Comments on Edward J. Balistreri, Jesper Jensen and David G. Tarr, "What Determines Whether Preferential Liberalization of Barriers against Foreign Investors in Services are Beneficial or Immizerising: Application to the case of Kenya."

This paper evaluates the potential impacts of preferential liberalization of access to goods and services markets by Kenya using a numerical model with monopolistic competition and foreign direct investment (FDI) in services with Dixit-Stiglitz endogenous productivity effects from additional varieties. A key feature of the approach is to generate probability distributions of all parameters, with results reported as the probability of an outcome. The authors show that preferential liberalization of services by Kenya may be immizerising if this involves agreements with countries – in this case other African nations – to open up to suppliers that are less efficient (innovative; productive) than firms located in the rest of the world. The authors consider different scenarios as to whether pre-agreement policies generated rents for Kenyan nationals that may be either dissipated or be shared with partner country suppliers post-agreement. They show that welfare losses are more likely the greater the share of initial rent capture by Kenyan nationals associated with services trade/investment barriers and the more technologically advanced are the firms in the rest of the world that are excluded from the trade agreement.

This is an excellent paper in showing how it is possible to use analytical techniques in combination with data on market structure and estimation of the magnitude of trade barriers to assess the potential impacts of different types of liberalization. The model itself has been developed and published in other papers and will not be discussed here.The results conform with both theory and intuition that preferential liberalization may not be welfare improving. The results that non-discriminatory liberalization dominates by far preferential approaches, and that an agreement with a large high-income set of countries like the EU dominates an deal with countries that have lower productivity/less efficient firms are important from a policy perspective, suggesting that insofar as there are political economy constraints on unilateral reform, PTAs should be used as vehicles to promote reforms on a non-discriminatory basis.

One area in which the paper could be improved is in the explanation of how AVEs are calculated, and in particular how discriminatory policies are differentiated from non-discriminatory regulatory barriers that apply to all firms. The results appear to be driven primarily by liberalization of transport services and cut flowers (fig. 5). It would help to understand why this is the case – what are the policies that bind in these sectors? What explains the large change in output from air transport liberalization given an AVE of only 2%? The text mentions that AVE estimation and data collection was focused on maritime transport – but there are benchmark distortions reported for all transport sectors in Table 1 – so where do these come from? Is maritime transport = port services? Why is the AVE for telecoms only 4% if there are big problems with permitting new entry/issuing new licenses?

A more general issue that would be helpful to discuss is the actual feasibility of liberalizing FDI in services on a preferential basis. Clearly this can be done if the barrier to entry is a QR – as in the case of telecoms where the issue is additional licenses. But it is not clear that the types of polices mentioned in Section III can be addressed on a preferential basis. Even if they can and are, it may be that in practice the reform will also benefit firms from other regions. For example, the scenario of an agreement with African countries may allow a US or EU firm into the market is it has an affiliate that has established in one of the African partner countries. Much therefore depends on the "rules of origin" that will be applied in any preferential agreement. When it comes to FDI it may be much more difficult for governments to discriminate than when it comes to trade in goods.

A couple of specific comments:
p.3: There has been some research assessing the welfare impacts of (preferential) liberalization with imperfect competition but it has been sector-specific. An Africa-relevant paper is Murinde, Victor, and Cillian Ryan. 2003. "The Implications of WTO and GATS for the Banking Sector in Africa."

World Economy, 26(2): 181–207. Joe Francois and Ian Wooton have a number of papers that focus on transport and distribution services.

It would be useful for researchers if the authors could discuss how their measures of trade restrictiveness compare with the STRI data that has been compiled by the World Bank and the extent to which the STRI data could be used for similar analyses for other countries.