

# A theory of protectionist populism: The role of elite cues and identity on protectionism.

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September, 2022

## Abstract

The combination of populism and protectionism emerged primarily from social class cleavages during the 20th century, to protect those affected by international economic competition. In the 21st century these cleavages have also involved an ethnic dimension, which regards the ethnic majority as the citizens deserving protection even though ethnic minorities are affected by international competition. What does explain this puzzle? I posit that this *protectionist populism* is especially likely to emerge when populists shape voters' preferences over protectionism using elite cues. Cues generate voter polarization by activating voters' social identities, and this benefits populists. However, populists may not use cues on ethnic minorities when their support isn't essential because doing so isn't cost-effective. Counterintuitively, populists use cues when there's little voter polarization ex-ante. I also find that higher international competition is generally insufficient to generate demands for protectionist populism in the absence of elite cues. My findings also provide various empirical implications.

**Keywords:** identity politics, globalization, protectionism, populism.

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# 1 Introduction

Globalization has bolstered populism and protectionism across the world. The evidence indicates that international competition is one of the main causes behind the recent wave of populism and economic nationalism in developed economies (Autor et al., 2016; Colantone and Stanig, 2018; Ballard-Rosa et al., 2021). Specifically, increased import competition—such as cheaper Chinese products—caused lay-offs and lower wages, triggering demands for anti-globalization policy to protect the livelihoods of workers in the affected sectors. However this *protectionist populism* is not new. Europe and Latin America experienced protectionist populism during the 20th century as evidenced by Dornbusch and Edwards (2007) and Funke et al. (2020).<sup>1</sup>

Herein I examine a puzzling shift in the origins of populism and protectionism over time. In the 20th century, the combination of populism and extreme protectionism emerged primarily from social-class cleavages, yet in the 21st century these cleavages involve an ethnic dimension.<sup>2</sup> I establish novel microfoundations for addressing this puzzle. I also demonstrate that higher international competition is generally insufficient to generate demands for protectionist populism; we need to consider the supply-side of politics to better characterize this phenomenon.

In a model of protectionism, I incorporate the role of *elite cues* by a politician; i.e., campaign messages, advertising, sloganeering, spectacle, etc. Cues have two characteristics: First, they confer an issue ownership over policy because they are the campaign-hooks onto which the politician hangs her electoral aspirations (Riker et al., 1986; Petrocik, 1996). Second, they define the politician’s political base by shaping voters’ social identities, creating divisions in the electorate (De Leon et al., 2020; Puleo, 2021). I characterize the incentives that the politician faces to invest costly effort in finding successful cues in response to increased international competition.

Elites cues are theoretically-relevant because they shape voters’ preferences over protectionism by activating voters’ social identities. That is, voters’ preferences are a function of their identity and not only a function of their material welfare—building on the seminal work by Shayo (2007) on identity politics. In this sense individuals’ behavior is congruent with their social identity, which is voluntary and unregulated. The spectrum of social identities that an individual can identify with are the result of the social environment, historically-defined.<sup>3</sup>

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<sup>1</sup>Protectionism has been a staple of populism throughout history because high tariffs benefit the losers from international competition. This occurs because tariffs increase the price of income competing products and thus reduce (boost) the demand for foreign (local) products, benefiting workers in the import-competing sector.

<sup>2</sup>For example Ernst Boulanger (France), Salvador Allende (Chile) and Alan Garcia (Peru), among many other, banked on class cleavages (Dornbusch and Edwards, 2007); recently Donald Trump (U.S.), Marie Le Penn (France) and other European political leaders have banked on nativism (Smith and King, 2021; Hawkins et al., 2018).

<sup>3</sup>There is a spectrum of nominal identities. When an identity activates, the individual professes membership to it, or she is assigned to it by others as a member (Chandra, 2012).

Identity affects voters' preferences through a psychological channel that responds to the level of inequality between groups. To operationalize this attribute I borrow from the literature on the psychology of identity (Tajfel et al., 1979; Tajfel, 1981; Turner et al., 1987): Voters compare themselves to a prototypical member of their identity group and they derive satisfaction from the relative status of that group in society. There is also a cost of *cognitive dissonance* that obtains from the differences between voters' identity group and all other groups. Voters only identify with a group when they obtain a net psychological benefit from doing so. When voters identify broadly with other members of society, they exhibit other-regarding attitudes and they moderate their policy preferences. If narrower social identities are activated instead, voters exhibit *in-group* favoritism and as a result their preferences become more polarized.

Elite cues work by targeting the cost of dissonance, exacerbating the differences between identity groups, causing narrower identities to activate. For instance, Donald Trump used campaign rhetoric to underline the differences between predominantly white Americans in the import-competing industries, and most other segments of the population (Smith and King, 2021).<sup>4</sup> A populist has incentives to use elite cues because voter polarization created by activated identities can boost her political appeal due to the issue advantage. However, the success of these cues is probabilistic and depends on the effort that the populist invests in finding a cue relative to the effort that her political rival invests to prevent it. Hence if the expected value from protectionist populism is too low, there are no incentives to use cues—in this sense elite cues are endogenous.

International competition plays an important role in the dynamic described above. A drop in the price of imports reduces the demand for import-competing products, which are produced domestically, harming the workers whose livelihoods depend on them. It also makes them worse-off vis-à-vis their peers in other sectors because inequality increases against them. Hence these “losers from trade” have incentives to demand more protectionism to safe-keep their livelihoods, whereas their peers do not (Rogowski, 1987). Moreover, rising inequality increases the likelihood that voters' identities activate by growing the cost of dissonance because it generates differences between workers in different sectors.<sup>5</sup> If identity activates, the losers from international competition adopt in-group attitudes, their policy preferences toward protectionism become more extreme, and polarization over policy increases (Grossman and Helpman, 2018).

Starting from a baseline where identities are not activated, I demonstrate that the populist is endogenously protectionist because the expected value of using cues is largest if she is able to obtain the support of the largest voting bloc. This bloc is made of unskilled workers, who by definition

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<sup>4</sup>Kazin (2017) and Hawkins et al. (2018) show that this is not an isolated case.

<sup>5</sup>The underlying assumption that economic outcomes affect identity and thus preferences has been confirmed using experiments: Klor and Shayo 2010; Marchlewska et al. 2018; Aksoy and Palma 2019; Belardinelli and Stanig 2020.

have a low marginal productivity per unit of labor, and are employed especially the import competing sector (Feenstra, 2015). Hence the populist has incentives to activate this *class identity*,<sup>6</sup> creating stronger preferences for protectionism amongst these voters. Thus the populist needs to be an extreme protectionist, and as such she obtains an issue advantage over high protectionism if a cue is successful. In contrast, her rival adopts a less protectionist stance because if the populist's cues fail, she would have an issue advantage over a more moderate policy. Hence populists have incentives to use elite cues in response to international competition because cues confer issue advantage over protectionism.

Importantly, protectionist populism comes at a cost for social welfare. By activating identity, the populist focuses policy on reducing the level of inequality to the benefit of the unskilled labor, but this comes reduces the average income in society. This policy stance is electorally beneficial because the populist guarantees bigger reductions in inequality that favor the unskilled, boosting her political appeal, even if they come at the expense of lower income growth.

The populist also has incentives to activate narrower identities. In an extension of the model that incorporates ethnic identity,<sup>7</sup> I find that if the support of ethnic minorities is not necessary for obtaining electoral victory, the cost-effective option is to use elite cues to activate identity only in the unskilled ethnic majority. In this case protectionist policy by the populist largely reflects the preferences of the ethnic majority vis-à-vis the preferences of skilled labor and ethnic minorities. Furthermore, I show that this is more likely to occur in ethnically-diverse communities because if the ethnic minority becomes a relatively larger group, the expected benefit from creating ethnic polarization increases.

Counterintuitively, the populist has incentives to use elite cues when voter polarization is low ex-ante. When cues are successful, polarization generates large benefits relative to the effort that the populist invests for finding a cue. Hence the benefit of using cues decrease in a divided society, and is zero if identity is already activated. Populists use cues to shake the political landscape by creating divisions because the expected political returns to do so are high.

An increase in import competition also provides incentives for using elite cues. When the effectiveness of protectionism falls in response to lower import prices and the government cannot properly compensate with transfers the losers from international competition, the wage gap between unskilled workers and skilled workers widens. This induces an increase in the level of

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<sup>6</sup>The social marker (or descent-based attribute) that defines the social identity reflects the fact that unskilled labor is poorer than skilled labor because on average the marginal return to one unit of labor is comparatively lower for unskilled labor. Thus unskilled workers are income-poor while skilled workers are income-rich.

<sup>7</sup>For tractability I use only two identities: social class and ethnicity. These identities are amongst the most relevant ones, both economically and socially. Ethnicity is broadly defined in terms of the existence of an ethnic majority and ethnic minority, whereby the composition of the ethnic groups is not context dependent.

polarization if identities activate, boosting the expected value of using elite cues.

Identity can activate without elite cues, however the conditions under which this occurs are restrictive. To generate voter demand for extreme protectionism in the absence of cues, protectionism in the import competing sector must be high ex-ante and worker-compensation schemes must be weak. In this case, very high levels of protectionism are necessary to effectively curb import competition and reduce inequality. This may occur when there is a very large increase in import competition because this event can induce a large enough cost of dissonance—via higher inequality—to activate identity without elite cues.

The theoretical findings herein contribute to the understanding of the political economy of protectionist populism (Frieden, 2017; Mansfield et al., 2021; Brutger and Rathbun, 2021), especially the role that identity plays in this phenomenon (Grossman and Helpman, 2018; Gaikwad and Suryanarayan, 2021), and more generally to the theoretical literature about populism (Acemoglu et al., 2013; Kaltwasser et al., 2017; Eguia and Giovannoni, 2019). My findings characterize a populist as an opportunistic politician that benefits from adopting extreme protectionism and creating a demand for high protectionism, by generating political polarization between social classes using elite cues. It also shows that ethnic minorities are not always targeted by populist politicians with elite cues, when generating ethnic polarization is not cost-effective electorally. Thus, my theoretical model provides an explanation for the puzzle that motivates this paper.

My findings also provide a number of important empirical implications for studying populist protectionism. Among the most important ones: The model helps us addressing the inherent problem of self-selection in empirical studies due to the fact that populist protectionism is identified ex-post, which may limit external validity. My findings highlight the role of elite cues as relevant mediator in the causal chain from import competition to protectionism, addressing the previous issue by taking into account the endogenous nature of populism. They also indicate that ethnic diversity is an important moderator, strengthening the effect of import competition on populism and protectionism. I elaborate on other relevant empirical implications in Section 5.2.

## 2 Populism and protectionism

The work by Dornbusch and Edwards (2007) on populism in Latin America, and subsequent work by Funke et al. (2020) for a bigger number of countries, shows that macroeconomic policy espoused by populist leaders promotes economic nationalism. Import tariffs are particularly high because they safeguard the import-competing sector, whose competitiveness depends much on the relative price of the goods produced locally against the price of foreign goods. High tariffs

shift the demand away from imports to locally produced goods, which benefits the workers in the import-competing sector—boosting wages and employment (Feenstra, 2015).

In the process that leads to this *protectionist populism* two social groups become relevant: the winners and the losers from international competition. The losers are the workers in the import-competing sector, who vote for higher tariffs in order to protect their livelihoods by making imports more expensive. The winners do not work in this sector and they benefit from exactly the opposite, because if they work for instance in the export competing sector their relative wages increase with more international competition.<sup>8</sup> Populist leaders can thrive in this context because this process generates inequality between the winners and losers, to the benefit of the former, creating the possibility for generating a social cleavage that they can be exploit for electoral purposes. In fact, the literature defines populism in this way: Populism is a political cleavage between a group called the *demos* and another one called the *elite*, where the former designates themselves as the only true citizens worthy of consideration (Mudde and Kaltwasser, 2017). Congruently, populist protectionism promotes the well-being of the *demos* at the expense of all other social groups.

In the context herein, economic forces can naturally map the winners and losers from international competition to the elite and the *demos* respectively. However, this would be insufficient. Populists play a proactive role defining and refining the composition of the *demos* along the economic dimension and also along other dimensions, such as ethnicity, religion, nationality, etc. (Kazin, 2017; Kaltwasser et al., 2017; Hawkins et al., 2018). For instance, in the U.S. the 1890s the People’s Party pitted small farmers against industrial interests; during the 1960s George Wallace infamously spearheaded the white-backlash embedded in the segregationist movement in the south; in the 1980s divisions between conservatives and liberals were fueled by the coalition between Reagan and the Christian Right; more recently Donald Trump exacerbated these divisions along nativist lines (Kazin, 2017). Kaltwasser et al. (2017) discusses similar examples for other countries. Therefore populism may not emerges if the populist doesn’t define the social cleavage between the *demos* and the elite. But how do populists shape these cleavages?

## 2.1 The role of elite cues

Theoretical models about populism usually strip political leaders of their role shaping and defining their political base. Many start from the assumption that populism emerges from a discontent with the political status quo. Voters elect “political outsiders” because they are not constrained by special interests or institutional norms, and thus they credibly represent the interests of the *demos* (Acemoglu et al., 2013; Karakas and Mitra, 2017; Buisseret and Van Weelden, 2020). Fujimori

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<sup>8</sup>This is a standard result in international trade theory (Feenstra, 2015), on which I elaborate in Section 3.

is an example of this, due to his Japanese ancestry and the fact that he was virtual unknown a month before the 1990 presidential election. He surged to victory by capitalizing on the crisis of established parties, running against conservative Mario Vargas Llosa, who had the backing of Peru's traditional elite (Levitsky and Roberts, 2011).

However many populists do not conform to the “outsider” status. For example Geert Wilders in the Netherlands was an influential backbencher in charge of foreign policy in the conservative People's Party for Freedom and Democracy before his tenure in Party for Freedom; Rafael Correa, former president of Ecuador, served in Alfredo Palacio's cabinet as minister of finance; Collor de Mello had been elected on the ticket of many different parties before becoming president of Brazil. The recent literature posits instead that populists are political opportunists that espouse extreme political views for electoral purposes (Mukand and Rodrik, 2018; Eguia and Giovannoni, 2019).

In this regard, the comparative literature about populism sees populism essentially as a Manichaeian discourse that identifies Good with a unified will of the people—the demos—and Evil with the elite (Kaltwasser et al., 2017). The discursive definition describes an innate cultural aspect to populist politics in the Geertzian sense, which is rooted in our shared ability to assign meanings to the world around us (Eckstein, 1988); it as a set of ideas instead of a set of actions isolated from their underlying meanings for leaders and participants (Mudde and Kaltwasser, 2017). These ideas take the form of narratives, or *elite cues*, and they are intended to differentiate the demos from the elite on social and economic grounds, such that everything that does not belong to the demos, is alien to it—excluded from *vox populi*. In this sense, populists are not passive “outsiders” that transform voters' preferences into policy; populists are politicians that use rhetoric, narratives, sloganeering, and spectacle to win voters over (Riker et al., 1986). They engage in a discursive exercise to remold the voters' interests and its rivals positions, undertaking the task of defining and mobilizing the interests of her political base (Schumpeter, 1942; De Leon et al., 2020).

Populists commitment to the policies they espouse is relevant in this context, because otherwise exhibiting more extreme positions in comparison to the more traditional politician would be too costly (Eguia and Giovannoni, 2019). As with politicians in general, when populists spend time and effort creating narratives supporting a particular policy, they obtain an issue advantage regarding their policy stance (Petrocik, 1996). This issue advantage benefits the populist whenever voters' preferences shift in favor of her policy stance (Egan, 2013). Thus the populist commitment to an extreme policy stance is a reflection of the electoral incentives that she faces, thanks to the issue advantage she obtains from spending effort in finding narratives for the political marketplace.

The aforementioned characteristics are visible as far back as the 19th century in the context of protectionist policy. For example, during the long-depression (1880s), France observed a marked



contraction in its trade balance. The levels of economic vulnerability engendered by this crisis in the manufacturing sector led to profound and widespread animosities towards the governing Republican elite, who appeared to be indifferent to ordinary people's plights. In this context, George Ernst Boulanger rose to power by promoting aggressive nationalist policies known as *Revanchism*. "Boulangist propaganda was relentless in attacking the parliamentary regime, characterized as a corrupt oligarchy; an assembly of irresponsible, ineffective 'tripoteurs' (shady dealers), indifferent to the concerns of ordinary people" (Hawkins et al., 2018). Boulanger promoted himself as a man of the people, who, as his 1888 program claimed, sided with those desperately looking for work. Boulanger's campaign employed all the techniques of modern mass politics—advertising, sloganeering, spectacle—to fasten the public's attention on him (Nord, 2017). Other notable examples include Juan Peron and Eva Peron in Argentina; Getulio Vargas and Collor de Melo in the case of Brazil; Alan Garcia in Peru; Salvador Allende in Chile; Luis Echeverria and Lopez Portillo in Mexico (Dornbusch and Edwards, 2007).

Another empirical regularity that has attracted much attention involves the fact that recently, populists in developed countries exclude ethnic minorities from the *demos*, despite that they also lose from international competition. In the context of protectionism, Smith and King (2021) analyses Trump's campaign rhetoric and political actions, finding that he narrates American identity as a tale of predominantly white America, where he advocates for white protectionism while reducing or eliminating initiatives designed to assist non-whites; they write: "Trump is neither an explicit white nationalist nor a true adherent to color-blindness. He is instead a white protectionist." Similarly Katitas (2021) indicates that campaign adds often seek to fuel protectionism and nativism. In other countries protectionist populism has also involved an ethnic dimension whereby populists advocate for protectionism for natives. Some notable examples include: Pauline Hanson in Australia; Marie Le Penn in France; Boris Jhonson in the UK; and more generally parties such as Socialistische Partij in the Netherlands, die Linke in Germany, and Partij voor de Vrijheid in the Netherlands (Van der Waal and De Koster, 2018).

Altogether this characteristic of populism whereby populists seek to create divisions between a well-defined *demos* and an elite is ubiquitous (Hawkins et al., 2018). However, one shortcoming is that little is known about the determinants behind populists' incentives to use narratives to define the *demos* only along the lines of class, and when do they refine the definition of the *demos* to exclude some specific social identities—like ethnicity.

This shortcoming is more evident in the study of protectionist populism where this question remains understudied. Next, I address this shortcoming.



### 3 The model

Consider two groups: skilled workers ( $S$ ) and unskilled workers ( $U$ ). Define  $i = \{U, S\}$ . The population is normalized to one such that  $\lambda_S + \lambda_U = 1$ , with  $\lambda_U > \lambda_S > 0$ ; I relax this assumption in Section 5 to include ethnicity to the group typology. The economy has two sectors, each producing a (generic) good using a combination of skilled and unskilled labor. Production technologies exhibit constant returns to scale, are homogeneous of degree one, and are twice differentiable and strictly concave. All markets are perfectly competitive and in equilibrium.

I assume, without loss of generality, that the commodity  $X$  is exported and that  $Z$  is the import-competing good. The exported good makes relatively intensive use of the skilled labor, while the import-competing good makes relatively intensive use of unskilled labor.<sup>9</sup>

The price of  $X$  is normalized to one to serve as numeraire;  $q > 0$  is the international price of  $Z$ . Governments collect taxes on imports using tariffs,  $\tau \in \mathfrak{R}$ , thus the domestic price of  $Z$  is  $p = q(1 + \tau)$ . Importantly,  $q$  captures the relative price of exports in terms of imports—or the *terms of trade*. That is,  $q$  is the amount of imports an economy can purchase per unit of exports. Hence, when imports become cheaper the terms of trade improve and the demand for them increases. Since  $p$  is a linear function of tariffs,  $p$  is also a measure of the level of protectionism.

Workers enjoy two types of well-being: i) material well-being, which is captured by a function  $v_i(\cdot)$ , and ii) psychological well-being, which is captured by a function  $\vartheta_i(\cdot)$ . Both functions are increasing, concave, continuous and differentiable in their arguments. Workers' utility is given by the sum of these two types of well-being:

$$u_i(p, q) = v_i(p, q) + \vartheta_i(p, q).$$

The addition of psychological well-being expands the standard utility function, capturing the stylized fact that individuals not only make choices on the basis of their material well-being but also on other types of well-being (Akerlof and Kranton, 2005).

The material well-being has a standard formulation:

$$v_i(p, q) = \omega_i(p) + T(p, q) + \Gamma(p)$$

where  $\omega_i(p)$  is the wage of an individual in group  $i$ , with  $\omega_S(p) > \omega_U(p)$ ;<sup>10</sup>  $T(p, q) = (p - q)\Omega(p)$

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<sup>9</sup>In developed countries  $X$  can be tied to simple manufactures: furniture, auto parts, textiles, and similar goods.  $Z$  can be associated to complex manufactures: airplanes, robots, smart phones, etc. In a less technologically advanced country,  $X$  can be tied to agricultural products and  $Z$  to manufactures in general.

<sup>10</sup>Wages are lower for unskilled workers because they are less productive than skilled workers per unit of labor.

is the per-capita rebate from tariff revenues, where  $\Omega(p)$  is the import-demand function; and  $\Gamma(p)$  is the consumer surplus. The demand for imports and consumer surplus fall as protectionism rises.

The psychological well-being is given by:<sup>11</sup>

$$\vartheta_i(p, q) = \mathbb{I}_i \{ \bar{v}(p, q) - \beta_i \lambda_i [v_{-i}(p, q) - v_i(p, q)]^2 \},$$

where  $\mathbb{I}_i$  is an indicator function defined by

$$\mathbb{I}_i = \begin{cases} 1 & \text{if } \bar{v}(p, q) - \beta_i \lambda_i [v_{-i}(p, q) - v_i(p, q)]^2 \geq 0, \\ 0 & \text{otherwise.} \end{cases}$$

$\bar{v}(\cdot)$  is the average material utility in the population, and  $\beta_i > 0$  is the degree of discontent with the differences between groups. The former term captures the benefit or *warm glow* that  $i$  enjoys when they identify with other people different from them. The latter term captures the degree of aversion to inequality because individual care about the relative economic position of their group in society. Workers also care more about inequality when their share in their population increases.

The psychological component emphasizes the idea that individuals face a trade-off between being members of larger, more diverse group vis-à-vis being members of coarser groups. This occurs because there is a *cost of dissonance* from identifying with other individuals that are different from oneself (Tajfel et al., 1979; Tajfel, 1981; Turner et al., 1987).

The indicator function defines a *social identity equilibrium* in reduced form: When  $\mathbb{I}_i = 0$  individuals follow the prescribed behavior of their group and care only about their group status because identity has activated. As a result, they adopt *in-group* attitudes. If  $\mathbb{I}_i = 1$  they exhibit other-regarding attitudes instead. Individuals identify with a group only when the glow is larger than the cost of dissonance. In this sense, social identities are congruent with the socio-economic environment, but they are also voluntary and unregulated (Shayo, 2009).

When identity activates  $i$  is defined by the skill-group, or (what is the same herein) their social class, individuals choices are congruent only with the preferences of their class. This may seem limited at first glance because a person's identity can be multifaceted, and more complex than these two identity groups presuppose (Bernstein, 2005), but this simplification facilitates the exposition of the model and the main results ahead. In Section 5 I add ethnicity as a cross-cutting identity.

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<sup>11</sup>I borrow some elements from Grossman and Helpman (2018) for this formulation.

Finally, note that we can rewrite  $i$ 's utility function as

$$u_i(p, q) = \omega_i(p) + T(p, q) + \Gamma(p) + \mathbb{I}_i\{Y(p) + T(p, q) + \Gamma(p) - \beta_i \lambda_i [\delta(p)]^2\}. \quad (1)$$

where  $\delta(p) = \omega_S(p) - \omega_U(p) > 0$  denotes the wage gap, which is decreasing in the level of protectionism by the standard Stolper-Samuelson theorem.<sup>12</sup>  $Y(p) = \lambda_S \omega_S(p) + \lambda_U \omega_U(p)$  is the aggregate demand. The glow can thus be proxy by the level of material prosperity per-capita: the average income, whereas the cost of dissonance by the level of inequality between groups.

**Individual preferences over protectionism.**  $i$ 's preferred level of protectionism is characterized by  $p_i^* \equiv \operatorname{argmax}_p u_i(p, q)$ , where a higher  $p^*$  means more protectionism. Unskilled workers prefer higher levels of protectionism vis-à-vis skilled workers because they are the factor that is used most intensively in the import-competing sector, hence they benefit from a higher demand for local products because their wages improve as a result (Rogowski, 1987).

Since  $u_i(\cdot)$  depends on the indicator function defined above, the preferred level of protectionism depends on whether identity is activated or not. When identity is not activated ( $\mathbb{I}_i = 1$ ),  $i$  faces a trade-off between the glow from identifying with a socially diverse society and a cost of dissonance from identifying with others. As a result,  $i$ 's preferences over protectionism are more moderate. When identity is not activated ( $\mathbb{I}_i = 0$ ), this no longer occurs.

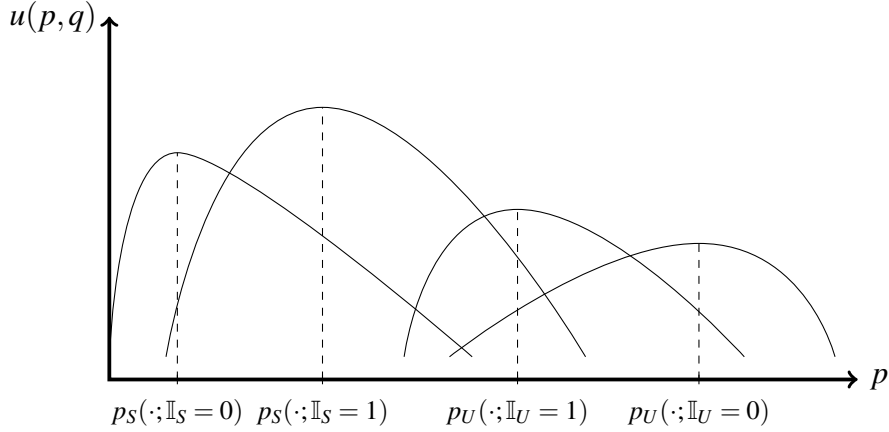
Figure 1 illustrates the previous point. In it, I plot  $i$ 's well-being as function of the level of protectionism. Each curve illustrates the utility of a representative worker with skill  $i$  and identity profile  $\mathbb{I}_i$ . The optimal tariff policy for  $U$  is always at the right of  $S$  by Stolper-Samuelson. Note that when identity is not activated, the preferences over tariff policy are comparatively moderate along the free-trade-to-protectionism spectrum (left to right in the x-axis). Thus  $u_i(p, q|\mathbb{I}_i = 0) < u_i(p, q|\mathbb{I}_i = 1)$ . In contrast when identity is activated (for all  $i$ ), preferences over policy are more polarized because individuals only care about their group.

This result shows that there are differences over the preferences for protectionism between skilled and unskilled labor because their policy preferences differ. Moreover, polarization over policy increases when identity activates.

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<sup>12</sup>This is a standard theorem in trade theory, and states that a rise in the level of protectionism leads to a rise in the real return to the factor which is used most intensively in the production of import-competing goods (i.e., unskilled labor) and to a fall in the real return to the other factor (i.e., skilled labor).

**Figure 1: Individuals' preferences for protectionism**



### 3.1 Political competition

There are two political candidates  $E$  and  $O$  who compete for office by proposing a binding tariff policy; denote  $k = \{E, O\}$ . The candidate with most votes wins.

$O$  is a *populist*; that is an “opportunistic politician” (Section 2).  $E$  is part of the political establishment; I will refer to her more generally as *the establishment*. The difference between these candidates is that the former may use elite cues—campaign speeches, ads, sloganeering, spectacle, etc.—in an attempt to activate (social-class) identity among voters, creating political polarization. Instead, the establishment may try to prevent this from happening by using counter-propaganda.<sup>13</sup>

Candidates need to invest costly effort  $e_O \geq 0$  and  $e_E \geq 0$  to find a cue or to use counter-propaganda, respectively. These choices are simultaneous. A cue is successful with probability  $\phi(e_E, e_O)$ , where  $\phi(\cdot)$  is increasing and concave in  $O$ ’s effort, and decreasing in  $E$ ’s effort.

To activate identity the opportunistic politician needs a mechanism that affects voters’ preferences. Among the primitives of the model, manipulating international prices ( $q$ ) and the population shares ( $\lambda$ ) can be prohibitively costly because the opportunistic candidate needs the ability to affect the global and local economic structure by herself. However, politicians often manipulate people’s feelings of dissatisfaction because by doing so they can shape, organize and galvanize their political base (De Leon et al., 2020). This means that the populist has the ability to manipulate the degree of inequality aversion ( $\beta_i$ ), and thus the cost of dissonance. If she discovers an effective cue targeted at  $i$ , then  $\beta_i = \tilde{\beta}_i$  such that  $\mathbb{I}_i^{\tilde{\beta}_i} = 0$ , by increasing the cost of dissonance.

<sup>13</sup>Counter propaganda is used to discredit candidates that are not from the political establishment (Kaltwasser et al., 2017). For instance, during the 2016 presidential campaign in the U.S., Hillary Clinton ran ads that were mostly devoid of policy content, whose objective was to discredit Donald Trump (Fowler et al., 2016).

When a politician invests time and effort in finding narratives for the political marketplace, she also obtains issue ownership over policy (Petrocik, 1996). This provides an advantage over a policy stance, because the politician becomes the most competent candidate for delivering the policy in the eyes of voters (Egan, 2013). This is valuable for the populist if she is a protectionist vis-à-vis the establishment, because most of the electorate would prefer high protectionism if identity is activated (Figure 1). Further, since by construction the establishment cannot have issue advantage over high protectionism, it must be that she would exhibit an issue advantage over low protectionism. Hence, if the elite cue fails in this case, then high protectionism as a policy stance is a harmful for the populist. I denote the issue advantage by  $\alpha > 0$ , which is a standard assumption used in similar models of electoral politics.<sup>14</sup>

Having the previous in mind, the timing of the game is as follows:

- $E$  and  $O$  simultaneously choose their policy platforms.
- $E$  decides whether or not to invest effort in finding a divisive cue.
- If  $E$  decides investing effort,  $O$  and  $E$  choose their level of effort simultaneously.
  - If the cue is successful (an) identity activates and workers vote for their preferred candidate.
  - If the cue is unsuccessful identity does not activate and workers vote for their preferred candidate.
- If  $E$  does not invest effort, there are no cues and workers vote for their preferred candidate.

## 4 Equilibrium

The equilibrium concept is sub-game perfect Nash equilibrium (SPNE). Thus I proceed to solve the game by backward induction.

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<sup>14</sup>A costly signaling game could provide an alternative to the contest success function if  $O$  uses a costly signal to convince  $i$  that  $\beta_i$  is higher. This alternative is less tractable in a model with an open economy, adds fewer additional insights, and eliminates an intuitive aspect behind successful cues: Elite Cues are a bet whereby the populist's success depends on the level of counter-propaganda by the establishment.

## 4.1 Benchmark equilibrium: no elite cues

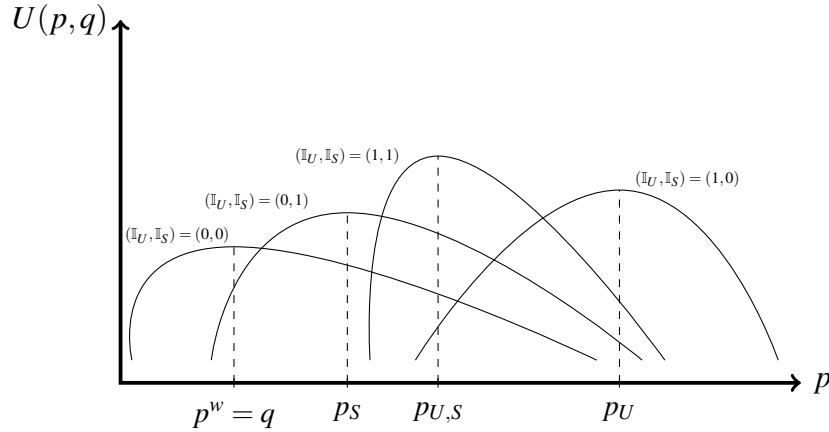
First, I characterize the sub-game equilibrium where the opportunistic politician does not use cues, which mirrors [Grossman and Helpman \(2018\)](#). If candidates view all voters as having ideological preferences drawn from a common distribution, the equilibrium policy features convergence and the equilibrium policy maximizes the utilitarian social welfare function.<sup>15</sup> Hence, using the vote shares as the welfare weights, candidate  $k$ 's optimal policy is

$$p_k = p^w \equiv \underset{p}{\operatorname{argmax}} Y(p) + T(p, q) + \Gamma(p) + \sum_i \lambda_i \mathbb{I}_i \{Y(p) + T(p, q) + \Gamma(p) - \beta_i \lambda_i [\delta(p)]^2\}, \quad (2)$$

where  $p^w$  denotes the welfare-maximizing policy.

Figure 2 illustrates the utilitarian social welfare functions for different values of the vector  $(\mathbb{I}_U, \mathbb{I}_S)$  as a function of the level of protectionism.<sup>16</sup> Equilibria at  $p^w = q$ ,  $p_U$ ,  $p_S$  and  $p_{U,S}$  are all possible outcomes associated with  $(\mathbb{I}_U, \mathbb{I}_S) = (0, 0)$ ,  $(\mathbb{I}_U, \mathbb{I}_S) = (0, 1)$ ,  $(\mathbb{I}_U, \mathbb{I}_S) = (1, 0)$  and  $(\mathbb{I}_U, \mathbb{I}_S) = (1, 1)$  respectively. Note that  $p^w = q$  when both class identities activate,  $(\mathbb{I}_U, \mathbb{I}_S) = (0, 0)$ , because the optimal policy must be one of free trade. This is a standard result in international trade theory. When identity is not activated,  $p^w > q$  because there is an aversion to inequality, and inequality falls with higher levels of protectionism.

**Figure 2: Tariff policy in equilibrium**



<sup>15</sup>The optimal policy maximizes the utilitarian social welfare function wherein the welfare weights are determined by the political clout of the voting blocs ([Grossman and Helpman, 1996](#)). The equilibrium policy possesses similar implications to the median voter's preferred policy because the resulting policy is driven by the group(s) with the largest political clout.

<sup>16</sup>The socially optimal equilibrium level of protectionism increases if  $U_p(p, q|\cdot, \mathbb{I}_U = 1) = 0$  and  $U_p(p, q|\cdot, \mathbb{I}_U = 0) > 0$ . Note that  $U_p(p, q|\cdot, \mathbb{I}_U = 0) > U_p(p, q|\cdot, \mathbb{I}_U = 1)$  if and only if  $\beta_S \lambda_S > \beta_U \lambda_U$ .

#### 4.1.1 Protectionist populism from the bottom-up

Protectionist populism corresponds to a sharp increase in the level of protectionism (Dornbusch and Edwards, 2007). When does this occur? Figure 2 shows that the most protectionist policy emerges when only unskilled voters adopt in-group preferences. Thus let us assume identity is not activated—that is  $(\mathbb{I}_U, \mathbb{I}_S) = (1, 1)$  and the status-quo policy is  $p^w$ . Protectionism increases sharply when the unskilled adopt in-group attitudes  $((\mathbb{I}_U, \mathbb{I}_S) = (1, 0))$ . In the absence of elite cues, this occurs whenever the level of inequality ( $\delta^2$ ) increases faster than the average income ( $\bar{v}$ ). Thus populist protectionism focuses on reducing the level of inequality to the benefit of the unskilled labor at the cost of reducing the average income of society, harming economic growth.

Since I want to understand the effect of import competition on protectionist populism, I analyze when the equilibrium policy becomes more protectionist if imports become cheaper ( $dq < 0$ ). The necessary condition requires that cheaper imports reduce the cost of protection while also boosting the responsiveness of the wage gap to a change in prices (Lemma 1). In other words, if tariffs become less effective for protecting workers in the import-competing sector because the deadweight loss falls, and compensation from government transfers is insufficient for workers, there's a protectionist reaction. Similarly, we should observe a stronger protectionist reaction from workers in industries with a larger import-price pass-through because higher tariffs are ineffective at shifting the demand from imports to local goods. Congruently, I assume that  $\delta''(p) \geq 0$  and  $\Omega''(p) \leq 0$  from here onward.

**Lemma 1.** *If  $\Omega''(p) \leq 0$  and  $\delta''(p) \geq 0$  then  $\frac{d\tau_i^w}{dq} \frac{q}{1+\tau^w} < 0$ .*

Proof in Appendix A.

Define  $\gamma = \lambda_U \beta_U$  as the *marginal cost of dissonance*.  $\gamma$  increases when both the share of unskilled workers goes up and when unskilled workers care more about inequality. While the former is easy to measure with economic data, the latter is much harder to measure. However, I establish meaningful testable hypothesis in Section 5.1 on the basis of this apparent limitation.

Let us define

$$\gamma_U^{**} = \frac{\bar{v}(p^w, q)}{\delta(p^w)^2} \quad (3)$$

is a critical point such that when  $\gamma_U^{**}$  increases it becomes more likely that unskilled workers adopt in-group attitudes because if  $\gamma_U^{**} > \gamma$  identity activates. A fall in import prices generates a fall in  $\gamma_U^{**}$  when  $d\gamma_U^{**}/dp > 0$ , or equivalently

$$\frac{\delta'(p^w)}{\Omega'(p^w)} > \frac{p^w - q}{2\bar{v}(p^w, q)}.$$



The right-hand side of the inequality is less than one and likely small, thus we focus on the left-hand side, which needs to be larger than the right-hand side. The latter is likely to occur when  $p^w$  is high at the baseline identity profile,  $(\mathbb{I}_U, \mathbb{I}_S) = (1, 1)$ , because inequality would increase fast as a result of an increase in import competition whereas tariff rebates increase slowly. In such a scenario, unskilled workers are not adequately compensated for the decline in their incomes.

## 4.2 The role of elite cues

Recall that elite cues activate identity by increasing the cost of dissonance over the glow that individuals feel from identifying with others by increasing voters' discontent with inequality. Since the unskilled are the largest voting group,  $E$ 's dominant strategy is to target them because this is the cost-effective alternative. Hence skilled workers endogenously take the role of the *elite* whereas the unskilled become the *demos*, in accordance with the literature (Section 2). A successful cue is therefore  $\tilde{\beta}_U$  such that  $\mathbb{I}_i^{\tilde{\beta}_U} = 0$ , creating in-group attitudes in the demos/unskilled labor.

The effectiveness of a cue is a probabilistic outcome. For tractability, let us assume  $\phi_O(\cdot, \cdot)$  follows a standard contest success function:  $\phi_O(e_O, e_E) = \frac{e_O}{e_O + e_E}$ . Recall that  $e$  stands for the amount of resources used to find a cue in the case of the populist ( $O$ ), and the amount of resources used for counter-propaganda in the case of the establishment ( $E$ ).

$i$  maximizes the expected value of holding office net the cost of finding a cue:

$$\operatorname{argmax}_{e_O} R \left[ \pi^I(p_O, p_E; q, \alpha) \phi(e_O, e_E^*) + \pi^{NI}(p_O, p_E; q, \alpha) (1 - \phi(e_O, e_E^*)) \right] - e_O.$$

$\pi^I(\cdot)$  is the populist's probability of winning when the cue is successful, and  $\pi^{NI}(\cdot)$  when it isn't. Recall that the populist receives an issue advantage  $\alpha > 0$  if she discovers a successful cue; this issue ownership is harmful if she fails. The establishment's maximization problem is similar.

Consistent with the literature on elite cues, I assume that the populist (establishment) holds an issue advantage over the establishment (populist) if identity does (does not) activate. However, I do not investigate the implications for equilibrium regarding the size of the issue advantage because this removes our focus from the behavioral incentives of the populist, and places it instead in a rather mechanical feature of elite cues. Hence assume that  $\alpha$  is large enough to generate incentives for investing positive effort into cues and counter-propaganda.

The solutions are symmetric and characterized by

$$e_i^* = \frac{\lambda_U R}{2} \cdot \left[ \vartheta_U(p_E, q | \mathbb{I}_U = 1) - \vartheta_U(p_O, q | \mathbb{I}_U = 1) \right]. \quad (4)$$

The effort invested by both candidates is function of the difference in the psychological well-being from unskilled labor, conditional on the candidates' optimal policies when identity is not activated. This difference captures the electoral benefits from voter polarization if the populist and the establishment run on divergent policy platforms. Note that both candidates invest more effort in finding a cue if the populist can create more political polarization.

A necessary condition for observing cues requires that the populist chooses a policy that is more protectionist than that of the traditional politician, whereas the latter chooses the welfare maximizing policy at  $(\mathbb{I}_U, \mathbb{I}_S) = (1, 1)$  (Lemma 2). This is consistent with the evidence showing that populists are comparatively protectionists (Funke et al., 2020).

**Lemma 2.** *A necessary condition for  $e_k > 0$ , for all  $k$ , requires that  $p_O > p_E$ , and that  $p_E \equiv p^w$ , and  $p_O$  to be no larger than the autarky price, at identity regime  $(\mathbb{I}_U, \mathbb{I}_S) = (1, 1)$ .*

Proof in Appendix A.

Having the previous in mind, the populist invests effort in finding a cue whenever  $\vartheta_U(p_E, q | \mathbb{I}_U = 1) > \vartheta_U(p_O, q | \mathbb{I}_U = 1)$ , otherwise the cost of using cues is larger than the benefit. Using this expression and rearranging, define the critical point

$$\gamma_U^* = \frac{\bar{v}(p_E, q) - \bar{v}(p_O, q)}{\delta(p_E)^2 - \delta(p_O)^2}. \quad (5)$$

such that when  $\gamma_U^*$  falls elite cues become more likely because if  $\gamma_U^* > \gamma$  then both politicians invest positive effort into cues/counter-propaganda. Since the populist must be more protectionist than the establishment, the previous expression implies that protectionist populism is a situation where: the establishment's policy leads to higher average wage (or economic growth) whereas the populist guarantees lower levels of inequality at the expense of income growth. This is consistent with the observations in the seminal work by Dornbusch and Edwards (2007).

Proposition 1 summarizes the best responses in equilibrium. The results can be interpreted as follows: The populist has incentives to use elite cues when voter polarization is small ( $\gamma < \gamma_U^*$ ), because by activating identity she generates in-group attitudes in unskilled voters, generating more voter polarization. This in turn increases the expected benefit from using elite cues because the populist guarantees bigger reductions in inequality that favor the unskilled, boosting their political appeal. In contrast, when the cost of dissonance from identifying with others relative to the glow of doing is higher ( $\gamma > \gamma_U^*$ ), there are no incentives to use elite cues. In this case, the amount of additional polarization that cues create is too low, thus the expected benefit from using them is too low as well. Therefore the populist behaves like a more traditional party.

**Proposition 1.** *The SPNE of the game described above is:*

- i) If  $\gamma_U > \gamma_U^*$ : the vector  $(p_E, p_O, e_E, e_O) \equiv (p^w, p^w, 0, 0)$  characterizes the SPNE.
- ii) If  $\gamma_U < \gamma_U^*$ : the vector  $(p_E, p_O, e_E, e_O) \equiv (p^w, p_O, e_E^*, e_O^*)$  where  $e_E^*$  and  $e_O^*$  are defined as in Equation 4. The equilibrium policy is  $p_O$  with probability  $\pi_E^I(p_E, p_O; q, \alpha)\phi_O(e_E^*, e_O^*)$ , and it is  $p^w$  otherwise.

*Proof.* Proof in the text. □

Since  $\gamma_U^{**} > \gamma_U^*$  (Corollary 1), if the cost of dissonance is very high ( $\gamma > \gamma_U^{**}$ ), unskilled workers adopt in-group attitudes because identity activates. Nevertheless, because there are no incentives to invest effort in elite cues, both the populist and the establishment's best response is to converge to a more protectionist platform vis-à-vis the baseline where identity is not activated. Thus high levels of protectionism can emerge from the bottom-up (Section 4.1.1).

**Collorary 1.**  $\gamma_U^{**} > \gamma_U^*$

*Proof.* The proof follows directly from the proof for Lemma 2. □

The results above also capture the stylized fact that populists are not necessarily political outsiders, but rather political opportunists that adopt extreme political views for electoral purposes (Proposition 1). For instance, think about two of the most successful populist radical right parties in western Europe: the Freedom Party of Austria and the Swiss People's Party, which started out as traditional, mainstream parties. Party leaders Jorg Haider and Christopher Blocher transformed them into radical parties. Moreover, they also accept the possibility that even establishment parties may converge to the positions adopted by populists (Corollary 1).

#### 4.2.1 Protectionist populism from the top-down

Does protectionist populism emerges from import competition via the use of elite cues? I have posited that elite cues are an important mechanism whereby import competition increases the likelihood of protectionist populism. Hence I analyze if the critical point  $\gamma_U^*$  falls when imports become cheaper ( $dq < 0$ ). I find that indeed  $\gamma_U^*$  increases in response to more import competition, furthermore politicians' effort on elite cues and counter-propaganda also increases (Lemma 3).

**Lemma 3.** Both  $\gamma_U^*$  and  $e_k^*$  (for all  $k$ ) increase in response to an improvement in the terms of trade.

Proof in Appendix A.

Since  $\gamma_U^{**} > \gamma_U^*$ , the increase in the level of import competition for observing bottom-up protectionist populism must be larger than the one needed for top-down protectionist populism. Top-down protectionist populism emerges instead when there is an opportunity to boost voter polarization. Hence top-down protectionist populism does not need large import shocks to generate extreme protectionism. Hence bottom-up protectionist populism is a rarer phenomenon.

This finding is congruent with the idea that social movements need to develop a frame through which they define the relevant social grievance affecting society. Grassroots movements, for instance, need to define a common identity and a common enemy, relying on its capacity to interpret a widespread feeling of anger with the status quo, for which the solution lies in the (sovereign) masses. Some examples include the “we are the 99%” movement or “indignados” in Spain. However, finding a frame is difficult because social movements need to aggregate preferences and define who is friend and who is not. In this regard, major events—such as economic crises—can create a focal points that generate an organic social movement (Fukuyama, 2018). A crisis is unnecessary for populists—they only need an opportunity to create polarization for their electoral benefit (Hawkins et al., 2018; Eguia and Giovannoni, 2019).

## 5 Activating ethnic identity

Identities are multidimensional social constructs, and politicians may build electoral support by appealing to more than one dimension of voters’ identity (Posner, 2017). Populists, for instance, may exclude certain social groups from being considered worthy of protection from international competition, refining the demographic composition of the demos. This is possible because the composition of the demos is not predetermined, it is malleable and the populist plays an active role in shaping it (Kaltwasser et al., 2017). Indeed, populists have refined the demographic composition of this group to exclude ethnic minorities, even if the latter are affected by import competition (Van der Waal and De Koster, 2018; Smith and King, 2021). In developed countries, these ethnic minorities are often defined as all other individuals than are not native; this often means non-whites and individuals that are not from European descent (Jardina, 2019). However this form of identity politics is not exclusive to these contexts.

For tractability and to facilitate interpretation, I analyze populists’ incentives to use elite cues when there are two identities: social class and ethnicity. These identities are amongst the most relevant ones, both economically and socially, and also in the study of protectionist populism. However ethnicity is broadly defined in terms of the existence of an ethnic majority and an ethnic minority, whereby the composition of these ethnic groups is not fixed. Hence for the purposes of

interpretation, the exact definition of an ethnic minority (or majority) is context independent.

Let us assume that society is composed of two cross-cutting groups: a worker group and an ethnic group. Workers can be skilled ( $S$ ) or unskilled ( $U$ ); an ethnicity can belong to the majority ( $m$ ) or the minority ( $n$ ). Let  $i = \{U, S\}$  and  $j = \{m, n\}$  and  $l \in i \times j$ . The population is normalized to one such that  $\sum \lambda_l = 1$  (Table 1).  $\lambda_U > \lambda_S$ , consistent with the previous model, and  $\lambda_m > \lambda_n$  such that ethnic minorities are the smallest ethnic group regardless of their skill type. For tractability, I assume that the marginal productivity of labor is the same for any ethnicity belonging to the same skill group, hence  $\omega_m(\cdot) = \omega_n(\cdot)$ .

**Table 1: Group shares**

Group	Unskilled	Skilled	Total
Minority	$\lambda_{Un}$	$\lambda_{Sn}$	$\lambda_n$
Majority	$\lambda_{Um}$	$\lambda_{Sm}$	$\lambda_m$
Total	$\lambda_U$	$\lambda_S$	1

Voters' maximization problem is similar as before:

$$p_l^* \equiv \operatorname{argmax}_p \omega_l(p) + T(p, q) + \Gamma(p) + \mathbb{I}_l \{Y(p) + T(p, q) + \Gamma(p) - \beta_l \lambda_l [\delta(p)]^2\}.$$

If workers' identities are activated, their preferences for protectionism within-group are the same because workers have the same marginal productivity within skill-group regardless of their ethnicity. If identity is not activated, there are differences in the preferences within skill-group. These differences are determined by the group-specific level of discontent with inequality ( $\beta_l$ ) and their share in the population ( $\lambda_l$ ).

The game is the same one as before (Section 3.1), and no identity is activated at the baseline:  $(\mathbb{I}_{Um}, \mathbb{I}_{Un}, \mathbb{I}_{Sm}, \mathbb{I}_{Sn}) = (1, 1, 1, 1)$ . In this case the populist can use his effort and resources to target four groups with elite cues instead of two. Candidate  $k$ 's utility function is thus given by:

$$\operatorname{argmax}_{\mathbf{e}_k} E[R|\mathbf{p}, \mathbf{e}; q, \alpha] - \sum_j e_k^j, \quad (6)$$

where the bold letters denote vectors. Proposition 2 summarizes the equilibrium results.

**Proposition 2.** *The SPNE of the game described above is:*

- If  $\lambda_{Um} > 1/2$  and  $\gamma_{Um} > \gamma_{Um}^*$  then  $e_k^{Um} = 0$ ,  $e_k^{Un} = 0$  and  $e_k^{Sn} = 0$  and the equilibrium policy is  $p^w$  at identity profile  $(\mathbb{I}_{Um}, \mathbb{I}_{Un}, \mathbb{I}_{Sm}, \mathbb{I}_{Sn}) = (1, 1, 1, 1)$ .

Otherwise:

- If  $\lambda_{Um} > 1/2$  and  $\gamma_{Um} < \gamma_{Um}^*$  then  $e_k^{Um} > 0$ ,  $e_k^{Un} = 0$  and  $e_k^{S\cdot} = 0$ .
- If  $\lambda_{Um} < 1/2$ , then:
  - If  $\gamma_{Um} < \gamma_{Um}^*$  and  $\gamma_{Un} > \gamma_{Un}^*$  then  $e_{Um}^k > 0$ ,  $e_{Un}^k = 0$  and  $e_{S\cdot}^k = 0$ .
  - If  $\gamma_{Um} > \gamma_{Um}^*$  and  $\gamma_{Un} < \gamma_{Un}^*$  then  $e_k^{Um} = 0$ ,  $e_k^{Un} > 0$  and  $e_k^{S\cdot} = 0$ .
  - If  $\gamma_{Um} < \gamma_{Um}^*$  and  $\gamma_{Un} < \gamma_{Un}^*$  then  $e_k^{Um} > 0$ ,  $e_k^{Un} > 0$  and  $e_k^{S\cdot} = 0$ .

Furthermore,  $p^O$  is the equilibrium policy, conditional on the resulting identity profile, with probability  $\pi_E^I(p_E, p_O; q, \alpha)\phi(\mathbf{e}^*)$ , and it is  $p^w$  otherwise.

Proof in Appendix A.

Lemma 2 can be interpreted as follows: Although unskilled workers are still the largest group, when we consider ethnicity the populist may have incentives to only target the unskilled ethnic majority ( $Um$ ) with elite cues, if this is the cost-effective alternative. If  $\lambda_{Um} \geq 0.5$  the dominant strategy is to activate in-group attitudes in the unskilled ethnic majority, because their support is sufficient to win the election. Thus if the marginal cost of dissonance is below the critical value because polarization is low enough among the ethnic majority, the populist uses elite cues. This increases polarization to the benefit the populist politician because she is an extreme protectionist.

In this scenario, the populist guarantees bigger reductions in inequality that favor the unskilled ethnic majority, although this may come at the cost of the votes from the unskilled ethnic minority. Although unskilled minorities are protectionist, they moderate their preferences for protectionism because they care about the other members of the population. As a result, the populist does not consider ethnic minorities as citizens' worthy of his effort to shape his political base.

In contrast, when  $\lambda_{Um} < 0.5$ , the populist has incentives to target other voting blocs using elite cues. However, she targets the unskilled workers since for all other permutations she has incentives to deviate, because these do not maximize the expected return to effort. If the discontent with inequality is low in both groups and similar, then the populist has incentives to activate identity in all unskilled workers using elite cues because she can create substantial polarization to her benefit. This generates a social-class cleavage because the ethnic minorities are part of the winning coalition. If they are not, they may still support the populist with probability of a coin toss because both candidates set their policy to make these voters indifferent.

A limitation of this set-up is that  $\beta_l$  may not be measurable. Thus it can be difficult to determine whether the cost of dissonance is larger (or smaller) for the ethnic majority vis-à-vis the ethnic

minority. However, I address this limitation next. What we can conclude is that a fall in import prices ( $dq < 0$ ) increases the likelihood of using elite cues by Lemma 3.<sup>17</sup>

## 5.1 The cost of dissonance and ethnic diversity

Assume that  $\beta_U = \beta_U$ , thus any worker with the same skill level faces the same level of discontent with inequality. For simplicity, assume that this parameter is normalized to one. Therefore the cost of dissonance for any group  $j$  only depends on the share of the group in the population ( $\lambda_j$ ). That is, worker diversity or voter diversity—which are widely measured—can be used to redefine straightforwardly the equilibrium outcomes because  $\gamma_j = \lambda_j$ ; see Proposition 3.

**Proposition 3.** *The SPNE of the game is:*

- If  $\lambda_{Um} > 1/2$  and  $\lambda_{Um} < \lambda_{Um}^*$  then  $e_k^{Um} = 0$ ,  $e_k^{Un} = 0$  and  $e_k^{S\cdot} = 0$ .

*Otherwise:*

- If  $\lambda_{Um} > 1/2$  and  $\lambda_{Um} < \lambda_{Um}^*$  then  $e_k^{Um} > 0$ ,  $e_k^{Un} = 0$  and  $e_k^{S\cdot} = 0$ .
- If  $\lambda_{Um} < 1/2$ , then:
  - If  $\lambda_{Um} < \lambda_{Um}^*$  and  $\lambda_{Un} < \lambda_{Un}^*$  then  $e_k^{Um} > 0$ ,  $e_k^{Un} = 0$  and  $e_k^{S\cdot} = 0$ .
  - If  $\lambda_{Um} > \lambda_{Um}^*$  and  $\lambda_{Un} < \lambda_{Un}^*$  then  $e_k^{Um} > 0$ ,  $e_k^{Un} > 0$  and  $e_k^{S\cdot} = 0$ .

$p^O$  is the equilibrium policy, conditional on the resulting identity profile, with probability  $\pi_E^I(p_E, p_O; q, \alpha)\phi(\mathbf{e}^*)$ , and it is  $p^w$  otherwise.

Proof in Appendix A.

Proposition 3 facilitates measurement because the cut-off strategies that define the equilibrium outcomes are defined in terms of population shares. Furthermore, this simplification is useful for other practical matters:  $\lambda_l$  is a good proxy for  $\gamma_U$ . if  $\lambda_U$ . and  $\beta_U$ . are positively correlated across geographical areas. If this is not the case,  $\lambda_U$ . measures  $\gamma_U$ . with error. Hence if we observe polarization, extreme protectionism and (little to) no effort on elite cues (violating Proposition 3), then it must be that at least  $\beta_{Um}$  is high and negatively correlated with  $\lambda_{Um}$ . In other words, the

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<sup>17</sup>Recall that the social welfare function is a weighted average of the individual functions. This allows me to characterize separately the relevant comparative statics; the lemma thus holds for two cross-cutting groups.



assumption that  $\beta_U$  is constant is violated. Thus identity has to be activated from the bottom up because elite cues are not mediating the effect of import competition on protectionism.

Another implication of using vote shares to proxy for the cost of dissonance is that they moderate the effect of import competition on the incentives to use elite cues: By Lemma 3 we know that the populist is more likely to invest in elite cues in response to lower import prices ( $dq < 0$ ), because  $\lambda_{U_m}^*$  and  $\lambda_{U_n}^*$  are growing with higher import competition. In other words, the populist can reduce inequality sharply to the benefit of unskilled labor with extreme protectionism, and thus the expected return of increasing polarization goes up. This implies in turn that an increase in the share of ethnic minorities, *ceteris paribus*, raises that probability that the populist uses elite cues to activate identity in the unskilled ethnic majority. He does not activate identity in the unskilled ethnic minority because the expected benefit from creating ethnic polarization increases. That is, the cost-effective strategy for the populist is to activate identity in the unskilled ethnic majority. Therefore the likelihood of observing an ethnic cleavage in protectionist populism goes up if the share of unskilled ethnic minorities raises (Corollary 2).

**Collorary 2.** *A rapid increase in the share of ethnic minorities increases the probability that the populist uses elite cues to activate identity only for the unskilled ethnic majority, in response to increasing import competition.*

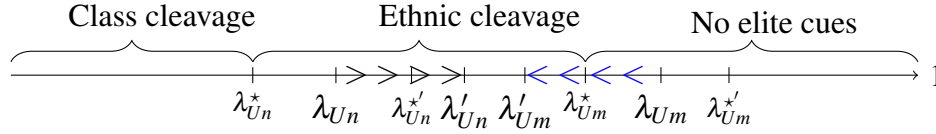
*Proof.* In the text. □

Figure 3 illustrates the previous finding: To keep things simple, the  $x$ -axis illustrates the best responses of the populist for different shares of unskilled labor, accounting for ethnicity on the basis of Proposition 3.<sup>18</sup> Consider an increase in the share of unskilled ethnic minorities, from  $\lambda_{U_n}$  to  $\lambda'_{U_n}$  (black arrows), that reduces the share of the unskilled ethnic majority from  $\lambda_{U_m}$  to  $\lambda'_{U_m}$  (blue arrows). An increase in import competition moves the critical point,  $\lambda_{U_n}^*$  and  $\lambda_{U_m}^*$ , to the right to  $\lambda_{U_n}^*$  and  $\lambda_{U_m}^*$ . Before the increase in diversity in the unskilled group, none of the identities were activated because  $\lambda_{U_n} > \lambda_{U_n}^*$  and  $\lambda_{U_m} > \lambda_{U_m}^*$ . After the increase we have that  $\lambda_{U_n} > \lambda_{U_n}^*$  and  $\lambda_{U_m} < \lambda_{U_m}^*$ . Hence the populist has incentives for using elite cues to make identity salient in the unskilled ethnic majority as a response to more ethnic diversity and import competition, but not in the unskilled ethnic minority. Thus ethnic diversity raises the likelihood that of populist protectionism thrives on an ethnic cleavage, which regards the ethnic majority as the only citizens worth of consideration, even though ethnic minorities also lose from international competition.

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<sup>18</sup>This figure it is not an exact graphical representation, but it is nonetheless useful for illustration purposes.

**Figure 3: Elite cues as a function of the population shares**



## 5.2 Empirical implications

The model has a number of empirical implications for the study of populism. First, it is hard to study populist protectionism because this phenomenon is endogenous to the political incentives of politicians. Hence there is an inherent problem of self-selection because populist protectionism is identified ex-post. Therefore, although it makes sense to study the direct effect of import competition on economic nationalism as many have done, we are uncertain about the external validity of these results. Additionally, these studies overlook by design the behavioral mechanisms by which populist protectionism takes place.

These limitations justify the use of theory to understand this phenomenon better. The model herein provides an alternative to bypass these issues because we can study populist protectionism by analyzing politicians' effort on elite cues during the campaigning trail. This is relevant because populist protectionism is unlikely to emerge without elite cues—which is perhaps the most important political mechanism discussed in the literature about populism (Hawkins et al., 2018). Elite cues are thus a relevant mediator in the causal chain from import competition to protectionism, taking into account the endogenous nature of populism. By being an intermediate outcome itself, we should study the effect of import competition on politicians incentives to use elite cues.<sup>19</sup>

Furthermore, the analysis of the model suggests that we can distinguish populist protectionism from the bottom-up, from top-down populist protectionism. If we observe populist protectionism but no elite cues, this means that populist protectionism emerges from the bottom-up (Section 5.1). This can be subject to empirical scrutiny in three possible ways: Places where we observe little to no elite cues are those where i) Voters are very polarized and protectionist on average preceding an import shock, or ii) Voters experience bigger shocks relative areas with no elite cues, or iii) Policy is ineffective at reducing the demand for imports, or iv) The government cannot properly compensate workers in the import competing sector.

Second, ethnic heterogeneity moderates the effect of international competition on populist protectionism (Corollary 2). The model suggests that ethnic diversity predating an import shock increases the likelihood of observing elite cues and populist protectionism more generally. In this

<sup>19</sup>Katitas (2021) provides a noteworthy example in the context of deindustrialization and campaign adds.

regard, diversity can be measured using the demographic composition of the voting population and also the demographic composition of the population of workers—although this latter proxy is imperfect.<sup>20</sup> Additionally, there are other proxies that can moderate the effect of protectionism but that may be harder to measure: the level of inequality between groups before the shock relative to the average income, and measures of identity salience that proxy  $\beta$ .

Lastly, a general empirical implication is that when tariff policy is ineffective at protecting workers from the negative effects import competition, protectionist populism becomes more likely. This is a consequence of Lemma 1, which indicates that when import prices’ pass-through is more complete higher tariffs are not very effective at shifting the demand from imports to local goods. Therefore increasingly more protectionism is needed to protect workers in the import competing sector. In this regard, there is suggestive evidence that the import price pass-through is high in the U.S. (Fajgelbaum et al., 2020), where we indeed observe protectionist populism.

In this regard, the extant evidence uses net imports from China as a measure for import competition to study populist protectionism. However it is often difficult to control for unobserved factors affecting both the demand for foreign products, and local changes in politics, in this research design. My findings suggests that we can use prices to generate an alternative measure to study the effect of import competition on populism and protectionism. This is useful for empirical analysis because shocks to international prices can be used as a quasi-exogenous source of variation to estimate the effect of import competition on populist protectionism.

## 6 Conclusions

I established microfoundations to understand the role of elite cues in populism and extreme protectionism. Elite cues are politically consequential because they activate voters’ social identities. I showed that voters become politically more polarized when their identities activate because they adopt in-group attitudes. As a result, those identity groups whose livelihoods have been affected by import competition demand higher levels of protectionism. Voter polarization benefits the populist because she adopts an extremely protectionist policy platform. Populists, however, do not target ethnic minorities with elite cues when they are not indispensable for winning an election. Finding a successful cue is costly, requiring effort and resources, thus the populist seeks the most cost-effective option for electoral success even if this costs her votes.

I also showed that higher international competition is generally insufficient to generate demands for protectionist populism in the absence of elite cues. Populist protectionism emerges

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<sup>20</sup>The model assumes all workers vote, but this is unlikely to hold in reality.

without elite cues when international competition increases sharply, because import tariffs may not immediately translate into a higher demand for local products or because voters affected by imports cannot be properly compensated by the government. Elite cues characterize better protectionist populism because they can cause it even in the absence of big shocks to import competition.

My model also reveals pathways to empirically examine protectionist populism. By studying the endogenous nature of elite cues as relevant moderator in the causal chain from import competition to protectionism, we can address the inherent problem of self-selection in empirical studies owing to the fact that populist protectionism is identified ex-post. We can also learn much from estimating the impact of import competition on the effort and resources that politicians invest in elites cues – including campaign rallies, TV ads, and other forms of political propaganda. My findings also indicate that ethnic diversity is an important moderator, which strengthens the effect of import competition on the incentives of populists to use elite cues, and on extreme protectionism.

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## A Mathematical appendix

*Proof of Lemma 1.* Calculate  $\frac{d\tau_i^w}{dq}$ . Rearranging terms

$$\frac{d\tau_i^w}{dq} \frac{q}{1+\tau^w} = -1 + \frac{(1+\mathbb{I}_i)q\Omega'(p^w)}{p^w U''(p^w, q)}. \quad (\text{A.1})$$

This right-hand side takes a negative value whenever  $\delta''(p) \geq 0$  and  $\Omega''(p) \leq 0$ .  $\square$

*Proof of Lemma 2.* Assume

$$\bar{v}^N(p_E, q) - \bar{v}^N(p_O, q) > \beta_U [\delta(p_E)^2 - \delta(p_O)^2].$$

at identity regime  $(\mathbb{I}_U, \mathbb{I}_S) = (1, 1)$  as required. Trivially, it cannot be the case that  $p_O = p_E$  or  $p_O = p^w$  because then  $e_k = 0$  for all  $k$ . Below I explore the remaining cases:

*Case 1:*  $\bar{v}^N(p_E, q) < \bar{v}^N(p_O, q)$  and  $\delta(p_E) > \delta(p_O)$ . The inequality above is not satisfied; we arrive to a contradiction. So it cannot be that  $p^w > p_O > p_E$ .

*Case 2:*  $\bar{v}^N(p_E, q) > \bar{v}^N(p_O, q)$  and  $\delta(p_E) < \delta(p_O)$ . Since  $U$  becomes more protectionist when preferences are activated, any  $k$  has incentives to deviate toward  $p^w$  if they are less protectionist than welfare maximizing policy because  $p^w$  is the Condorcet winner, thus  $e_k = 0$  for all  $k$ . So it cannot be that  $p^w \geq p_E > p_O$ .

*Case 3:*  $\bar{v}^N(p_E, q) < \bar{v}^N(p_O, q)$  and  $\delta(p_E) < \delta(p_O)$ . Players seek to maximize their expected value of holding office by using the least amount of effort ( $e$ ) holding  $\beta_U$  constant. Effort is smallest for both players whenever the ratio

$$\frac{\bar{v}^N(p_E, q) - \bar{v}^N(p_O, q)}{\delta(p_E)^2 - \delta(p_O)^2}$$

is the tiniest possible. However the ratio cannot be less or equal to one because it must be that  $p_E > p_O \geq p^w$  for  $\bar{v}^N(p_E, q) < \bar{v}^N(p_O, q)$  and  $\delta(p_E) < \delta(p_O)$ .

Since  $p_E > p_O$  in this case, this means that the distance between  $p_O$  and  $p_E$  must be the biggest possible because lower import prices reduce the marginal efficiency cost of protection (reducing the marginal response of the numerator to a change in prices) while also boosting the responsiveness of the wage gap (increasing the marginal response of the denominator to a change in prices). So  $p_O$  must be as close as possible to  $p^w$  because  $p_E$  cannot be larger than the autarky price ( $p^A$  s.t.  $\Omega(p^A) = 0$ ). Furthermore,  $p_E \leq 2(p_U - p_E)$ . Hence  $p_E = \min\{p^A, 2(p_U - p^w)\}$ . However, since it must be that  $p_O > p^w$ ,  $E$  always has incentives to deviate because she always wants to get

infinitesimally closer to  $p^w$ . Thus  $p_E > p_O$  cannot be an equilibrium.

*Case 4:*  $\bar{v}^N(p_E, q) > \bar{v}^N(p_O, q)$  and  $\delta(p_E) > \delta(p_O)$ . Using cases 1-3 we know that  $p_O > p_E = p^w$ , moreover  $p_O = \min\{p^A, 2(p_U - p_E)\}$ . Since  $\delta(p_O) < \delta(p_E)$  by the Stolper-Samuelson effect, and  $\bar{v}^N(p_O, q) > \bar{v}^N(p_E, q)$  because higher tariffs generate a larger dead-weight loss, the inequality we started with is satisfied.

Finally, it must be that

$$\frac{\bar{v}^N(p^w, q)}{\delta(p^w)^2} > \frac{\bar{v}^N(p_E, q) - \bar{v}^N(p_O, q)}{\delta(p_E)^2 - \delta(p_O)^2}.$$

Since  $p_E = p^w$  we can simplify the previous expression to obtain

$$\frac{\bar{v}^N(p_O, q)}{\delta(p_O)^2} > \frac{\bar{v}^N(p^O, q)}{\delta(p^O)^2}.$$

Therefore it must be that

$$\bar{v}^N(p_O, q) - \beta_U \delta(p_O)^2 > \bar{v}^N(p^O, q) - \beta_U \delta(p^O)^2,$$

which is the same as

$$\beta_U > \frac{\bar{v}^N(p^O, q) - \bar{v}^N(p_O, q)}{\delta(p^O)^2 - \delta(p_O)^2}.$$

Since  $\bar{v}^N(p^E, q)/\delta(p^E)^2 > \beta_U$  then

$$\frac{\bar{v}^N(p^E, q)}{\delta(p^E)^2} > \frac{\bar{v}^N(p^O, q) - \bar{v}^N(p_O, q)}{\delta(p^O)^2 - \delta(p_O)^2}.$$

□

*Proof of Lemma 3.* Using the implicit function theorem and the chain rule:

$$\begin{aligned} \frac{d\beta_U^*}{dq} = & \frac{(p_E - q)\Omega'(p_E)(1 + \tau_E) - (p_O - q)\Omega'(p_O)(1 + \tau_O) + \tau_O\Omega(p_O) - \tau_E\Omega(p_E)}{\delta(p_E)^2 - \delta(p_O)^2} \\ & - \frac{[\bar{V}^N(p_E, q) - \bar{V}^N(p_O, q)][2\delta(p_E)\delta'(p_E)(1 + \tau_E) - 2\delta(p_O)\delta'(p_O)(1 + \tau_O)]}{[\delta(p_E)^2 - \delta(p_O)^2]^2}. \end{aligned}$$

Since  $\tau_O\Omega(p_O) - \tau_E\Omega(p_E) < 0$ ,  $\bar{V}^N(p_E, q) - \bar{V}^N(p_O, q) > 0$  and  $\delta(p_E) - \delta(p_O) > 0$ , both

$$(p_O - q)\Omega'(p_O)(1 + \tau_O) > (p_E - q)\Omega'(p_E)(1 + \tau_E)$$

and

$$\delta(p_O)\delta'(p_O)(1 + \tau_O) > \delta(p_E)\delta'(p_E)(1 + \tau_E)$$

are sufficient conditions for  $\frac{d\beta_U^*}{dq} < 0$ .

Dividing the previous sufficient conditions and re-organizing:

$$\left[ \frac{\delta(p_E)}{\delta(p_O)} \right] \cdot \left[ \frac{\delta'(p_E)}{\delta'(p_O)} \right] > \left[ \frac{\tau_E}{\tau_O} \right] \cdot \frac{\Omega'(p_E)}{\Omega'(p_O)}.$$

Then it follows that the right-hand side of the inequality is greater than one and the left-hand side less than one. Thus the inequality is always satisfied.

Since  $e_k^*$  also depends on the ratio

$$\frac{\bar{V}^N(p_E, q) - \bar{V}^N(p_O, q)}{\delta(p_E)^2 - \delta(p_O)^2}$$

which defines  $\beta_U^*$ , it follows that

$$\frac{de_k^*}{dq} < 0$$

for all  $k$ . □

*Proof of Proposition 2. Case 1:*  $\lambda_{Um} > 1/2$ . Since the maximization problem for candidate  $k$  is additively separable, the optimal levels of effort are characterized by

$$e_k^{Um*} = \frac{R\lambda_{Um}}{2} \cdot \left[ \vartheta_{Um}(p_E, q | \mathbb{I}_{Um} = 1) - \vartheta_{Um}(p_O, q | \mathbb{I}_{Um} = 1) \right]$$

and  $e_k^{Un*} = e_k^{Sn*} = e_k^{Sm*} = 0$ . Therefore it is straightforward to corroborate that there exists a critical point  $\gamma_{Um}^* > 0$  such that when  $\gamma_{Um} < \gamma_{Um}^*$  then  $e_k^{Um*} > 0$ , with  $\gamma_{Um} = \beta_{Um}\lambda_{Um}$ .

The SPNE is therefore:

i) If  $\gamma_{Um} > \gamma_{Um}^*$ : the vector  $(p_E, p_O, e_E^{Um}, e_E^{Un}, e_E^{Sm}, e_E^{Sn}, e_O^{Um}, e_O^{Un}, e_O^{Sm}, e_O^{Sn}) \equiv (p^w, p^w, 0, 0, 0, 0, 0, 0, 0, 0)$  characterizes the SPNE.

ii) If  $\gamma_{Um} < \gamma_{Um}^*$ : the vector

$$(p_E, p_O, e_E^{Um}, e_E^{Un}, e_E^{Sm}, e_E^{Sn}, e_O^{Um}, e_O^{Un}, e_O^{Sm}, e_O^{Sn}) \equiv (p^w, p_O, e_E^{Sm*}, e_E^{Sn*}, e_O^{Um*}, e_O^{Un*}, e_O^{Sm*}, e_O^{Sn*}),$$

characterizes the SPNE.

The social welfare function is a weighted average of the group-level functions and unskilled workers always prefer more protectionism vis-à-vis skilled labor, regardless of their ethnicity. Thus the equilibrium policy is  $p_O > p^w$ —by extending Lemma 2 to two cross-cutting groups—with probability  $\pi_E^I(p_E, p_O; q, \alpha)\phi(\mathbf{e}^*)$ , and it is  $p^w$  otherwise.

**Case 2:**  $\lambda_{Um} < 1/2$ . Since the maximization problem for candidate  $k$  is additively separable, the optimal levels of effort are given by

$$e_k^{Um*} = \frac{R\lambda_{Um}}{2} \cdot \left[ \vartheta_{Um}(p_O, q | \mathbb{I}_{Um} = 1) - \vartheta_{Um}(p_E, q | \mathbb{I}_{Um} = 1) \right],$$

$$e_E^{Un*} = \frac{R\lambda_{Un}}{2} \cdot \left[ \vartheta_{Un}(p_O, q | \mathbb{I}_{Un} = 1) - \vartheta_{Un}(p_E, q | \mathbb{I}_{Un} = 1) \right].$$

and  $e_k^{Sn*} = e_k^{Sm*} = 0$ . Therefore there exist critical points  $\gamma_{Um}^* > 0$  and  $\gamma_{Un}^* > 0$  such that when  $\gamma_{Um} < \gamma_{Um}^*$  then  $e_k^{Um*} > 0$ , and when  $\gamma_{Un} < \gamma_{Un}^*$  then  $e_E^{Un*} > 0$ . The equilibrium policy is  $p_O > p^w$  by Lemma 2, conditional on the resulting identity profile, with probability  $\pi_E^I(p_E, p_O; q, \alpha)\phi(\mathbf{e}^*)$ , and it is  $p^w$  otherwise.  $\square$

*Proof of Proposition 3.* Set  $\gamma_l = \lambda_l$ , and this proof follows directly from Proposition 2.  $\square$