UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

Measuring Restrictions on FDI in Services in Developing Countries and Transition Economies

UNITED NATIONS
New York and Geneva, 2006

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UNCTAD/ITE/IIA/2006/1

UNITED NATIONS PUBLICATION
Sales No. E.06.II.D.13
ISBN 92-1-112707-6
ISSN 1818-1465

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Printed in Switzerland

Preface

The world economy has shifted markedly towards services. This shift manifests itself in several ways. First, services assume increased importance for the competitiveness of firms in all sectors. Second, new technology has made it possible for more services to be internationally traded, with new export opportunities for developing countries as a result. Third, reflecting these developments, the national as well as international policy agenda – ranging from liberalization to promotional efforts – is increasingly tilting towards services.

Services – particularly in infrastructure, finance and business – are critical to the development of a competitive business sector. As documented in the *World Investment Report 2004: The Shift Towards Services*, transnational corporations can contribute to enhancing the provision of such services and have an indirect impact on the systemic competitiveness of host economies. At the same time, however, foreign direct investment in services can generate concerns and potential costs that have to be addressed through appropriate policies. The potential costs rise when efficient regulation is missing; when institutions and instruments needed to manage privatization and utilities, for example, are weak; or when the investment is undertaken in socially or culturally sensitive areas. Indeed, as many services are embedded in the social, cultural and political fabric of societies, the challenge is to strike a balance between economic efficiency and broader development objectives.

Despite the importance of services, our knowledge of the extent to which developing countries have opened up to foreign direct investment in services is very limited. Most available studies have relied primarily on the information provided through country schedules of the General Agreement on Trade in Services (GATS) under Mode 3 (commercial presence). Important drawbacks to that approach are that the schedules do not take account of unilateral steps taken to liberalize services beyond what has been committed to under the GATS, and that the schedules are not necessarily up to date.

As part of UNCTAD's work on assisting developing countries in their policy formation and implementation in the light of international developments, this study aims to fill at least a part of this information gap. It attempts to quantify and analyse the existing and available measures of restrictions on FDI in the services sector for developing countries. It is my hope that its findings will stimulate further discussion and contribute to better assessments of the dynamic interaction between FDI in services, national policies and the implications for development.

Supachai Panitchpakdi
Secretary-General of UNCTAD

Geneva, July 2006

Acknowledgements

This report is part of a new Series of Current Studies on FDI and Development published by UNCTAD. The series aims to contribute to a better understanding of how transnational corporations and their activities impact on development. The present study quantifies and analyses measures of restrictions on inward FDI in the services sector for developing countries. It aims at stimulating discussion and further research on the subjects addressed.

The study was prepared under the overall guidance of Anne Miroux and Torbjörn Fredriksson. It is based on a manuscript prepared by Stephen Golub with the assistance of Qing Ling. Abraham Negash was the project officer responsible for its production.

The text benefited from specific inputs provided by Fiorina Mugione, Ahmed Sharafat and Palesa Tlhapi, and from comments and feedback by Sam Laird, Dong Jae-Lee, Kálmán Kalotay, Padma Mallampally, Nicole Moussa, Roy Nixon, Thomas Pollan, Kee Hwee Wee and Larry Westphal.

The text was copy-edited by Graham Grayston and desktop publishing was done by Teresita Ventura.

The cooperation of the relevant countries, Permanent Missions and international organizations is acknowledged with gratitude.

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Executive summary

Notwithstanding the worldwide trend towards liberalization since the early 1990s, there remain substantial disparities between regions and individual countries in the severity of observable restrictions on inward foreign direct investment (FDI) in services. This paper quantifies and analyses such restrictions in the services sector of developing countries and economies in transition, using a methodology developed in a recent study of OECD countries.

The study contains a more comprehensive and up-to-date compilation, quantification and analysis of restrictions on FDI in services in developing countries than prior studies, many of which have tended to rely on the General Agreement on Trade in Services (GATS) schedules for information. It draws on a large number of sources in addition to the GATS.

The study is confined to measuring restrictions discriminating between foreign and domestic investors and does not take into account policies impinging on all investors, such as product or labour market regulations. The sample includes 50 developing countries in Latin America, Asia, Africa and Europe.

Several different types of restrictions are considered: limitations on foreign ownership, screening or notification procedures, management restrictions and operational restrictions. These restrictions on FDI are computed for a large number of services industries and aggregated into a single measure for the services sector as a whole in each country. The results should be interpreted carefully in the light of the frequent changes to, and complex nature of, national policies on FDI, which render classification and quantification challenging.

The study finds that the GATS schedules by themselves are poor guides to the stance of policies on FDI for most countries and generally underestimate the extent to which countries have opened up their services industries to FDI. It provides a heretofore unavailable systematic and internationally-comparable set of indicators for policies on FDI in services that will be of value to policymakers concerned with international negotiations on FDI and researchers studying FDI.

Moreover, the analysis suggests that Latin America and economies in transition generally have relatively low levels of restrictions, whereas higher levels of restrictions are found in East Asia and the Middle East. Inward FDI in services is strongly negatively correlated with the severity of restrictions.

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