

Does Bilateralism Undermine Global Free Trade?

Implications of Endogenous Tariffs in the Heckscher-Ohlin Trade Model

by

Constantinos Syropoulos
Florida International University
syropoul@fiu.edu
<http://www.fiu.edu/~syropoul>

Elias Dinopoulos
University of Florida
dinopoe@ufl.edu
<http://bear.cba.ufl.edu/dinopoulos>

Current Version: August 2001

Abstract

We extend the literature on bilateralism and multilateralism by introducing tariffs in a three-country version of the standard Heckscher-Ohlin trade model and allowing majority voting to determine the nature of trade agreements. Contrary to perceived wisdom, our analysis indicates that, in the presence of endogenously determined tariffs and strategic policy interactions, the formation of a customs union (CU) may undermine internal support for multilateral free trade when such trade is politically feasible initially. This possibility arises because the majority of voters in potential CU members prefer a bilateral agreement over global free trade which, in turn, they find superior to a totally non-cooperative trade regime. However, our analysis also reveals that the formation of a CU may enhance the collective market power of its constituent policymakers' (median voters) sufficiently, so that the majority of voters in the outside country who initially did not favor multilateral trade liberalization now find it appealing. Lastly, the paper identifies and analyzes some of the determinants of these possibilities, including the relative size of trading partners, relative endowments, and the distribution of factor ownership.

Keywords: Multilateralism, bilateralism, customs union, domestic politics, median voter, endogenous tariffs
JEL Classification: F11, F13, F15, F42

Address for Correspondence: Constantinos Syropoulos, Department of Economics, Florida International University, University Park, DM-321, Miami, FL 33199; E-mail: syropoul@fiu.edu.

* We appreciate the helpful comments of Pascalis Raimondos-Møller and of participants at the Nordic International Trade Seminars in Copenhagen, Denmark. Syropoulos thanks EPRU at the University of Copenhagen, where part of this paper was written, for its hospitality.