Rules of origin and regional upstream competition

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Abstract

Rules of origin (ROO) in a free trade area (FTA) define the level of regional content required for firms to enjoy preferential access. Hence, ROO govern inter-firm transactions between upstream and downstream firms. We show that asymmetric multiple equilibria in the downstream market, where one firm meets ROO while the other does not, can emerge because of regional upstream competition. Importantly, our results, which correspond to the real situation, maximize consumer surplus for the final-good importer and the total welfare of the FTA. Therefore, if practitioners in member countries promote FTA utilization, such a policy may backfire.

Key words: Rules of origin; Inter-firm transactions; Upstream competition; FTA utilization

JEL classification: F12; F13; L13; D43

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