

ESSAYS ON THE INTERACTION BETWEEN MULTILATERAL TARIFF  
BINDINGS AND THE FORMATION OF PREFERENTIAL TRADE  
AGREEMENT

**Abstract**

This dissertation studies the effect of continual reduction in the tariff bindings and its implications on the static and dynamic formation of preferential trade agreements (PTAs). Underlying trade model is a three country “competing exporters” model. First, utilizing a static game of endogenous trade agreement formation between three countries, we examine the effects of continual reduction in tariff bindings on the role of PTA formation in attaining global free trade. We show that, in the free trade agreement (FTA) formation game, when countries are completely symmetric, free trade always obtains as the coalition-proof Nash equilibrium (CPNE) of the FTA game. Under the customs union (CU) game, CU members exercise an exclusion incentive and free trade fails to be a CPNE. When countries are asymmetric with respect to their comparative advantage, the country with a weaker comparative advantage has an incentive to free ride on trade liberalization of the two others and continual reduction in tariff bindings facilitates FTA formation in attaining global free trade.

Next, we employ a three country dynamic model of PTA formation where countries form PTAs over time and investigate the impact of multilateral tariff binding liberalization on the equilibrium extent of FTA and CU formation in isolation. When forming FTAs under relatively high tariff bindings, a myopic free riding incentive of FTA non-members constrains FTA formation. Thus, tariff binding liberalization can facilitate FTA expansion to global free trade. However, when forward looking countries do not value this myopic free riding incentive, tariff binding liberalization can impede FTA expansion to global free trade. In our CU game, CU formation proceeds to global free trade only for relatively high tariff bindings.

Finally, we examine the PTA game where countries endogenously choose between CU and FTA formation. Under such a game, we show that the equilibrium emergence of CUs can prevent global free trade that would otherwise occur through FTAs. In contrast, the equilibrium emergence of FTAs can facilitate global free trade that would otherwise not occur through CUs.