

Strategic Trade Policy and the Threat of Regionalism

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Abstract:

We examine the formation of trade agreements when markets are characterized by imperfect competition and governments can alter the strategic interaction between oligopolistic firms through the use of import tariffs and export subsidies. Using a simple three-country model of intra-industry trade, we show that whether preferential trade agreements are stepping stones or stumbling blocs towards the attainment of multilateral cooperation depends on the degree of product differentiation and industry concentration. However, when import tariffs are the only available policy instrument, global free trade is always sustainable.

Our analysis provides a rationale for the recent attempts to strengthen international rules against the use of export subsidies. It also suggests that focusing on one dimension of strategic interaction only might result in drawing incorrect conclusions about the outcome of the trade negotiations.

Key words: Imperfect Competition, Trade Negotiations.

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