

Weakly Renegotiation Proof Strategies in Intra-Industry Trade

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Abstract

An infinitely repeated intra-industry trade game was analyzed in detail by Green and Landrigan (2007). Within an infinitely repeated modeling structure free trade is shown to be subgame perfect. A Pareto superior subgame perfect equilibrium exists when the focus of the analysis rests on governments instead of the firms. Governments can reach the outer boundary of their Feasible and Individually Rational Set of payoffs by using a tax on exports. The current paper extends Green and Landrigan's (2007) infinitely repeated model by narrowing the set of subgame perfect equilibria to the set of Weakly Renegotiation Proof (WRP) payoffs. Weakly Renegotiation Proof strategies provide a payoff during the punishment phase of a subgame perfect strategy favoring the punishers', making them no worse off than during the cooperative phase of play. This characteristic of a subgame perfect strategy creates equilibrium strategies that neither governments nor firms would wish to renegotiate should the game ever enter a punishment phase.