

Hosts and guests: policy and multinational activity in services

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ABSTRACT: In this paper we examine the interaction between policy and modes of entry in services. We first develop a model of sales through either arms length cross-border trade or sales through affiliates (establishment-based trade). This framework links modes of market entry, and the volume of sales, to both fixed and variable costs faced by multinational service firms. We develop an augmented gravity equation that accounts for differential modes of entry in services. We take these analytical results to the data. Working with a panel of trade and establishment data for 2008, together with data on regulatory barriers affecting both establishment (fixed) and operating (marginal) costs, we find evidence supporting the impact of policies on the mode of entry, and on total trade in services consistent with our theoretical framework.

Keywords: Services trade, firm heterogeneity, establishment, services modes

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