

Incentive to Form FTA with Different Cost Conditions

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Abstract

This paper examines the formation of Free Trade Agreements (FTAs) between the countries with different cost conditions. Using n countries model, we analyze whether these countries have incentives to form FTA each other. In particular we assume many goods which are not completely substitutable each other are traded in the world. Then from our analysis, we see that each country levies higher (lower) tariffs to a country with lower (higher) marginal cost when the substitutability between goods is sufficiently low. Further, we obtain that each country has an incentive to form FTA with a higher marginal cost-country and the countries which have similar marginal costs are likely to form FTA each other. It is also shown that gains from FTA decrease (increase) as FTA-partners' marginal costs become higher (lower).

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