If a proposed strategic trade policy can overcome these criticisms, it still faces the problem of foreign retaliation. Strategic policies are beggar-thy-neighbour polices that increase our welfare at other countries' expense. These policies therefore risk a trade war that leaves everyone worse off. Few economists would advocate that Canada be the initiator of such polices. Instead, the most that is usually argued for is that Canada itself be prepared to retaliate when other countries appear to be using strategic policies aggressively.

2. Strategic Trade Policy to Promote Market Entry or Exit

The issues of entry and exit in designing optimal trade policies for oligopolies are also important. Dixit and Kyle argued that trade policies can be used strategically to deter or promote entry.[51] As an example of their analysis, consider an industry in which a foreign-based firm has already borne the sunk cost of entry. Suppose a domestic rival contemplates entry but cannot cover its fixed cost in competition with the foreign incumbent.[52] An import prohibition will drastically change this equation. The home country will benefit from an import prohibition as long as the domestic firm earns positive profits as a monopolist and its incremental cost is not too much greater than that of the foreign firm. The welfare benefit of the protectionist policy is readily seen from the fact that the consumer surplus is not much affected by the switch from one monopolist to another, but the producer surplus increases from zero when the policy-induced entry occurs. Of course, the survival of both firms would be preferred as this could induce competition beneficial to the consumer and to efficiency gains by the firms.

Next, consider an oligopolistic market with ease of entry. A new firm will enter the market and drive the profits of the marginal entrant to zero. In such a setting, Horstman and Markusen model the home and foreign markets as integrated in the sense that each firm chooses an aggregate output level, and its goods command the same price no matter where in the world they are sold.[53] In this case, export subsidies and import tariffs that advantage domestic firms in the global competition induce inefficient entry at home. Any profits that are shifted strategically to domestic firms are dissipated in the cost of entry, and national welfare typically falls. By contrast, Venables found that import tariffs raise home welfare when national markets

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[51] Avinash K. Dixit and Albert S. Kyle, "The Use of Protection and Subsidies for Entry Promotion and Deterrence", *American Economic Review*, (75) 1985: 139-152.

[52] That is, duopolistic competition.

[53] Ignatius J. Horstmann and James R. Markusen, "Up the Average Cost Curve: Inefficient Entry and the New Protectionism", *Journal of International Economics*, (20) 1986: 225-47.