Preferential Trade Agreements and Unilateral Liberalization: Evidence from CAFTA

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Abstract

There is no consensus in the literature on whether preferential trade agreements help or hinder trade liberalization toward non-members. We examine the link between preferential trade liberalization and tariffs imposed against non-member countries for the case of CAFTA-DR. Using product data at the 6-digit HS level, we find that products with larger reductions in preferential tariffs experienced larger increases (or smaller decreases) in most-favored nation tariffs applied against non-members. However, we also uncover some interesting dynamics regarding the relationship between preferential liberalization and tariffs imposed against non-members. When we split the sample period into two sub-periods, we find an initial negative relationship between changes in preferential and most-favored nation tariffs during the first half of the sample period, followed by a positive relationship during the second half, although the evidence on the latter is not as strong. The results thus provide the first evidence of an initial stumbling block effect of preferential trade liberalization on unilateral liberalization, as well as (weaker) evidence of a subsequent building block effect.

JEL classification: F10, F13