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The Effects of Strategic Subsidies under FTA with ROO

by

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Abstract

This paper builds a model of Free Trade Area (FTA) that imposes Rules of Origin (ROO) under asymmetric oligopoly. Following the existing literature, we also consider ROO to be a protectionist device. Whereas, we show that the level of ROO in protecting the domestic industry is weakened if some strategic interaction between governments is considered. In such a situation, the government of the final good's exporter within the FTA chooses [i] *laissez faire* or [ii] production tax and these bring about a lower level of ROO, so that a less restrictive FTA is reached.

Key words: Rules of Origin (ROO), Free Trade Area (FTA), Subsidy

JEL classification: F12, F13, F15

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