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Foreign investment liberalization and incentives in selected Asia-Pacific Developing Countries: Implications for the health service sector in Nepal

By

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Executive Summary

To take full advantage of the opportunity provided by integration with the global economy – reflected partly by membership in the World Trade Organization (WTO) - it is essential that developing countries have built-up appropriate supply capacity to ably meet with the standards of consumers and governments in other countries; this point is especially true in the leading sector of growth for developing economies – the services sector. For attaining the aforementioned goal of strengthening the domestic service industry, it is necessary for attracting foreign investors since their input is felt to provide necessary quality and methods, to ensure that domestic service products are internationally competitive. This can be seen in most countries having given preference to liberalization of foreign direct investment (FDI) in the service sector through commercial presence. A problem, however, is that utilizing the experiences of developed countries to optimize this strategy for attracting investment in the service sector in developing countries, may not be appropriate and practicable. The paper focuses on attracting FDI in the health services, in large part due to its importance to a country's overall development. Further, the paper endeavors to utilize the lessons from successful developing countries for attracting FDI in the service sector (in particular health) for the Kingdom of Nepal, a least developed country (LDC) located in south Asia.

The prime objective and main research questions of the study are: 1) What are the practices of service sector investment liberalization and incentives from selected developing countries, and 2) How those experiences can be applied to the investment liberalization and provision of incentives in the Nepalese services sector, with focus on the health service sector? It should be pointed out that a country's liberalizing strategy refers to a dynamic policy process through a flow in time; however since this study is presently limited to focus on a point in time (e.g. 2003), attention is given to FDI incentives in selected developing countries to tease out lessons of a broad service related investment (health) liberalization strategy.

The study initially reviews literature on FDI attractors and makes a distinction between determining factors and incentives. The prior are factors being more difficult to change (such as size and population of the economy), while the later are less rigid and can influence the direction of the determining factors. In this regard, the four major determinants of FDI are: quality of infrastructure; level of skill and human capital; regulatory environment; and incentives (facilitating mechanism [procedure etc.], infrastructure incentive, regulation incentives and fiscal and financial incentive). The review focuses on the services sector and concludes that there is no consensus among the analysts on the role of various determinants and incentives. Literature relating to FDI in health is also reviewed where an important issue is the degree of commercialization of health services to benefit from FDI in health.

The study focuses on the experiences of liberalization strategies and incentives for attracting investment in (health) services of selected developing countries – Bangladesh, India, Malaysia, People's Republic of China, Singapore, Sri Lanka and Thailand. The study finds that despite these countries being quite varied (e.g. economic size, area,

population), the incentives are similar in both their non-specific nature to services as well as the general ranges of incentives offered, although variable in regulatory incentive. It was observed for the countries examined that there did not appear to be a clear relationship between the incentives (e.g. liberalization strategy) and FDI flows; the exception is the regulatory incentive which perhaps gives an indication of the investment climate – this has a strong relation with FDI flows.

Further, of the seven above mentioned countries, only three – India, Malaysia and Singapore – have made limited multilateral commitment in the health sector – confirming reluctance of countries to open this sector to international competition. Again, this reluctance may be due to countries not being confident enough of the control they can have in this sector (through appropriate regulation, supervision and monitoring) despite having acknowledged the importance of investing in health. This suggests a need for case studies to examine countries with both successful experiences and accessible information – this may be on developed countries whose information can be interpreted for country situation.

Based on those experiences, the study provides a road map for the future liberalization - investment in general and health services in particular - in Nepal. The study finds that the country does have a facilitating mechanism however there is presently confusion since there exists more than one, without clearly defined authorities. Further, gaps have been highlighted in the above mentioned broad incentive in comparison to those found from the examined developing countries. A roadmap of an investment liberalization strategy, is produced which tries to bridge those incentive gaps with particular attention being paid to appropriate regulation of health investment. Finally, three points are interjected for implementing this roadmap given the present condition in Nepal. These are: timing, sequence, and pace.

It should be noted that all these incentives reflect investment liberalization which try to make a hospitable environment for FDI. However political and economic stability may still be the crucial factor in determining the level of FDI – both in general and with regard to service and in particular health. An important area for the future research is what constitutes an effective package of reforms regarding the regulations of the services according to the country specific situation. In other words, it is observed that emphasis seems to be on the determinant of the investment climate.

It therefore concludes that for Nepal to capture the benefit of investment liberalization, it must continue enhancing the existing facilitating mechanism, the determinants of FDI along with the incentives in the services sector. Ensuring a stable domestic environment will be much more important to win confidence among investors. In other words, despite the roadmap for Nepal, it is felt that a more “difficult” road lies ahead for the country in attracting investment in general and specific to services (health).

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APPENDICES

1. Introduction:

To take full advantage of the opportunities provided by integration into the global economy – reflected partly by membership in the World Trade Organization (WTO) - it is essential that developing countries have built-up appropriate supply capacity to ably meet with the standards of consumers and governments in other countries. This point is especially true in arguably the leading sector of growth for developing economies – the services sector. For attaining the aforementioned goal of strengthening the domestic service industry, it is necessary for attracting foreign investments since their input is felt to provide necessary quality and methods and to ensure that domestic service products are internationally competitive. This can be seen in most countries having given preference to liberalization of foreign investments in the service sector through commercial presence.[1] A problem, however, is that utilizing the experiences of developed countries to optimize this strategy for attracting investment in the service sector in developing countries, may not be appropriate and practicable. The research study addresses this shortcoming by providing a critical review on the practices of selected developing countries in regard to liberalization of investment in the service sector and focuses on the health sector in particular. The selection of this sector is largely due to the importance of this sector, especially to a developing country who can benefit from several new forms of health services delivery that have emerged during the last decade. These new delivery forms result from increased ability to pay for health services arising from rising income levels, integration of information technology with health care services, movement of people seeking health care made possible by declining transportation cost and duration of travel, institutional developments in health financing and economic reform in the health care services sector (Chanda, 2001). In other words, it is felt that development of health services are both means and ends of a country's overall development.

Further and to add to the policy relevance of the analysis, the aforementioned generalized study is distilled to provide lessons to the Kingdom of Nepal, the first least developed country (LDCs), to have acceded to the WTO via the full membership process and having become the 147th member of the WTO. This analysis is focused on the health service sector of WTO's General Agreement of Trade in Services (GATS)[2], due to its importance for the Kingdom's economic growth and development (Adhikari, Maskay and Sharma, 2004). Under the language of GATS, there are four ways to provide health services,[3] however the study focuses on delivery through "commercial presence" and mostly by means of FDI flows. The specific problem is thus to provide to country specific suggestions for crafting an appropriate and attractive incentive package for

[1] For example, this is noted by WTO in their 2002 handbook when it is stated: "Another key policy area that comes under the spotlight in services liberalization is the treatment of foreign direct investment (FDI). Commercial presence is a key mode of supply for services, and developing countries have historically places significant restrictions on FDI in order to encourage domestic ownership of capital, limit repatriation of profits, and increase the linkages of the multinational firm with upstream suppliers".

[2] For description, see appendix 1.

[3] For description, see appendix 2.

attracting foreign investment in the domestic service sector, with focus on the domestic health service sector.

The prime objective and main research questions of the study are: 1) What are the practices of service sector investment liberalization from selected developing countries, and 2) How those experiences can be applied to the investment liberalization in the Nepalese services sector, with focus on the health service sector? It is important to point out that a country's liberalizing strategy refers to a dynamic policy process, but this study limits its focus to the selected one point in time (i.e.. 2003). This focus is given to FDI incentives in selected developing countries to tease out lessons of a broad service related investment (health) liberalization strategy. With this in mind, it is expected that the research outcome will be of policy significance for developing countries in general and provide necessary information appropriate to Nepalese policy makers in particular, to facilitate drawing foreign investment in the service sectors with focus on the health sector.

In view of the above objectives, the research paper proceeds in three parts moving from general discussion on investment incentives to narrowed down exploration of investment incentives in health services: in the first part, the theoretical and empirical studies are reviewed for preliminary identification and differentiation of determinants and incentives for attracting FDI and construction of a basic[4] investment-incentive matrix. The second part of the report critically analyzes the best practices of selected developing countries.[5] The experiences and the components of successful service sector investment liberalization will be delineated mainly at the multilateral level, which includes the various generalized incentives mentioned above to attract FDI in services. Additionally, the identified sample of countries will be further focused to those countries which have committed to multilateral liberalization in the health related service sector and what were their policies (i.e. best practices) used to mitigate negative repercussion. Further, the review will cross reference the above developed basic investment-incentive matrix, and produce a refined investment-incentive matrix for the services (health) sector in developing countries. In the third part the above analysis is applied - with refined investment-incentive matrix - to Nepal. For this purpose, a brief background is provided of both the service sector of Nepal along with the country's GATS commitments, with a description of the market for the health services. In sum, this exercise attempts to provide foundation for a feasible liberalization road map for attracting foreign investment in the Nepalese service sector with focus on the health services.

The major limitations of the study are highlighted at the end. Service sector liberalization is a very broad and emerging topic. The different types of service sectors and regulations of different countries make the policy-relevant generalizations difficult. As argued by Mattoo and Sauve, "…one of the most important and difficult issue in

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[4] Not limited to financial and fiscal incentives but more encompassing.

[5] It is felt that at this stage the analysis can be limited to liberalization of service sector investment in the developing countries of East Asia – e.g. People's Republic of China, Malaysia, Singapore and Thailand - and South Asia – e.g. Bangladesh, India and Sri Lanka -, as the highlighted countries have arguably had a successful experience in trade (goods and services) liberalization and cover both a great majority of the population and land mass of the Asia-Pacific region.

international trade today is the relationship between trade and investment liberalization and domestic regulatory autonomy" (World Bank, 2003). The study therefore, has attempted to broadly identify some of the important issues in attracting the FDI in services and health services in particular without going into details about each piece of legislation and regulatory regimes in those countries.