary setting. A hh's state are its asset holdings a and shock z.

1. The hh makes a variety choice (e.g. a US or Italian variety) and how much to consume. The choice probability is:

$$\pi_{ij}(a,z) = \exp\left(\frac{v_{ij}(a,z)}{\sigma_\epsilon}\right) \Big/ \sum_{j'} \exp\left(\frac{v_{ij'}(a,z)}{\sigma_\epsilon}\right),$$

where $v_{ij}(a,z)$ is the hh's value function conditional on a choice.

2. The hh makes an asset choice. Away from the constraint, asset choices (conditional on a variety choice) must respect this Euler Equation:

$$\frac{u'(c_{ij}(a,z))}{p_{ij}} = \beta \mathrm{E}_{z'}\left\{ -\sigma_\epsilon \frac{\partial \pi_{ii}(a',z')/\pi_{ii}(a',z')}{\partial a'} + \frac{u'(c_{ii}(a',z'))R_i}{p_{ii}} \right\},$$

where I'm exploiting an ACR-like feature that ex-ante value functions can be expressed in terms of i, i home choices.

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Aggregation

Aggregates arise from explicit aggregation of hh-level actions. Two examples:

Aggregate, bilateral imports and exports are

$$M_{ij} = L_i \int_z \int_a p_{ij} c_{ij}(a,z) \pi_{ij}(a,z) \lambda_i(a,z), \qquad X_{ji} = L_j \int_z \int_a p_{ji} c_{ji}(a,z) \pi_{ji}(a,z) \lambda_i(a,z),$$

where λ_i is the distribution of hhs across states and $c_{ij}(a,z)$ is the consumption function. Here trade flows take on a mixed logit formulation as in Berry, Levinsohn, and Pakes (1995).

The national income accounting identity (GDP = C + I + G + X - M) ...

$$p_i Y_i = \underbrace{L_i \sum_j \int_z \int_a p_{ij} c_{ij}(a,z) \pi_{ij}(a,z) \lambda_i(a,z)}_{\widetilde{P_i C_i}} + \underbrace{\left[\sum_{j \neq i} X_{ji} - \sum_{j \neq i} M_{ij} \right]}_{-R_i A_i + A_i'}.$$

Notice how trade is non-trivially connected to a county's capital account.

Equilibrium

The Decentralized Stationary Equilibrium. A Decentralized Stationary Equilibrium are asset policy functions and commodity choice probabilities $\{ g_{ij}(a,z), \pi_{ij}(a,z) \}_{ij}$, probability distributions $\{ \lambda_i(a,z) \}_i$ and positive real numbers $\{w_i, p_{ij}, R_i\}_{ij}$ such that

i Prices (w_i, p_{ij}) satisfy the firms problem;

ii The policy functions and choice probabilities solve the household's optimization problem;

iv The probability distribution $\lambda_i(a,z)$ induced by the policy functions, choice probabilities, and primitives satisfies the law of motion and is stationary;

v Goods market clears:

$$p_i Y_i - \sum_j^M X_{ji} = 0, \quad \forall i$$

v Bond market clears with

$$\mathrm{A}_\mathrm{i}' = 0, \quad \forall i.$$

Proposition #1: The H-A Trade Elasticity. The trade elasticity between country i and country j is:

$$\theta_{ij} = 1 + \int_a \int_z \left\{ \theta_{ij}(a,z)^I + \theta_{ij}(a,z)^E \right\} \omega_{ij}(a,z) - \left\{ \theta_{ii}(a,z)^I + \theta_{ii}(a,z)^E \right\} \omega_{ii}(a,z),$$

which is the difference between ij and ii expenditure-weighted micro-level elasticities. The micro-level elasticities for households with states a, z are an intensive and extensive elasticity

$$\theta_{ij}(a,z)^I = \frac{\partial c_{ij}(a,z)/c_{ij}(a,z)}{\partial d_{ij}/d_{ij}}, \qquad \theta_{ij}(a,z)^E = \frac{\partial \pi_{ij}(a,z)/\pi_{ij}(a,z)}{\partial d_{ij}/d_{ij}},$$

and $\omega_{ij}(a,z)$ are the expenditure weights.

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$$\theta_{ij}(a,z)^I = \left[- \frac{\partial g_{ij}(a,z)/p_{ij}c_{ij}(a,z)}{\partial p_{ij}/p_{ij}} - 1 \right] \frac{\partial p_{ij}/p_{ij}}{\partial d_{ij}/d_{ij}}.$$

The idea here is that reduction in trade costs relaxes the hh's budget constraint and then the division of new resources between assets and expenditure determines the intensive margin elasticity.

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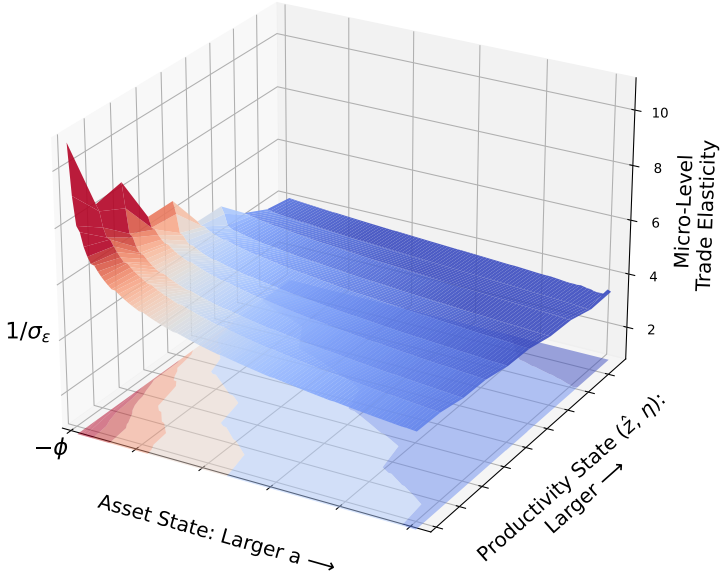
and $\omega_{ij}(a,z)$ are the expenditure weights.

$$\theta_{ij}(a,z)^E = -\frac{\partial \Phi_i(a,z)/\Phi_i(a,z)}{\partial d_{ij}/d_{ij}} + \frac{1}{\sigma_\epsilon} \frac{\partial v_{ij}(a,z)}{\partial d_{ij}/d_{ij}}.$$

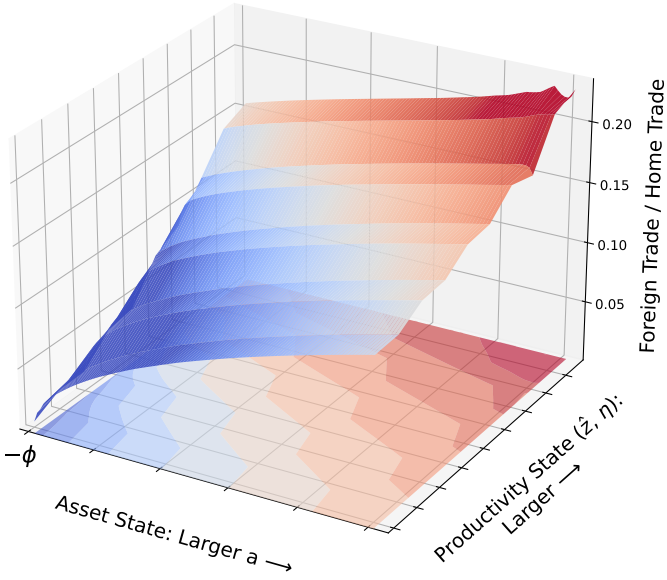
Key is $\frac{\partial v_{ij}(a,z)}{\partial d_{ij}/d_{ij}}$.

In the paper, I show that if relative risk aversion > 1 than hh's with (i) high $u'(c)$ and (ii) high MPCs are more price elastic. **So poor hh's are the most price sensitive.**

Trade Elasticities by HH-Level State



Trade Shares: $M_{ij}(a,z)/M_{ii}(a,z)$, by HH-Level State



Proposition #2: H-A Welfare Gains from Trade. The gains from trade under a utilitarian social welfare function are

$$\frac{\mathrm{d}W_i}{\mathrm{d}d_{ij}/d_{ij}} = \int_z \int_a \Bigg\{ \underbrace{\frac{\mathrm{d}v_i(a,z)}{\mathrm{d}d_{ij}/d_{ij}}}_{\text{gains to hh}} + \underbrace{v_i(a,z)\frac{\mathrm{d}\lambda_i(a,z)/\lambda_i(a,z)}{\mathrm{d}d_{ij}/d_{ij}}}_{\text{gains to reallocation}} \Bigg\} L_i \lambda_i(a,z),$$

where v_i is a hh's value function before taste shocks are realized.

Household-level gains are

$$\frac{\mathrm{d}v_i(a,z)}{\mathrm{d}d_{ij}/d_{ij}} = \mathbb{E}_z \sum_{t=0}^{\infty} \beta^t \left\{ -\sigma_\epsilon \frac{\mathrm{d}\pi_{ii}(a_t,z_t)/\pi_{ii}(a_t,z_t)}{\mathrm{d}d_{ij}/d_{ij}} + u'(c_{ii}(a_t,z_t))a_t \frac{\mathrm{d}R_i}{\mathrm{d}d_{ij}/d_{ij}} \right\}.$$

HH-level gains pick up two effects:

- An ACR-like term reflecting how it's home choice changes. . . basically the gains from substitution.
- How the value of a hh's wealth changes through GE effects on interest rates.

Proposition #3: Separation of Trade and Micro-Heterogeneity. In the dynamic, heterogenous agent trade model where preferences are logarithmic over the physical commodity

$$\tilde{u}(c_{ijt}, \epsilon_{jt}) = \log(c_{ij,t}) + \epsilon_{j,t},$$

the trade elasticity is

$$\theta = -\frac{1}{\sigma_\epsilon},$$

and is independent of household heterogeneity. And the welfare gains from trade are

$$\frac{\mathrm{d}W_i}{\mathrm{d}d_{ij}/d_{ij}} = -\frac{1}{\theta(1-\beta)} \times \frac{\mathrm{d}\pi_{ii}/\pi_{ii}}{\mathrm{d}d_{ij}/d_{ij}}.$$

and is (i) independent of the household heterogeneity and (ii) summarized by the trade elasticity and the change in the home choice probability (and home share).

Mimics the results of Anderson et al. (1987) and Arkolakis et al. (2012), remarkable as this is a far more complex economy...

Proposition #4: Trade Elasticities and Welfare Gains in the Efficient Allocation The trade elasticity between i, j in the efficient allocation is:

$$\theta_{ij} = -\frac{1}{\sigma_\epsilon}\left[u'(c_{ij})c_{ij}\right].$$

And the welfare gains from a reduction in trade costs between i, j are

$$\frac{\mathrm{d}W}{\mathrm{d}d_{ij}/d_{ij}} = \frac{\partial W}{\partial d_{ij}/d_{ij}} = \frac{1}{1-\beta} \times u'(c_{ij})c_{ij}\pi_{ij}L_i,$$

which is the discounted, direct effect from relaxing the resource constraint.

Mimics the results of Atkeson and Burstein (2010) but with household (not firm) heterogeneity.

With log preferences the direct effect is equivalent to Arkolakis, Costinot, and Rodríguez-Clare (2012).

Quantitative Analysis

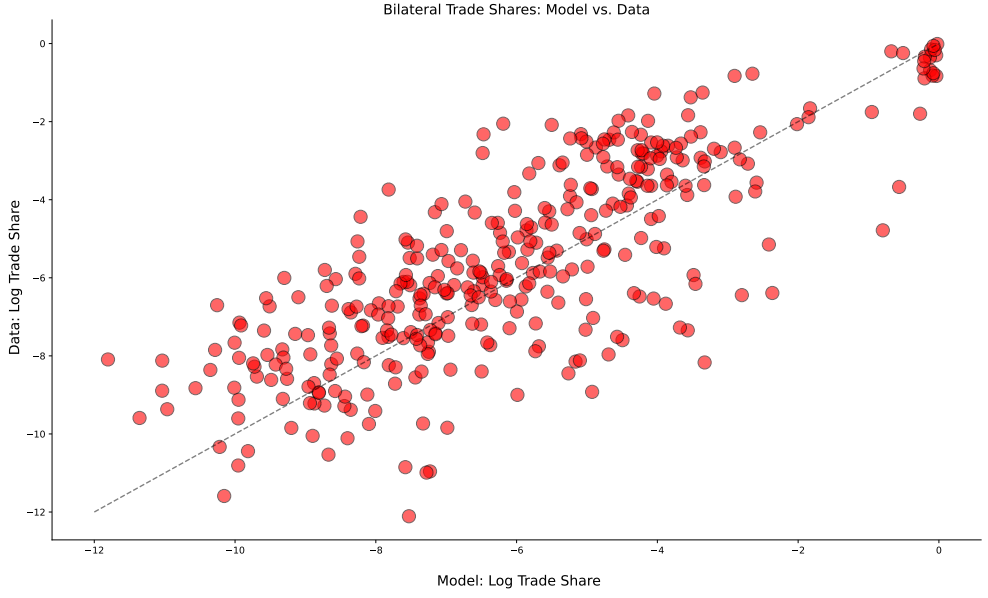
Still preliminary. This is what I'm going to do:

- Grab trade costs and productivity estimates from 19 country world of Eaton and Kortum (2002) and compute an equilibrium.
- Explore bilateral reduction in trade costs...I'll explain in two slides.

Other important parameters and how I set them for today.

- Taste shock parameter so $1/\sigma_\epsilon = 4.0$. CRRA for u with relative risk aversion $= 1.5$.
- Earnings process is a mixture of a persistent and transitory component and calibrated as in Krueger, Mitman, and Perri (2016).
- Borrowing constraint is set $\approx 2\times$ earnings for US. Discount factor set so $R \approx 2\%$ for US.

Bilateral Trade: Model vs. Data



Quantitative Experiment

Two ideas I want to illustrate:

1. You pick the market, you pick a person...

- In this calibration, the rich are more likely to consume all varieties; the poor are likely to consume the cheapest (which is typically the home good).

2. Modern day Stolper-Samuelson...

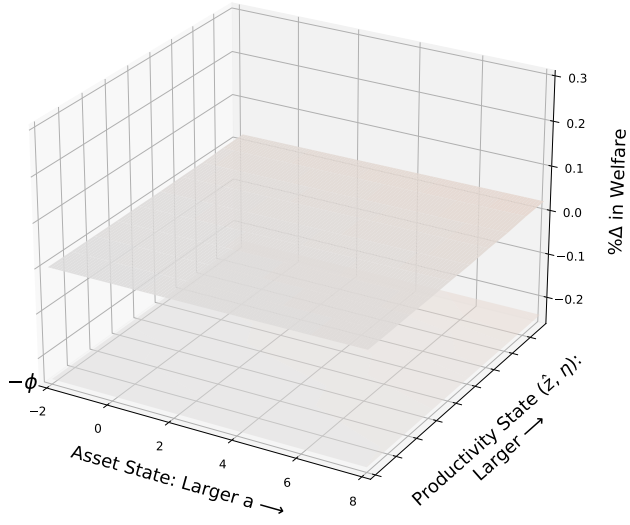
- Who directly benefits from **1.** effects $R \Rightarrow$ shapes the extent to which their are winners and losers.

Next slides: 10% reduction to US import trade cost on different source markets... Australia, Japan, Canada. Focus on US welfare and break it down by

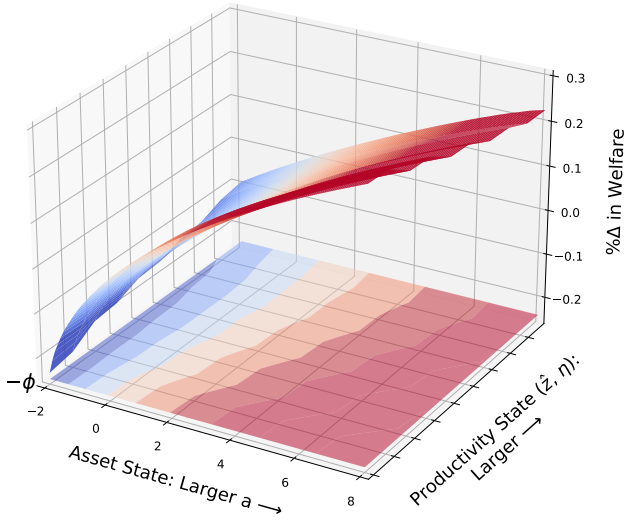
A. Fix R & w, so what is direct effect of change in trade cost,

B. R & w adjust to clear goods and asset markets.

U.S. Welfare: 10% Reduction to a Small Market (Australia), Fixed R & w



U.S. Welfare: 10% Reduction to a Small Market (Australia), GE

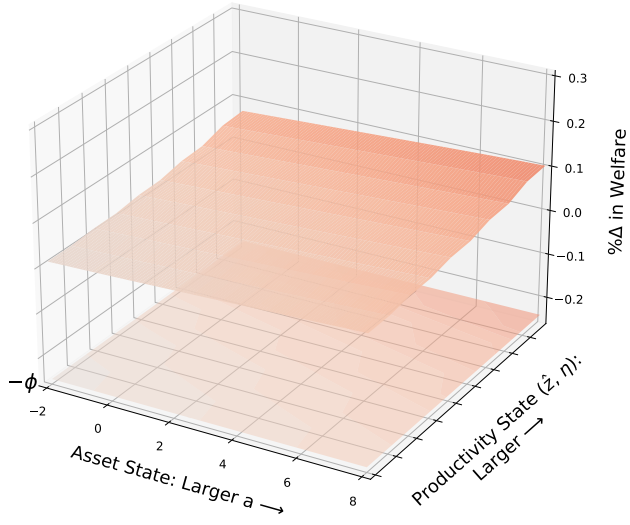


U.S. Welfare: 10% Reduction to a Small Market (Australia)

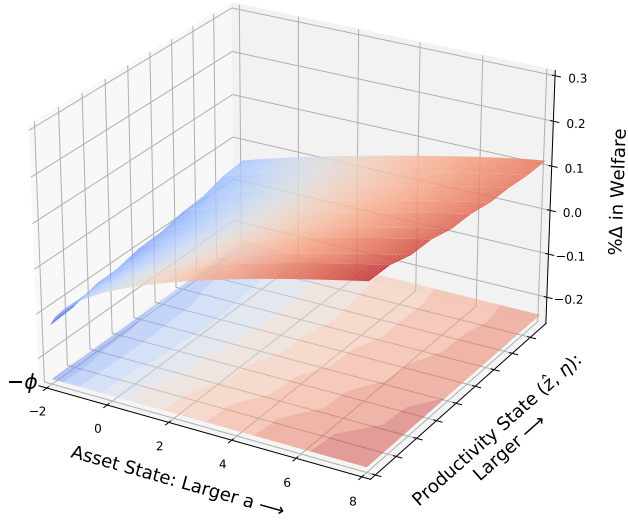
Welfare by Wealth — Australia 10% Reduction

	Fixed R & w	GE: Prices Adjust
Asset Quartile	Welfare (% Change)	Welfare (% Change)
Bottom quartile	0.0013	-0.163
Median	0.0023	-0.078
Upper quartile	0.0052	0.084
Aggregate	0.0031	-0.056
% losers	0.0	72.6

U.S. Welfare: 10% Reduction to a Medium Market (Japan), Fixed R & w



U.S. Welfare: 10% Reduction to a Medium Market (Japan), GE

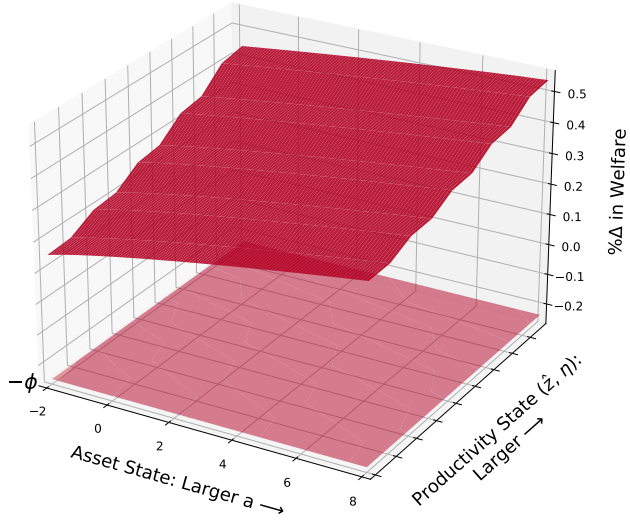


U.S. Welfare: 10% Reduction to a Medium Market (Japan)

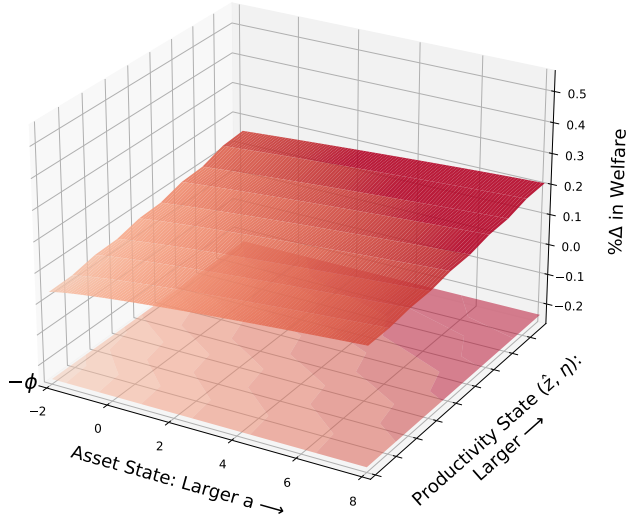
Welfare by Wealth — Japan 10% Reduction

	Fixed R & w	GE: Prices Adjust
Asset Quartile	Welfare (% Change)	Welfare (% Change)
Bottom quartile	0.0193	-0.095
Median	0.0306	-0.052
Upper quartile	0.0535	0.030
Aggregate	0.0031	-0.040
% losers	0.0	77.8

U.S. Welfare: 10% Reduction to a Large Market (Canada), Fixed R & w



U.S. Welfare: 10% Reduction to a Large Market (Canada), GE

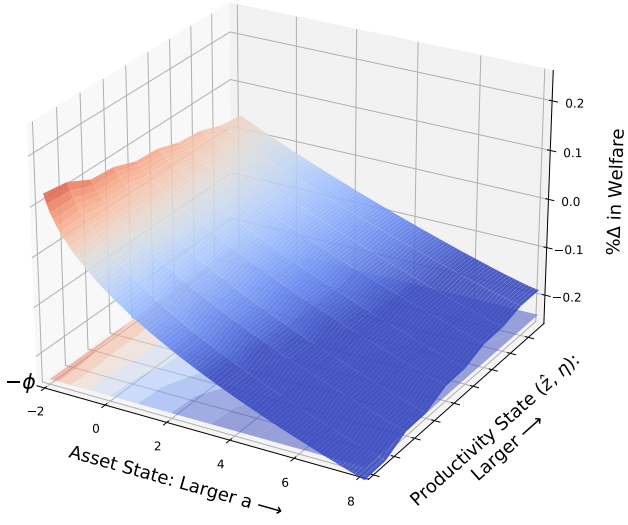


U.S. Welfare: 10% Reduction to a Large Market (Canada)

Welfare by Wealth — Canada 10% Reduction

	Fixed R & w	GE: Prices Adjust
Asset Quartile	Welfare (% Change)	Welfare (% Change)
Bottom quartile	0.21	0.06
Median	0.28	0.09
Upper quartile	0.39	0.14
Aggregate	0.30	0.09
% losers	0.0	0.0

U.S. Welfare: 10% Increase to a Small Market (Australia), GE



Problems...

These are some issues I'm mulling over:

1. Differences in hh-level shares too different (at least for US).

2. How to think about China?

3. Sectors?

Where I'm headed next...

Lot's to do, but "big picture" this is where I'm aiming:

1. Can trade policy improve outcomes?

- This is a useful laboratory to think about policy because (i) there is scope for it and (ii) have a direct representation of utility (not an indirect representation).

2. How financial globalization relates globalization in goods trade?

- The model provides a coherent account of both trade in goods and assets. I think it'd be interesting to see what happens.

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Bilateral Trade Elasticities: German Example