The Rationale for International Trade Cooperation

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I. Multilateral versus unilateral liberalization

- Economic theory suggests that there are gains from trade if a country moves unilaterally to liberalize its trade
- Are there theoretical reasons for coordinating liberalisation with others?

1. Strategic interaction between governments (in the case of a large country)
2. Strategic interaction between government and private sector

1 Strategic interactions between governments: the large country case

International commitments avoid tit-for-tat trade restrictions that make all countries worse off

Country B / Country A	Multilateral liberalisation	Optimal Tariff
Multilateral liberalisation	10 / 10	20 / -10
Optimal Tariff	-10 / 20	-5 / -5

Without coordination both countries would seek to impose the optimal tariff and they would lose. Coordination allows both countries to win

2 Strategic interactions between government and private sector

- Underpinning trade policy to a multilateral commitment
- Enhances credibility of a trade policy and avoids time inconsistency problems
- Reciprocal exchange of market access allows governments to mobilize export lobbies to counter-balance import competing lobbies

2 ...Strategic interaction between governments and private sector

Time inconsistency

- Example: Interaction with financial sector

- Because of protection national banks are inefficient and have accumulated credits not refundable.
- The government announce that it will open the financial sector to foreign competition
- Banks do not adjust to the announcements.
- If the government liberalize, there will be a crisis in the financial sector. So it will decide not to liberalize.

- Time inconsistency occurs when the announcement at time 2 is no longer an optimal policy at time 4. Aware of time inconsistency problems, banks will decide not to adjust.

- International commitments solve the time inconsistency problems because the government can be penalized for not honouring international obligations