

Preferential Trade Agreements and Global Sourcing*

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September 10, 2020

Abstract

We develop a new framework to study the welfare consequences of preferential trade agreements (PTAs) under global sourcing, incomplete contracts and endogenous matching. We uncover several new channels through which PTAs affect global welfare. There are effects stemming from intensive margin changes—i.e., changes in investment and production in existing vertical chains—and from extensive margin relocations—i.e., due to the formation and destruction of vertical chains. In each case, there are potential trade-creating, trade-diverting and relationship-strengthening forces. The first two are reminiscent of the classical Vinerian approach, but take different forms under global sourcing. The third is entirely new in the regionalism literature and arises because PTAs affect the severity of hold-up problems in sourcing relationships. We characterize those forces and show circumstances when PTAs are necessarily welfare-enhancing or welfare-decreasing. In particular, we show that, because of the relationship-strengthening effect, PTAs can improve global welfare even when all types of trade-creation forces are absent.

Keywords: Regionalism; hold-up problem; sourcing; trade diversion; matching; incomplete contracts.

JEL classification: F13, F15, D23, D83, L22

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