

Vertical Structure Causes Heterogeneous Regime

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Abstract

We develop a trade model of regional trade area (RTA) with rules of origin (ROO) that generates strategically different patterns of export (i.e., heterogeneous regime) between two exporting firms engaged in Cournot competition. In our model, the maximum value of the external tariff that induces both exporting firms not to conform to ROO requirements maximizes welfare in the RTA member country with final good market. Surprisingly, if either exporting firm conforms to ROO requirements, the welfare level is the worst.

Key words: Rules of origin, Vertical structure, External tariff, Heterogeneous regime

JEL classification: F12, F13, F15

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