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# Market structure, trade liberalization and the GATS

Joseph Francois [a,b,*], Ian Wooton [b,c]

[a] Tinbergen Institute and Faculty of Economics, Erasmus University, 3000 DR Rotterdam, Netherlands
[b] Centre for Economic Policy Research, 90–98 Goswell Road, London EC1 7RR, UK
[c] Department of Economics, Adam Smith Building, University of Glasgow, Glasgow G12 8RT, UK

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## Abstract

In this paper, we examine the interaction between the different modes of market access commitments in services (cross-border and establishment), market structure, and regulation. In this context, we focus on the impact of improved domestic market access for a foreign-service provider on a domestic service market. We work with a model where the domestic industry is assumed to be imperfectly competitive and, as a result of domestic regulation, able to act as a cartel. We also examine the incentives for the domestic firms to accommodate the entry of the foreign firm by inviting it to join the cartel. © 2001 Published by Elsevier Science B.V.

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## 1. Overview

From its inception, the multilateral trading system has been focused on trade in goods. Hence, from 1947 through the Tokyo Round, services were not covered in successive rounds of trade negotiations. The Uruguay Round, and the subsequent launch of the WTO, changed this. They brought an incorporation of services into the multilateral trading system under the General Agreement on Trade in Services (GATS). However, the actual degree of liberalization has been relatively limited,

* Corresponding author. Faculty of Economics, Erasmus University Rotterdam, Burg Oudlaan 50-H8-18, 3000DR Rotterdam, Netherlands. Tel.: +31-10-408-1256; fax: +31-10-408-9146.
*E-mail address:* francois@few.eur.nl (J. Francois).

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with many of the GATS schedules involving simple stand still commitments (or less). It is generally recognized that there still remains significant scope for liberalization in the service sectors.

This paper is concerned with the analytical implications of service-sector liberalization, and in particular the role of market structure. The trade theory literature has traditionally focused on trade in goods, with the literature on international trade in services being a relatively limited and recent addition. (See, for example, Francois, 1990a; Francois and Schuknecht, 1999; Hoekman, 1994; Markusen, 1988, 1989; Sampson and Snape, 1985; Stern and Hoekman, 1988; Deardorff, 1985). In addition, while there is a sizable empirical literature on service sector policy and deregulation, this is largely focused on domestic deregulation.[1] In contrast, we focus here explicitly on cross-border trade in services, and the interaction of international trade with market structure and public regulation.[2]

Of course, in many ways, the insights from the theoretical literature on international trade apply equally to goods and services. This is particularly true for cross-border trade. There are, however, some important differences. One is the role of proximity (see Francois, 1990b; Sampson and Snape, 1985), which has important analytical implications. The significance of proximity for service transactions means that “trade” in the case of services often requires a mix of cross-border transactions and local establishment (i.e., FDI). The importance of trade through affiliates is illustrated, for the case of the US, in Table 1. The US is the leading service exporter, with US$245.7 billion in 1998. The level of US service sales through affiliates (establishment trade) is comparable. Establishment sales amounted to US$258 billion in 1997, which compares to US$240 billion in direct exports.

The empirical and operational importance of establishment leads to a second important difference between goods and services. This is an institutional difference. While the GATT emphasizes barriers at the border (tariffs, quotas, etc.), the GATS has a different focus. From the outset, it has emphasized both cross-border barriers and barriers to local establishment. Consequently, the GATS blurs trade and investment restrictions, and covers both trade and investment rules to the extent that they limit market access in service sectors.

Given the structure of the GATS, negotiations involve parallel commitments on cross-border trade and local establishment by foreign service providers. We argue in this paper that these two modes (a simplification of the four modes actually listed in the GATS) can carry different implications for national welfare, market structure, profits, and related metrics tied to trade liberalization. In particular, given imperfect competition in services (often in conjunction with domestic

[1] A thorough overview is provided by WTO (1998).

[2] An exception is Cho (1988), who discusses Korean–US negotiations on insurance and the implications of the Korean insurance cartel for the gains from trade in insurance services.

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