Strategic Regulatory Bias and Mutual Recognition Agreements.

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Abstract

I examine the setting of regulatory minimum quality standards in an oligopolistic industry, and the interaction of standard-setting with trade. Where an industry is monopolistic, there is a tendency to reduce quality, as well as quantity of goods supplied, and monopolistic distortions can be reduced by setting minimum quality standards. Regulations in this context increase trade.

I set up a Cobb-Douglas/Cournot model of a cross-hauling duopoly. In a noncooperative setting, regulators will set the highest standards consistent with firms remaining in the market. This is still below the global optimum (so noncooperative standards are not welfare-reducing). When a mutual recognition agreement is introduced, standards may either stay at this level or decline, depending upon demand elasticities. In the latter case, mutual recognition reduces global welfare compared to noncooperation.