“Firms, Dynamics, and Stumbling Blocks in Trade”

A longstanding question in the international political economy literature is whether or not preferential trade agreements (PTAs) are "building blocks" or "stumbling blocks" in the larger project of building a more open world trading system. This paper presents a dynamic political economy model with three important features - heterogeneous firms, technology-based differences in comparative advantage across countries, and fixed costs to lobbying - that demonstrates that the impact of PTAs on demands for future liberalization can be conditional on the characteristics of the parties to a given PTA. In particular, while international competition leads to a within-industry shift in the distribution of firms towards larger, more productive firms, when this occurs within a PTA for countries that are otherwise at a comparative disadvantage in that industry with respect to world markets, it can actually strengthen protectionist demands by politically empowering firms who would be threatened by extra-PTA foreign competition.

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