

Free Trade Agreements and Multilateral Trade Liberalization under Asymmetric Countries *

Noriaki Yoshikawa[†]

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Abstract

We examine the static and the dynamic impact of the formation of free trade agreements (FTAs) on the world trading system, by considering an oligopolistic-political-economic model with asymmetric production costs across countries. We focus on how a government endogenously determines trade regime and external tariff rates under political pressure. As to the static impact of FTAs, the model suggests that, even if we allow cost asymmetry across the countries, the agreements are always trade creating and beneficial for the outside country. We then evaluate the dynamic impact of the FTAs on Multilateral Trade Liberalization (MTL). We find that cost asymmetry can generate the situation where lobbying groups can gain more excess rent and get more political influence under FTAs than under multilateral protection. Thus, FTAs may induce it more likely that a political-minded government blocks welfare-improving MTL. Furthermore, the static gains of FTAs for the non-member can weaken the incentive for the country to support MTL. Therefore, under cost asymmetry, FTAs can undermine the incentives for both the member and the non-member of FTAs to promote further liberalization. I also find the FTAs tend to be more harmful for MTL, the less efficient the FTAs partner is.

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[†]Graduate school of Economics, University of Tokyo. e-mail:ee46035@mail.ecc.u-tokyo.ac.jp