

Karunaratne, Neil Dias

**Article — Digitized Version**

## The reality and the rhetoric of free trade in services: The case of telecommunications

Intereconomics

*Suggested Citation:* Karunaratne, Neil Dias (1993) : The reality and the rhetoric of free trade in services: The case of telecommunications, Intereconomics, ISSN 0020-5346, Nomos Verlagsgesellschaft, Baden-Baden, Vol. 28, Iss. 2, pp. 95-102, <https://doi.org/10.1007/BF02928110>

This Version is available at:

<https://hdl.handle.net/10419/140394>

**Standard-Nutzungsbedingungen:**

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

**Terms of use:**

*Documents in EconStor may be saved and copied for your personal and scholarly purposes.*

*You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.*

*If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.*

Neil Dias Karunaratne\*

# The Reality and the Rhetoric of Free Trade in Services

## The Case of Telecommunications

*The rapid globalisation of the information economy has unleashed new pressures for increasing the tradability of information services. There exists a large gap, however, between the rhetoric of the advocates of free trade in services and their protectionist practices.*

Most leading economies of the world are now information economies, where information-related activities or the information sector generate the lion's share of national income and employment. The growing international trade in services is an indicator of the rapidity of the globalisation of the information economy. Developing economies are also rapidly restructuring, on occasion telescoping or leapfrogging the stage-wise graduation process to become information economies.<sup>1</sup>

At the epicentre of the globalisation of the information economy and the informatisation of national economies lie the revolutionary changes in information technologies. A cluster of microelectronic and optoelectronic technologies have profoundly changed the production servicing and transmission processes that govern modern economic activity. The speed of electronically transmitted services has increased whilst the transactions costs have dropped dramatically. These developments have made services tradable that were hitherto nontradable. The transnationalisation of production by multinational corporations has stimulated the growth and diversification of trade in telecommunications services. The growth in intra-industry trade or trade in similar rather than different types of products is one indicator of the transnationalisation process. This in turn has contributed to the deregulation of domestic and international telecommunication organisations. Domestic telecommunication monopolies had to abandon their status as natural monopolies based on the provision of universal basic telecommunications, whilst international cartels such as the International Telecommunications

Union (ITU), that monopolised international linkage and operation, had to cope with increased competition. The ITU, which had regarded telecommunications services as a nontradable, eventually abandoned its stance and complemented the General Agreement on Tariffs and Trade (GATT) efforts to liberalise trade in services such as telecommunications. The globalisation of the information economy arguably is one of the important factors that made trade in services a central issue at the stalled multilateral trade negotiations (MTN) of the Uruguay Round (1986). The advanced information economies, motivated by self-interest, established a parallel forum known as the Group of Negotiations on Services (GNS) to examine the feasibility of replicating a GATT type of regime to regulate free trade in services such as telecommunications.

Trade in services occurs when a resident or factor of one country receives a payment from a foreign counterpart. The term covers both factor and nonfactor exchanges of services. However, GATT since its inception had steered clear of issues related to investment and factor movements. Under the aegis of the advanced information economies the GNS wanted to focus its attention on nonfactor services such as advertising, banking, finance, insurance and telecommunications. However, developing countries that had a comparative advantage in labour-intensive services such as construction wanted these on the GNS agenda. Curious anomalies surfaced when it came to the classification of services. For example, the movement of personnel from advanced to developing

---

<sup>1</sup> M. Jussawalla, D. M. Lamberton, N. D. Karunaratne: *The Cost of Thinking: Information Economies of Ten Pacific Countries*, Ablex Publishing Corporation, Norwood, N. J. 1988.

\* University of Queensland, Brisbane, Australia.

countries is classified as services whilst the reverse process is defined as immigration.<sup>2</sup> The GNS agenda eventually included several new issues such as trade related investment measures (TRIMs) and trade related intellectual property rights (TRIPs). Many developing economies contended that the inclusion of new issues would distract GATT from making headway in the unfinished area of the reduction of non-tariff barriers. However, proponents of GNS from advanced information economies eventually prevailed. It was argued that if GATT did not address these new issues it would be forgotten in the dust of history.<sup>3</sup> In the GNS negotiations the telecommunications sector became a prime target of scrutiny and it was the first sector to be tested. The inordinate attention bestowed on the telecommunications sector by the GNS was undoubtedly due to the fact that it is one of the leading sectors of the emergent information economy. In fact, telecommunications is regarded as the electronic highway of the modern information economy.<sup>4</sup>

### **Theoretical Rationale**

Goods and services have different attributes. However, that by itself does not provide a justification for establishing a separate framework to regulate free trade in services. We shall therefore first examine the characteristics of services and whether neo-classical trade theory and the principle of comparative advantage are tenable for trade in services, just as they are for goods. The attributes of services which differ from those of goods have been defined as intangibility, nonstorability or nonstockability, inappropriability and nontransparency.<sup>5</sup> Furthermore, the consumer and the producer must interact for the rendering of a service. The distinction between goods and services, however, remains fuzzy under the impact of modern technology. For example, the services of a tenor such as Pavarotti are converted into a good when recorded on a compact disc or cassette.<sup>6</sup> Furthermore, services through telecommunications can be recorded and retrieved. Non-marketed intra-firm services with specialisation become marketed. Therefore, given that goods and services change character and can be splintered or disembodied from one another, any regulatory system that attempts to separate

trade in goods and services would be unnecessarily buying into a maze of definitional problems.

Based on the Ricardian notion that factor mobility is a prerequisite for rendering services, recent taxonomies<sup>7</sup> identify at least four broad types of services:

- both the producer and the consumer are immobile when the service is transmitted (e.g. architects' drawings to an engineer abroad);
- only the producer is mobile and has to render services at a location where the consumer is immobile (e.g. Korean construction firm moving to build in Saudi Arabia);
- only the consumer is mobile and has to go to the producers' location to consume the service (Japanese tourist visiting Hawaii to enjoy the pleasures of a tropical island);
- both the producer and the consumer are footloose and can trade in services in any nominated location.

The principle of comparative advantage is deemed to be tenable for the various types except perhaps for the third, where exporting factors can shrink the production possibility curve of the exporting country and shift it out in the importing country undermining comparative advantage. This happens because the autarkic price of the factor for the exporting country exceeds that of the importing country.<sup>8</sup> However, even when the principle of comparative advantage is violated, trading is a positive sum game that enhances the welfare of the participants.<sup>9</sup> The whole gamut of neo-classical factor endowments theory or the Heckscher-Ohlin model appears to be applicable with equal vigour to trade in services as it is for trade in goods.<sup>10</sup> The fundamental theorems such as the Samuelson factor price equalisation theorem also seem to be tenable in the case of services.<sup>11</sup> Trade theory does not provide a persuasive rationale to treat trade in the intangible services any differently from the tangible trade in goods despite their obvious differences.

The classification of services has also been made on the basis of the cost of interaction between the consumer

<sup>2</sup> D. Nayyar: *The political economy of international trade in services*, in: *Cambridge Journal of Economics*, Vol. 12 (1988), p. 40.

<sup>3</sup> R. McCulloch: *Services and the Uruguay Round*, in: *The World Economy*, 1990, pp. 329-348, here p. 334.

<sup>4</sup> P. Robinson, K. Sauvart, Govitrikar (eds.): *Electronic Highways to World Trade*, Westview Press, Boulder, Colorado 1989.

<sup>5</sup> T. P. Hill: *On Goods and Services*, in: *The Review of Income and Wealth*, Series 23, 1977, pp. 315-318.

<sup>6</sup> J. N. Bhagwati: *Why are Services Cheap in Poor Countries*, in: *Economic Journal*, Vol. 94 (1984), No. 374, pp. 279-286.

<sup>7</sup> R. M. Stern, B. M. Hokeman: *Conceptual Issues Relating to Services in the International Economy*, Chapter 1, in: C. H. Lee, S. Naya (eds.): *Pacific and World Studies*, Westview Press, Boulder, Colorado 1988; G. P. Sampson, R. N. Snape: *Identifying the Issues in Trade in Services*, in: *The World Economy*, Vol. 8 (1985).

<sup>8</sup> A. V. Deardoff: *Comparative Advantage and International Trade and Investment in Services*, in: R. M. Stern (ed.): *Trade and Investment in Services: Canada/U.S. Perspectives*, University of Toronto Press (for Ontario Economic Council), 1985, pp. 53-68.

<sup>9</sup> R. W. Jones: *Comments*, in: A. V. Deardoff, *ibid.*

<sup>10</sup> B. Hindley, A. Smith: *Comparative Advantage and Trade in Services*, in: *The World Economy*, Vol. 7 (1984), No. 4, pp. 369-390.

<sup>11</sup> Cf. J. N. Bhagwati, *op. cit.*

and the producer of a service, defined as the simultaneity factor.<sup>12</sup> The simultaneity factor assumes values near the upper limit of unity for services that require high interaction costs between the consumer and the producer, whilst for traded goods the simultaneity factor may be near the lower limit zero as the required interaction is negligible. The revolution of information technology has reduced the transactions costs and generated increased interaction between service producers and consumers internationally. In other words, it has increased the tradability of services.

The revolution in information technology has increased the tradability of services through telecommunications. Rent-seeking developing economies are poised to milk some of these rents by instituting mercantilist policies. The advanced information economies and their multinational corporations do not wish to witness the undermining of free trade in services. Although there is no persuasive theoretical basis for establishing a separate GATT-like regulatory framework for services the advanced countries have flexed their muscle and put the issue of service negotiations firmly on the GATT agenda. However, without making the GATT regime on goods function true to its free trade charter, the introduction of another flawed institution to cover free trade in services appears to be questionable.

**Free Trade in Rhetoric Only**

The neo-classical free trade paradigm provides a clear message that free international trade based on perfectly competitive markets maximises the national income of the participants and thereby global welfare. Free trade is the first best optimum and its spirit is enshrined in the GATT principles and upheld by all its members at least in their public pronouncements, although not in their policies. This may be due to the fact that although the powerful normative superiority of free trade may win the argument on international trade it may not win the votes at home.<sup>13</sup> The lengthy deliberations on telecommunications in GNS is a case in point on the schizophrenic behaviour of both advanced and developing economies. They are overtly free trade in their rhetoric in international fora but are covertly protectionist when their self-interest or rent earnings are threatened.

The lengthy GNS deliberations on telecommunications did not advance beyond the acceptance of the same principles of free trade as are enshrined in the GATT

charter on goods. Basically, GATT principles are committed to free trade in a competitive market environment and therefore aim at the removal of trade barriers that distort gains from trade.<sup>14</sup> A review of the principles agreed for free trade in the telecommunications sector shows that they are the same old GATT principles with a new GNS label and they are:

- non-discrimination, or the most-favoured-nation (MFN) principle, whereby all trading partners are accorded the same treatment;
- transparency, or making the customs duties and non-tariff barriers to trade clear to prospective competitors;
- equal treatment, whereby foreign and domestic firms are treated equally by host governments;
- developing countries were also afforded progressive liberalisation or market access commensurate with their level of development, thereby affording them non-reciprocity;
- the right of establishment, or enabling foreign firms to perform their business operations through local branch offices in the host country.

However, when the first principle relating to non-discrimination or MFN provisions was put into practice the most vocal advocates of liberalisation of telecommunications sought to undermine it. The USA and its national lobbies such as AT&T successfully sought to exempt basic telecommunications from free trade coverage on the grounds that it would enable foreign competitors to free ride without offering any reciprocal benefits. However, when it comes to non-basic or value-added services, the USA and its giant telecommunications multinationals have enthusiastically supported liberalisation. Ironically, these multinationals enjoy a decisive technological lead and are poised to free ride in the telecommunication sectors of other countries and make massive profits. The double standards applied to liberalising non-basic services whilst protecting basic telecommunications services exemplifies once again the truth in the allegation that “free trade when you are strong and mercantilism when you are weak” has been the hallmark of GATT negotiations on telecommunications services. Despite the free trade rhetoric on services similar mercantilist behaviour was evident in relation to other sectors. For example, the USA was reluctant to liberalise trade in aviation and shipping, caving in to pressure from domestic lobbies.

The developing economies have also sought to undermine the demands for free network access or market

<sup>12</sup> S. Hirsch: Services and Service Intensity in International Trade, in: *Weltwirtschaftliches Archiv*, Vol. 125 (1989), pp. 44-60.

<sup>13</sup> L. B. Yeager, D. G. Tuerck: *Foreign Trade and U.S. Policy: The Case for Free International Trade*, Praeger Publishers, New York 1976.

<sup>14</sup> G. Feketekey: *International Trade in Services*, Ballinger, Cambridge, Mass. 1988.

access to domestic telecommunications markets by unbundling the mode of delivery from the network access issue. They hope thereby to secure a bargaining chip in subsequent rounds of GNS negotiations. Furthermore, developing countries, based on promptings of the International Telecommunications Union (ITU), would like to trade off market access for infrastructure development in the vital telecommunications sector. The apprehensions of developing countries with regard to the open door policy to telecommunications trade are not without some justification. First, developing economies fear that a free market in telecommunications services and equipment will toll the death knell of their nascent domestic telecommunications sectors. Second, they contend that technological and cultural imperialism and further marginalisation of their telecommunications sectors would result because of predatory competition by foreign multinationals. Third, they fear the loss of economic control over vital strategic sectors such as telecommunications, banking and finance, shipping and aviation. They consider that such an erosion of control over key service sectors would pose a threat to their national security and sovereignty. However, developing economies, despite their defiant and protectionist posturing, have often toed the line when threatened with

trade sanctions and other retaliatory measures by the advanced countries.

A major stumbling block in the progress of GNS at the beginning was the stubborn stance taken by the ITU, which regarded telecommunications to be a nontradable service. Partly, this was a legacy of the ITU as the supranational cartel that regulated the international trade in telecommunications during the moribund industrial era by its monopoly over technical standard setting, tariffication and accounting. The ITU cartel operation ensured the reaping of monopoly profits from the provision of vital services that enabled the international interconnectivity and interoperability of domestic telecommunications monopolies. However, multinational corporations in their push for the internationalisation of production demanded independent network access for enhanced services. Telecommunications was crucial to multinational firms' efficient performance in the competitive international trade arena. The ITU was exposed as a rent-seeking cartel which manipulated tariffs and accounting. It was also alleged that it failed to deliver as the official custodian of infrastructure development in developing countries. Under pressure and virtual blackmail the ITU has softened its uncompromising stance to become a partner with GATT. It now acts to complement

Peter Behrens (Ed.)

## **EEC Competition Rules in National Courts** **Les règles de concurrence de la CEE devant les tribunaux nationaux**

Part One: United Kingdom and Italy / Première Partie: Royaume Uni et l'Italie

The competition rules of the EEC are directly applicable in the Member States. Therefore, the national courts play an important role in the implementation of European competition law. The editor of this volume has initiated a research project which will analyse the national case law. This volume contains the national reports from the United Kingdom and Italy. Further national reports will follow.

The project is designed to make the national case law accessible to lawyers practicing in the field of European competition law. The Community organs get an overview over the implementation of Community law in Member States. Those interested in research find the materials for further comparative studies.

The authors are competition law experts from the different Member States. The editor is Professor of Law at the University of Hamburg and Member of the Board of Directors of the Institut für Integrationsforschung of the Stiftung EUROPA-KOLLEG Hamburg.

1992, 315 S., brosch., 88,- DM, ISBN 3-7890-2709-X

(Schriften des Europa Kollegs Hamburg zur Integrationsforschung, Bd. 1)



Nomos Verlagsgesellschaft • Baden-Baden



and support the GATT negotiations to establish a free trade regime for services.<sup>15</sup>

The progress of multilateral trade negotiations in the Uruguay Round (1986) has been thwarted mainly by the intransigence of the advanced countries with regard to the reduction of agricultural subsidies. With respect to GNS there is disarray and "the developed rather than the developing economies – which always espouse trade liberalisation but are sometimes driven more by mercantilist and protectionist impulses!"<sup>16</sup> are responsible for it. This is because their free trade rhetoric does not translate into policy actions.

### Strategic Trade Sector

The protectionist arguments for government intervention in high-tech sectors such as tradable telecommunications services have recently received some academic respectability from the so-called new trade theories. The new trade theories incorporate market imperfections, such as economies of scale, product differentiation, game theory, and organisational strategies. These new theories purport to explain why strategic sectors can maximise national welfare if promoted by government intervention by granting tariff and non-tariff protection. The new theories have explained the empirical puzzle of why much of the world's trade amongst advanced countries is increasingly intra-industry, or in similar goods and services, rather than in dissimilar ones as explained by the neo-classical theory of comparative advantage. Returns to scale internal to the firm and product differentiation become crucial in explaining the genesis of intra-industry trade. Here, the type of firm is invariably a multinational corporation and telecommunications play a vital role in both the internal and the international management of the firms' production and trading operations. Many governments therefore identify high-tech production and service sectors such as telecommunications as winners on strategic grounds for special protectionist treatment. It is generally argued that they generate positive externalities and R&D on them will not occur at the required level because of inappropriability problems.<sup>17</sup> These are grounds that new theories invoke to

justify protection for high-tech sectors such as telecommunications.<sup>18</sup>

It is possible to use game theoretic pay-off matrices to demonstrate that governments can shift rents and make the domestic telecommunications sector gain at the expense of potential foreign rivals.<sup>19</sup> However, in practice such interventionist policies open up a Pandora's box of uncertainties. First, the various game theoretic outcomes from the behaviour of rival interactions are very difficult to quantify. Therefore, policy formulation to implement strategic trade theory becomes a formidable task and a risky business.<sup>20</sup> Second, even when strategic trade policies are implemented they could attract foreign telecommunications firms to the domestic market. Then the government would unwittingly be subsidising the foreign competitor rather than the local firm, thus undermining the whole rationale of rent shifting.<sup>21</sup> Thirdly, the general equilibrium arguments militate against the strategic promotion of the telecommunications sector as this would shift resources away from other domestic sectors. Cost rises would make other competitive sectors in the economy uncompetitive. The losses from adverse effects on other sectors may far outweigh the benefits from the promoted domestic sector thereby resulting in a large overall macroeconomic loss of welfare. Fourthly, the introduction of domestic distortions to generate national welfare benefits at the expense of world welfare is a beggar-thy-neighbour type policy that can lead to retaliatory actions. These deficiencies make strategic trade policies lose some of their appeal.

Some analysts contend that there is nothing new about strategic trade arguments. They are allegedly the old wine of the infant industry argument in a new bottle. The infant industry argument has an economic basis if, according to the Mill-Bastable theorem, the net discounted value of an interventionist action turns out to be positive. However, the finely researched findings of the political economy of protection militate against the giving of protection even on a temporary basis as it has a tendency to outlive its usefulness. The political economy of protection highlights the inefficiencies associated with rent-seeking behaviour<sup>22</sup> and directly unproductive activities of

<sup>15</sup> International Telecommunications Union: The Challenge of Change, Document 145-E, 26 April 1991.

<sup>16</sup> B. R. Woodrow: Tilting towards a trade regime, The ITU and The Uruguay Round services negotiations, in: *Telecommunications Policy*, Vol. 4, 15 August 1991, pp. 323-342, here p. 341; by the same author: Technology in Environmental Management, in: *Futures*, Vol. 23, No. 5, pp. 451-468.

<sup>17</sup> B. Hindley, A. Smith, op. cit.

<sup>18</sup> G. M. Grossman, C. Shapiro: Normative Issues Raised by International Trade in Technology Services, in: R. M. Stern (ed.), op. cit.

<sup>19</sup> J. A. Brander, B. J. Spencer: International R&D Rivalry and Industrial Strategy, in: *Review of Economic Studies*, Vol. 50 (1983), pp. 707-722.

<sup>20</sup> G. M. Grossman, J. D. Richardson: Strategic US Trade Policies: A Survey of Issues and Early Analyses, Special Paper 5, International Finance Section, Princeton University Press, Princeton 1985.

<sup>21</sup> A. Dixit: International Trade Policies for Oligopolistic Industries, in: *Economic Journal*, Vol. 94 (1984), Supplement; I. Horstmann, J. R. Markusen: Up the Average Cost Curve: Inefficient Entry and the New Protectionism, in: *Journal of International Economics*, Vol. 20 (1986), pp. 225-248.

protectionist lobbies.<sup>23</sup> In retrospect even the architects of strategic trade theory acknowledge the allocative inefficiencies, administrative costs, and the danger of retaliation by rivals and recant their support for strategic intervention.<sup>24</sup> Therefore, after careful analysis of the inefficiencies inherent in strategic trade theory we concur that free trade is not *passé* after all.<sup>25</sup> It remains the dominant paradigm for distilling policy guidelines for international trade in telecommunications and other services.

### Telecommunications Blocs

The violation of the basic tenets of the free trade principles enshrined in the GATT non-discrimination articles or the MFN clause, and tariff only restrictions, are evident in the USA Super 301 laws, the voluntary export restraints (VER) on textile, car and other imports. One of the most flagrant violations of GATT principles is the French non-tariff barrier on Japanese video cassette recorders (VCRs) known as the Poitier syndrome. The French reduced Japanese VCR imports to a trickle by subjecting them to delaying customs checks in a remote border post called Poitier. The rising tide of neoprotectionism has led to the emergence of a trilateral trading world centred around North America, Europe and by default the Asia-Pacific Region. The close symbiotic relation that exists between trade and telecommunications has been analysed empirically.<sup>26</sup> It is manifest in the configuration of telecommunications to three separate blocs corresponding to the three trade blocs: the North American Free Trade Area (NAFTA), the European Community (EC) and the residual Asia-Pacific Trading Area (APTA). The leading information economies in the telecommunications blocs are engaged in fierce competition to become switching nodes for leased lines or regional hubs. The U.K. is the current hub for Europe and Hong Kong is the hub for the Asia-Pacific Region. But Ireland in Europe, and Singapore and Australia in the Asia-Pacific Region are increasingly competing to become regional hubs.<sup>27</sup>

The theory of economic integration or the customs

union theory enunciated by Viner<sup>28</sup> and refined by Lipsey and Lancaster<sup>29</sup> clarifies that the formation of regional trading or telecommunications blocs is a special case of the theory of the second best. This implies that regional blocs, whilst they liberalise trade between partners in the bloc, may be welfare enhancing only if the trade creation effects exceed the trade diversion effects. Vinerian theory defines trade creation as the increase in welfare due to extra consumption arising from cheaper imports from a bloc partner. Whilst trade diversion is the welfare loss due to higher cost imports from a partner, the fact that regional blocs can be welfare reducing makes them second best, as a move towards freer trade is not necessarily Pareto optimal. There is no reason why the logic of Vinerian integration theory is not applicable to trade in telecommunications services. In fact, the formation of NAFTA and the Single European Market are expected to result in massive welfare increases because trade in services is anticipated to increase within the regional trading blocs.<sup>30</sup> Much of the increase in intra-regional trade is anticipated to be generated from the expansion of value-added network services or VANS. However, the welfare improvements in regional trading and telecommunications blocs are achieved at the expense of the rest of the world as they have beggar-thy-neighbour effects. Some features of the North American and European regional telecommunications blocs are reviewed below.

The NAFTA has witnessed a significant liberalisation of telecommunications trade between the USA and Canada. The achievements of NAFTA on regional telecommunications provide a way out of the tardy global liberalisation efforts of telecommunications under GNS. However, the theory of the customs union warns that regional liberalisation in telecommunications trade could be second best. Also, from a global perspective it is welfare reducing because it is at the expense of the other telecommunications blocs. Nevertheless, significant breakthroughs on transborder US-Canada telecommunications trade have been achieved under NAFTA:

□ the right of establishment to compete in the area of non-basic value added network services;

□ the reduction of tariffs; the relaxing of non-tariff barriers or requirements on technical standards;

<sup>22</sup> A. O. Krueger: The political economy of the rent-seeking society, in: *American Economic Review*, Vol. 64 (1974), pp. 291-303.

<sup>23</sup> J. N. Bhagwati: Directly unproductive profit-seeking (DUP) activities, in: *Journal of Political Economy*, Vol. 90 (1982), pp. 988-1002.

<sup>24</sup> P. R. Krugman: Is Free Trade *Passé*?, in: *The Journal of Economic Perspectives*, Vol. 1 (1987), No. 2, pp. 91-107.

<sup>25</sup> J. N. Bhagwati: Is Free Trade *Passé* after All?, in: *Weltwirtschaftliches Archiv*, Vol. 125 (1989), pp. 17-44.

<sup>26</sup> N. D. Karunaratne: Symbiotics of Telecommunications, Trade and Development, in: *Economica Internazionale*, Vol. 51 (1988), Nos. 1-2, pp. 1-20.

<sup>27</sup> J. V. Langdale: International telecommunications and trade in services, in: *Telecommunications Policy*, 1989, pp. 203-221.

<sup>28</sup> J. Viner: *The Customs Union Issue*, Carnegie Endowment for International Peace, New York 1950.

<sup>29</sup> R. G. Lipsey, K. Lancaster: *The General Theory of the Second Best*, in: *Review of Economic Studies*, October 1956.

<sup>30</sup> S. Globerman, P. Booth: The Canada-US Free Trade Agreement and the telecommunications industry, in: *Telecommunications Policy*, December 1989, pp. 319-329; O. Stehmann: Liberalizing the intra-EC long-distance market, in: *Telecommunications Policy*, Vol. 15 (1991), No. 2, pp. 129-136.

- improved transparency in the regulation of telecommunications trade;
- streamlined bilateral dispute settlement mechanisms;
- the elimination of restrictions on direct investment and the lifting of impediments to the movement of business personnel.

The NAFTA agreement dodged the thorny transportation and culturally sensitive trade issues.

The Single European Market will integrate telecommunications networks and aid free transborder flows of telecommunications in the EC. Its architects realise that telecommunications are not merely a service but a vital resource that can be harnessed for economic integration by facilitating macroeconomic coordination and microeconomic harmonisation. Telecommunications services play a critical role similar to a single currency unit and free factor mobility in integrating and making the Single Market a reality. Therefore, the Commission of the European Communities has invoked the competitive provisions of the Treaty of Rome, Article 90, to end or vary domestic monopolies on terminal equipment, government procurement and technical specifications on services. The net trade creation effects emanating from an integrated telecommunications market among members of a community closely bound by economic and cultural ties are anticipated to be spectacular in the near future. The contemporary environment in Europe remains fractured by competition and regulation<sup>31</sup> but there are inexorable political forces that will hasten the integration of the European telecommunications markets in the long run.

### The Asia Pacific Region

The increasing competition amongst partners in each regional telecommunications bloc is manifest in the area of fibre optic and satellite facilities construction. In the Asia-Pacific Region the submarine coaxial networks are being duplicated by new fibre optic cables linking up the other regional blocs. Furthermore, Cable and Wireless, in implementing their strategy of establishing a global digital network, is linking up the ASEAN countries, Pacific Island

Nations (PINs) and the other regional blocs and investing in a manner that will deter rivals, as foreshadowed in strategic trade theory. Also several new satellites are anticipated to compete with INTELSAT. The net result is anticipated to be massive excess capacity and a fall in prices particularly in the Asia-Pacific Region. However, even in the Asia-Pacific Region the major beneficiaries from the telecommunications development bonanza are likely to be the richer countries that include the four dragons (Singapore, Taiwan, South Korea and Hong Kong). Australia and New Zealand have already embarked on a closer economic relationship agreement (CER) and there are larger benefits possible from integration into a single market.<sup>32</sup>

However, the PINs scattered over the 29 million square kilometres of the Pacific Ocean could miss out from the benefits of competition in telecommunications in the Asia-Pacific Region. Their dispersed nature makes them suitable for footprinting by satellites. However, the PINs are on the thin route telecommunication locus and do not offer multinationals the prospect of cream skimming. The economic disparities that exist between PINs are reflected in the teledensity disparities (telephones per 100 population) which is 1.5 for Papua New Guinea compared to 67 for New Zealand. The rural/urban disparities within PINs are also large.<sup>33</sup> The double dualism that prevails in developing PINs has been censured on humanitarian and common interest grounds.<sup>34</sup> The radical perspective contends that the infusion of high-tech such as telecommunications can further marginalise PINs economically and culturally. On the positive side, theoretical analyses show that the integration of PINs into a regional bloc would improve their welfare due to the presence of multinationals and their job creation effects.<sup>35</sup>

### Welfare Scenarios

The emergence of trilateral regional trading and telecommunications blocs is certainly second best as they do not maximise world welfare and, moreover, one region's gain is achieved at the expense of that of another bloc. However, in the area of trade in services all the trading and telecommunications blocs are poised to grow in a symbiotic fashion with the rapid globalisation of the information economy. Below, we make use of estimates from general equilibrium model calculations by the Centre for International Economics<sup>36</sup> to map out the welfare

<sup>31</sup> R. Mansell, P. Holmes, K. Morgan: European Integration and Telecommunications: Restructuring Markets and Institutions, in: Prometheus, Vol. 6 (1990), No. 1, pp. 50-66, here p. 64.

<sup>32</sup> P. Lloyd: The Future of CER. A Single Market for Australia and New Zealand, Committee for Economic Development of Australia, Monograph No. 96, The Institute of Policy Studies, Victoria University Press, 1991.

<sup>33</sup> M. Jussawalla, M. R. Ogden: The Pacific Islands. Policy options for Telecommunications investment, in: Telecommunications Policy, 1989, pp. 40-50.

<sup>34</sup> Sir Donald Maitland et al.: The Mission Link, ITU, Geneva 1984.

<sup>35</sup> H. Beladi, S. K. Samanta: Foreign Technology and Customs Unions: Trade Creation and Trade Diversion, in: Journal of Economic Studies, Vol. 17 (1990), No. 6, pp. 27-35.

<sup>36</sup> Centre for International Economics (CIE): Western Trading Blocs: Game, Set or Match for Asia-Pacific and the World Economy?, Canberra 1990.



scenarios resulting from the pursuit of different strategies by the major regional blocs. The estimates are only ballpark figures for services based on the heroic assumption that trade in services comprise 30% of the value of total merchandise trade, as reported in GATT statistics. The welfare implication *per se* for telecommunications services cannot be estimated, as published data on electronic trade in information services is not available.

The pay-off matrix for welfare effects of trade in services (Table 1) is estimated on the basis of the pursuit of both protectionist and free trade strategies in the North American and the European trading blocs. The resulting changes in the other regions are quantified in terms of GDP in the pay-off matrix. The worse case scenario quantifies that the world GDP losses due to the simultaneous pursuit of protectionist strategies by the North American and European trading blocs would be nearly \$US 61 billion, with Europe accounting for a major portion or over 61% of the loss and the Asia-Pacific Region accounting for about 8% of the loss in world GDP (Cell I, Table 1). If Europe opts for a free trade strategy while North America keeps the trade shutters down on services, world welfare will increase by \$US 40 billion and Asia-Pacific GDP will increase by 28% and the GDP of the other trading blocs increase much more (Cell II, Table 1).

If Europe opts for the "fortress Europe" strategy while the North American trading bloc opts for free trade in services, the world welfare increase as measured in terms of GDP increase would be only \$US 15 billion. The Asia-Pacific Region would gain as much in percentage terms compared to North America with both regions increasing their GDP by 13% each (Cell III, Table 1). The best welfare scenario eventuates when both North America and Europe go for free trade in services. World welfare would

increase significantly, as shown by the increase in GDP of \$US 119 billion (Cell IV, Table 1). Europe would be the largest beneficiary from the best case scenario, accounting for nearly four times the welfare gains of the Asia-Pacific Region. The difference in welfare gains from pursuing the worst case or protectionist and the best case or free trade strategies for services by the major regional blocs is about \$US 180 billion (i.e. Cell IV minus Cell I). Other calculations also indicate that if Asia-Pacific decides to unilaterally liberalise its trade in services it could gain \$US 67 billion, with Japan being the major beneficiary.<sup>37</sup>

### Concluding Remarks

The international trade paradigm and the associated principles of comparative advantage appear to be equally applicable to both goods and services such as telecommunications, although they share different characteristics. Therefore, there are no theoretical grounds for asserting that policy-making or institution-building for regulating free trade in services should be different from free trade in goods. In this context, it is quite pertinent to question all the fuss about negotiating for a free trade regime for services.<sup>38</sup>

The fact that the principal architects of GATT have flagrantly violated the cardinal free trade principles enshrined in Article 1 by non-tariff barriers needs to be rectified before a similarly flawed system is duplicated for services. The replication of a malfunctioning system does not augur well for free trade in services. It may only distract GATT from the fundamental task of counteracting the non-tariff barriers that are gnawing at its very existence as the free trade custodian of the world. Non-tariff barriers on goods are so adverse in their welfare impact and opaque and intractable when practised by nations. The insidious welfare effects and the nontransparency problems are likely to be more complex in the case of services. Unless the practitioners of neoprotectionism eschew them and promote a genuine free trade regime in goods according to the GATT free trade principles, having a separate GATT-like regime for services is unlikely to ensure free trade in services. Therefore, the fundamental problem that appears to threaten the world trade system is the spread of non-tariff barriers in goods and services or neoprotectionism. This has to be tackled head-on by spokespersons for both advanced information economies and developing economies by matching their public rhetoric on free trade with concrete policy actions at home.

**Table 1**  
**Pay-off Matrix for Trade in Services,**  
**Protectionist vs. Free Trade Scenarios**  
Percentage (\$US billion)

North America Europe		Protectionist	Free Trade
		Cell I	Cell II
Protectionist	Europe	-61% (-37)	32% (13)
	Asia Pacific	- 8% ( -5)	28% (11)
	North America	-31% (-19)	40% (16)
	World	-100% (-61)	100% (40)
		Cell III	Cell IV
Free Trade	Europe	74% (11)	53% ( 63)
	Asia Pacific	13% ( 7)	16% ( 19)
	North America	13% ( 7)	31% ( 37)
	World (\$USbn.)	100% (15)	100% (119)

Source: Centre for International Economics: General Equilibrium Model Calculations, Canberra 1990.

<sup>37</sup> G. Banks, A. Stoeckel: Western Trade Blocs & the New Protectionism, in: Policy, Vol. 6 (1990), No. 3, pp. 2-5.

<sup>38</sup> S. Voigt: Traded Services in the GATT - What's all the Fuss About?, in: INTERECONOMICS, Vol. 26 (1991), No. 4, pp. 177-186.