

INTERNATIONAL TRADE AGREEMENTS

Zhang Wei

SUBMITTED IN PARTIAL FULFILLMENT OF THE
REQUIREMENTS FOR THE DEGREE OF
DOCTOR OF PHILOSOPHY
AT
UNIVERSITY OF ADELAIDE
ADELAIDE, SOUTH AUSTRALIA
JUNE 2009

Table of Contents

Table of Contents	ii
Abstract	v
Declaration	vii
Acknowledgements	viii
1 Introduction	1
2 Literature Review	8
2.1 Introduction	8
2.2 The Multilateral Trading Regime and the History of RTAs	9
2.3 Theoretical Welfare Analysis	12
2.3.1 Traditional Theories of RTAs	12
2.3.2 The Vanek–Kemp Analysis	15
2.3.3 New Motivations for Forming RTAs	16
2.4 The Dynamic Time-path Issue and the Stability of RTAs	19
2.4.1 The Effects of the Formation of RTAs on Tariffs and World Welfare	19
2.4.2 Dynamic Motivations of Forming RTAs and Stable Structures of Trading Blocs	23
2.5 Conclusion	32
3 Trade Agreements in a Welfare-Maximising World	34
3.1 Introduction	34
3.2 The Static Trade Model	35
3.2.1 Basic Framework	35
3.2.2 Trade Equilibrium	36
3.2.3 Social Welfare, Government Objective and Optimal Tariffs . .	39
3.3 Trade Liberalisation through Bilateral FTAs or an MTA	40

3.4	Dynamic Negotiation Game	50
3.4.1	Setup of the Game	50
3.4.2	Equilibrium Outcome(s)	54
3.5	Conclusion	56
4	Trade Agreements under the Political Pressures from the Import-Competing Sector	58
4.1	Introduction	58
4.2	The Static Trade Model	60
4.2.1	Basic Framework	60
4.2.2	Trade Equilibrium	63
4.2.3	Equilibrium Tariffs and Political Contributions in the Presence of Political Pressures	64
4.3	Trade Liberalisation in the Presence of Political Pressures	66
4.4	Dynamic Negotiation Game	78
4.4.1	Setup of the Game	78
4.4.2	Equilibrium Outcome(s)	79
4.5	Conclusion	83
5	Trade Agreements under Political Pressures from All Sectors	85
5.1	Introduction	85
5.2	The Static Trade Model	87
5.2.1	Basic Framework	87
5.2.2	Trade Equilibrium	88
5.2.3	Equilibrium Tariffs and Political Contributions in the New Political Framework	90
5.3	Trade Liberalisation in the New Political Framework	92
5.4	Dynamic Negotiation Game	103
5.5	Conclusion	106
6	Trade Agreements in an Asymmetric World	108
6.1	Introduction	108
6.2	The Static Trade Model	110
6.2.1	Basic Framework	110
6.2.2	Equilibrium Tariffs and Export Subsidies in the Asymmetric World	111
6.3	Trade Liberalisation in the Asymmetric World	112
6.4	Dynamic Negotiation Game	123
6.5	Conclusion	128
7	Conclusion and Further Research	130

Abstract

In recent years, the use of the mode of regional trade liberalisation has proliferated, while the multilateral talks through the WTO have proceeded slowly, resulting in a debate on the role of bilateral and multilateral trade liberalisation. This thesis aims to provide new insights to this debate by studying the welfare effects of different types of trade agreements and the equilibrium outcome(s) of trade negotiation. We apply the three-country and three-good “competing-exporters model” developed by Bagwell and Staiger (1999) as our basic trade framework. By comparing the equilibrium welfare of each country under different structures of trading blocs, we clarify the welfare impacts of each trade agreement. Then we model the process of trade negotiation as a trade negotiation game, in which each country endogenously decides whether to negotiate through multilateral or bilateral trade liberalisation. By solving the equilibrium of the game, the stable structure of trading blocs and the path(s) to reach it can be found.

We start with a framework in which all countries are welfare maximising. We find that at the early stage of trade negotiation, a free trade agreement (FTA) is Pareto welfare improving, despite the fact that member countries benefit more than any non-member. Although being the hub is the best position, a spoke is in a worse position than being outside a single FTA. Thus, a “hub-and-spoke” structure cannot

be achieved and the unique equilibrium outcome of trade negotiation is given by multilateral free trade (MFT) through a multilateral trade agreement (MTA).

The welfare-maximising analysis is followed by the examination of cases in which each government is politically motivated. The political structure we use is similar to Ornelas (2005), which follows the basic framework developed by Grossman and Helpman (1995), emphasising the interaction between lobby groups representing the special interest of one industry and the government in their home country. We first consider a circumstance where the political pressures are only from the import-competing sector. It is then generalised to a case in which all sectors are allowed to lobby the local government. Furthermore, the analysis is extended into an asymmetric world that includes two big countries and one small country.

Our results show that political economy forces usually reduce the likelihood of forming trade agreements and that when the political concerns are sufficiently large, all trade agreements can be prevented by political pressures. Also, our findings suggest that the option of bilateral FTAs does not cause an initially infeasible MFT to become feasible, while a previously feasible MFT is likely to be blocked by the option of FTAs. Thus, our thesis provides some evidence to support the argument that the formation of FTAs can be a “stumbling block” for global trade liberalisation.

Declaration

This work contains no material which has been accepted for the award of any other degree or diploma in any university or other tertiary institution and, to the best of my knowledge and belief, contains no material previously published or written by another person, except where due reference has been made in the text.

I give consent to this copy of my thesis, when deposited in the University Library, being made available for loan and photocopying, subject to the provisions of the Copyright Act 1968.

Signature of Author

Acknowledgements

I would like to thank my supervisors, Professor Christopher Findlay and Professor Richard Pomfret, for their priceless encouragement, support and guidance during this research. They introduced me to this interesting area and provided me with great suggestions and assistance in producing this thesis. Without their direction, this work would never have come into existence.

I am indebted to all the staff at the School of Economics for their great help. In particular, thanks to Dr Ralph Bayer for his excellent advice, useful references and friendly talks throughout my postgraduate study, to Professor Jonathan Pincus for his detailed comments on several chapters of this thesis, and to Dr Raul Barreto, who has provided me with significant help on how to generalise my analytical framework.

I appreciate the generous financial support provided by the University of Adelaide, including the School of Economics, without which I could not have completed my PhD study in Adelaide.

I would also like to express my thanks to all my classmates and friends in Adelaide, who have given me technical assistance, moral support and companionship.

Finally, I dedicate my thesis to my family for their understanding and love. Without their support, I would never have had the opportunity to study in Adelaide and complete this thesis.