

Equilibrium Trade Regimes: Power- vs. Rules-Based

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Abstract: The rules of the World Trade Organization are increasingly being disregarded by its members, raising concerns about the future of multilateral liberalization. In this paper, we develop a dynamic model of the international trading system to analyze the sustainability of rules-based trade regimes. We consider a framework of stochastic asynchronous games, where a leading country determines the trade regime and the identity of this leader changes over time. In a many-country, infinite-horizon game, we show that transitioning from a power-based to a rules-based regime requires the presence of a hegemonic power -- i.e., a country significantly larger than all others. We find that the long-term viability of a rules-based regime hinges on the cost of establishing it: the cost must be neither too small nor too large. If the cost is too small, the system follows a cyclic equilibrium; if too large, a power-based regime prevails. Sustainability also depends on policymakers being sufficiently forward-looking. Furthermore, in a bipolar state, free-riding and market-power forces further undermine the feasibility of rules-based equilibria. Our findings highlight the risks posed by the ongoing erosion of multilateral cooperation and its potential long-term consequences for the world trading system.