

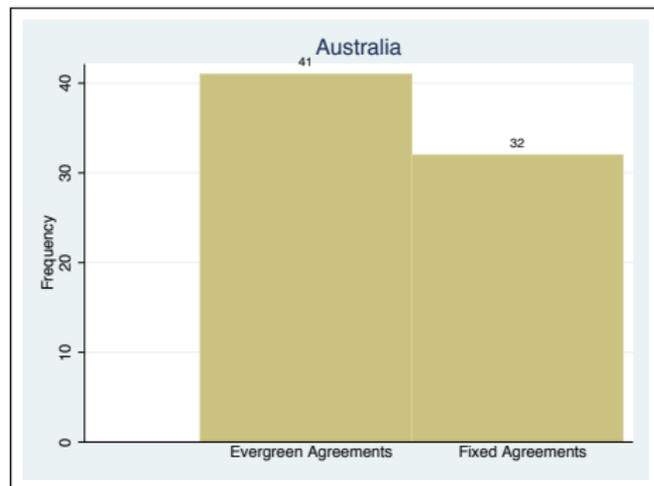
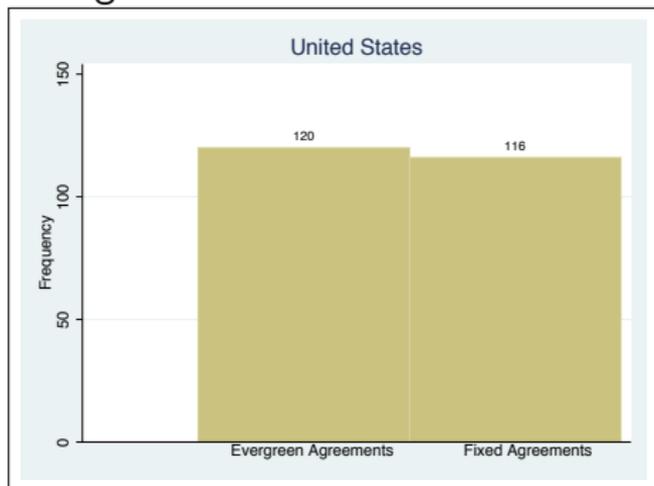
Tricks of the Trade: Using Trade Agreements as Leverage

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Descriptive Statistics

When, why and with whom do countries sign fixed trade agreements?



Overview and Key Results

Overview

- Infinite horizon bargaining model
- Countries select nature and duration of trade agreement.

Key Results

- Countries will sign fixed agreements to gain leverage over the unrelated policies of another country.
- Richer countries are more likely to sign fixed agreements with poorer countries to gain leverage over policies in those countries.
- Countries with greater parity sign evergreen agreements, which do not impinge upon their freedoms.
- Extremely repressive regimes will not sign fixed agreements.

Related Literature

- Previous work focuses solely on economic arguments to explain trade agreement duration
- Guriev and Klimenko (2008) claim duration depends on nature of underlying investment
- Guriev and Kvasov (2005) argue fixed agreements solve the hold up problem
- First paper with political argument explaining agreement duration

Utilities and Game Sequence

Utilities

- Players: Home H and Foreign F
- Countries have utility over F 's human rights violations v_j and total wealth (initial wealth W_j + agreement benefits w_j)

$$U_j = f(W_j + w_j) + v_j \quad (1)$$

- $f()$ is concave and increasing.

Timing

- Countries bargain over benefits w_j and duration of agreement
- If evergreen agreement is selected, the agreement is in force for the remainder of the game.
- If fixed agreement is selected, countries have the option to renew the agreement each period.

Home Strategy Set

- H chooses an amount of the surplus w_F and duration of agreement $\theta \in \{0, 1, \infty\}$ to offer to F
- H chooses whether to renew a fixed agreement each period

Foreign Strategy Set

- F chooses an acceptance rule under each type of agreement
- F chooses whether to violate rights and whether to renew a fixed agreement each period

Punishment Strategy

Evergreen agreement

- F violates rights each period
- No way to use agreement as leverage due to unenforceability of rights

Fixed agreement:

- H punishes F for one period if F violates rights.
- F never violates rights provided F is sufficiently patient.

Agreement Outcome Intuition

Evergreen agreement

- H has full bargaining power so makes F indifferent between accepting and rejecting
- H offers F amount $w_F = 0$ and keeps entire surplus $w_H = S$
- H receives utility $f(W_H + S) + v_H$

Fixed agreement

- H compensates F for ability to use agreement as leverage.
- To make F indifferent between fixed and no agreement, H chooses w_F that solves $f(W_H + S - w_F) = f(W_F) + v_F$
- H receives utility $f(W_H + S - f^{-1}(f(W_F) + v_F) + W_F)$

Key Comparative Statics

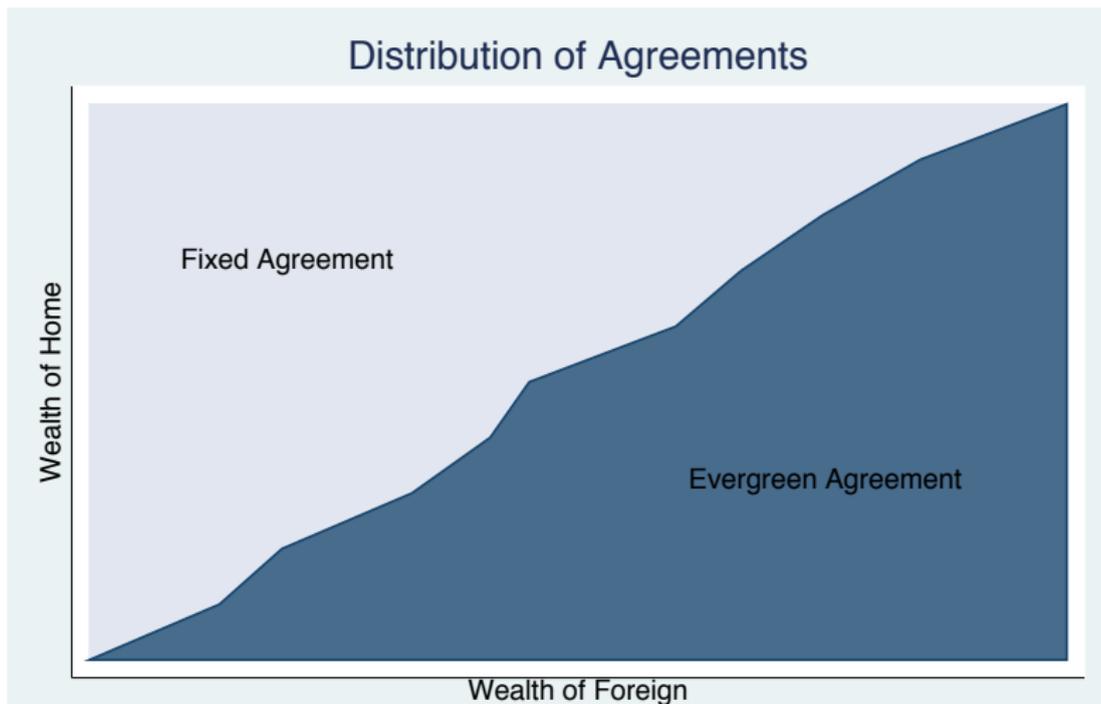
Check which agreement gives H higher utility and take derivatives.
Key equation:

$$f(W_H + S - f^{-1}(f(W_F) + v_F) + W_F) \geq f(W_H + S) + v_H \quad (2)$$

- The larger W_H , the less H values the agreement benefits relative to v_H due to concavity of $f()$
- The larger W_F , the less F values the agreement benefits relative to rights. H must pay F more to compensate it for ceasing to violate rights
- $W_H \uparrow$ fixed agreement \uparrow ; $W_F \uparrow$ fixed agreement \downarrow
- $v_H \uparrow$ fixed agreement \uparrow ; $v_F \uparrow$ fixed agreement \downarrow .

Graphical Illustration

Fixed agreements are more likely if home is wealthier and foreign is less wealthy. Utility over rights violations shifts the border up or down.



Stylized Facts

Both the United States and Australia sign more fixed agreements with poorer countries with worse human rights records.

