

Investment Facilitation and Mode 3 Trade in Services

Are Current Discussions Addressing the Key Issues?

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Abstract

Based on a novel approach to measuring the cost of trade in services for Modes 1 (cross-border supply), 2 (consumption abroad), and 4 (temporary movement of service suppliers), developed by the World Trade Organization Secretariat, this paper reviews available evidence on factors affecting trade costs for services supplied via a commercial presence in a host country market, so-called Mode 3 trade. It does so with a view to answering the question of whether the current “facilitation” agendas on services and investment proceeding at the World Trade Organization focus on the most important factors affecting Mode 3–related trade costs, by far the most important of all modes of supplying services

internationally. The paper explores the policy opportunity costs arising from the decision to focus the investment facilitation agenda on matters of regulatory transparency and the streamlining of administrative procedures. It recalls how reducing regulatory heterogeneity, tackling discriminatory impediments to cross-border investment, and developing investor-state conflict management mechanisms to retain and expand investment and prevent dispute escalation—all issues left unaddressed by ongoing negotiations—hold important potential for reducing Mode 3 trade costs and facilitating expanded investment.

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Investment Facilitation and Mode 3 Trade in Services: Are Current Discussions Addressing the Key Issues?

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1. Introduction

This paper addresses investment facilitation in services and the reduction of attendant trade costs involved in supplying services through an established presence in a host country market. Services have long been the fastest growing component of cross-border exchange. Of all modes of supply, Mode 3 (commercial presence, or investment)² remains by far the most important means of selling services abroad. The WTO estimates that Mode 3 transactions account for over three-fifths of aggregate services trade.³ This is so even as Mode 3 trade tends to be particularly vulnerable to risks deriving from host country conduct, typically confronts a range of trade-cost inducing measures in host country markets, particularly of a discriminatory nature, and as technological advances induce modal substitution effects favoring the remote (i.e. cross-border) supply of services over digital networks in the long-run.

This paper situates its analysis in the context of ongoing global discussions on trade facilitation in services as well as investment facilitation, two closely related topics currently taken up along separate negotiating tracks at the World Trade Organization (WTO). In the case of trade in services, discussions of trade facilitation provisions started within the aegis of the WTO Working Party on Domestic Regulation established by the Council on Trade in Services to develop additional GATS Article VI disciplines,⁴ a setting in which the issue of trade facilitation in services formally received greater attention in the wake of a proposal first mooted by the Government of India in September 2016.

In the case of investment facilitation, talks were initiated within the G20 Trade and Investment Working Group (TIWG) launched during the Chinese G20 presidency in 2015-16. These have subsequently been taken up within a so-called Joint Statement Initiative at the World Trade Organization (WTO) following the organization's 11th Ministerial meeting (MC11) held in Buenos Aires in December 2017.

Discussions held in Geneva over the past two years have seen the substantive perimeter of a possible multilateral investment facilitation regime progressively emerge. This is an important initial step. Yet, to bear fruit, discussions of investment facilitation in services should ideally be anchored in an integrated framework enabling stakeholders not only to properly assess the different dimensions of the potential impact of investment facilitation measures, but also to identify the main drivers of services trade costs through Mode 3 in order to prioritize and start working in those areas where the greatest impact may be achieved in the short- to medium-term.

This paper explores whether the current trade facilitation agendas in services and investment address the most important factors raising the cost of services delivered via Mode 3 trade. The paper draws on the

² Article I:2 (Scope and Definition) of the WTO's General Agreement on Trade in Services (GATS) states that the Agreement "applies to measures by Members affecting trade in services, including "by a service supplier of one Member, through commercial presence, in the territory of any other Member (Mode 3 – commercial presence)." Article XXVIII: d) (Definitions) defines commercial presence as "any type of business or professional establishment, including through: (i) the constitution, acquisition or maintenance of a juridical person, or (ii) the creation or maintenance of a branch or a representative office, within the territory of a Member for the purpose of supplying a service."

³ Roy, Martin, (2019), *"Elevating Services: Services Trade Policy, WTO Commitments, and their Role in Economic Development and Trade Integration"*, (March 8). Available at SSRN: <https://ssrn.com/abstract=3358775> or <http://dx.doi.org/10.2139/ssrn.3358775>.

⁴ GATS Article VI focuses on non-discriminatory domestic regulation.

cost component categories identified by a novel methodology recently developed by the WTO Secretariat to measure trade costs for services delivered via Modes 1, 2, and 4, while identifying the most important cost components affecting Mode 3 trade.

The investment facilitation agenda currently pursued at the WTO relates chiefly to two overriding objectives: (i) promoting greater regulatory transparency and the predictability of investment regimes and (ii) streamlining administrative procedures linked to investment entry and operations. The paper contends that such an approach needs to be complemented by efforts to address three of the most important factors increasing the cost of services traded under Mode 3. These are: (i) the economic costs deriving from erratic host state conduct; (ii) discriminatory barriers affecting the establishment of a commercial presence by foreign service providers; and (iii) costs deriving from cross-country regulatory heterogeneity.

The paper is structured as follows. Section 2 documents the significant weight that services play in global FDI flows and vice versa, that is, the significant predominance of commercial presence within services trade as a whole and the conceptual implications deriving from such a predominance. Section 3 situates the parallel evolution in time of the concepts of trade facilitation in services and investment facilitation. Section 4 focuses on the measurement of trade costs in services. Reviewing the recent specialized literature, the section examines available evidence on each trade cost component. Section 5 concludes the analysis and singles out the key policy implications deriving therefrom. In so doing, it sketches a preliminary framework linking trade costs with the different potential components of a comprehensive investment facilitation agenda, including potential diagnostic and impact indicators with which to operationalize it.

2. The importance of services trade through a commercial presence: Key trends and aggregates

The policy research community has long known that the contribution of services to world commerce has been underestimated. Trade in services is not only growing faster than trade in goods, but also creating value far beyond what national accounts measure, more so than trade in goods (McKinsey, 2019). The sheer importance of commercial presence - Mode 3 - as a means of delivering services to markets implies that the notion of investment facilitation, as currently discussed in rule-making circles, relates predominantly to steps taken to facilitate foreign investment in services. In the same vein, discussions of trade facilitation in services chiefly (if not exclusively) relate to commercial presence.⁵

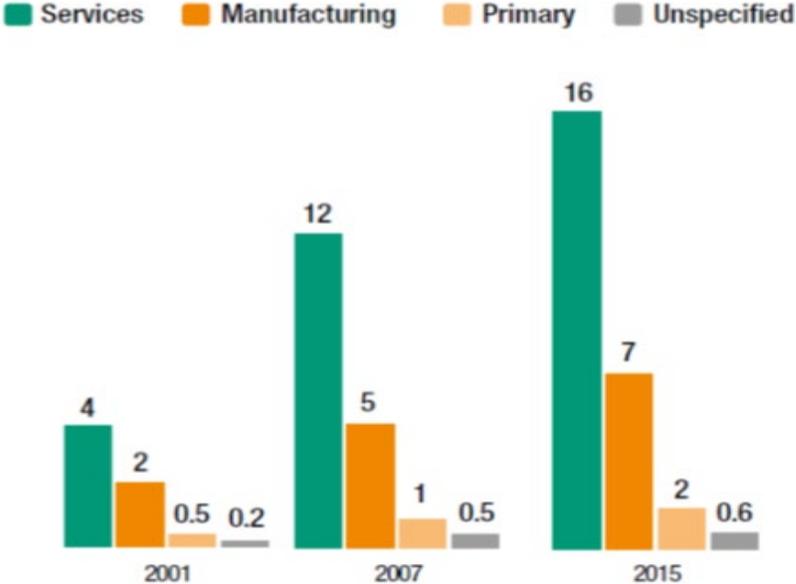
Statistics measuring the value of cross-border exchanges of services (as defined under trade agreements) could long only be found in countries' balance of payments (BoP) data, even though these only capture a limited share of world services trade. Indeed, the principal means of supplying services internationally, which is through a commercial presence abroad, is not captured in BoP statistics.⁶

⁵ While Mode 3 is central to any coherent discussion of trade facilitation in services, the Government of India has to date chosen not to take part in the Joint Statement Initiative on investment facilitation that pursues a number of aims closely aligned to those proposed by the Indian proposal on TFIS.

⁶ BoP statistics focus on transactions between residents and non-residents, and do not capture services that are supplied within the country through business establishments owned or controlled by foreigners.

Although data on foreign direct investment (FDI) in services are not a perfect proxy for services supplied through Mode 3, the growing importance of FDI in services nevertheless hints at a similar trend for Mode 3 trade. Services are today the predominant destination of foreign direct investment (FDI) activity. They account for over two-thirds of the global *stock* of FDI (see Figure 1). Such a figure stood at less than 50% in 1990 and at 25% in 1970 (UNCTAD, 2016). Services are also where a predominant share – close to 4 in 5 - of discriminatory investment barriers are found (Sauvé *et al.*, 2006).

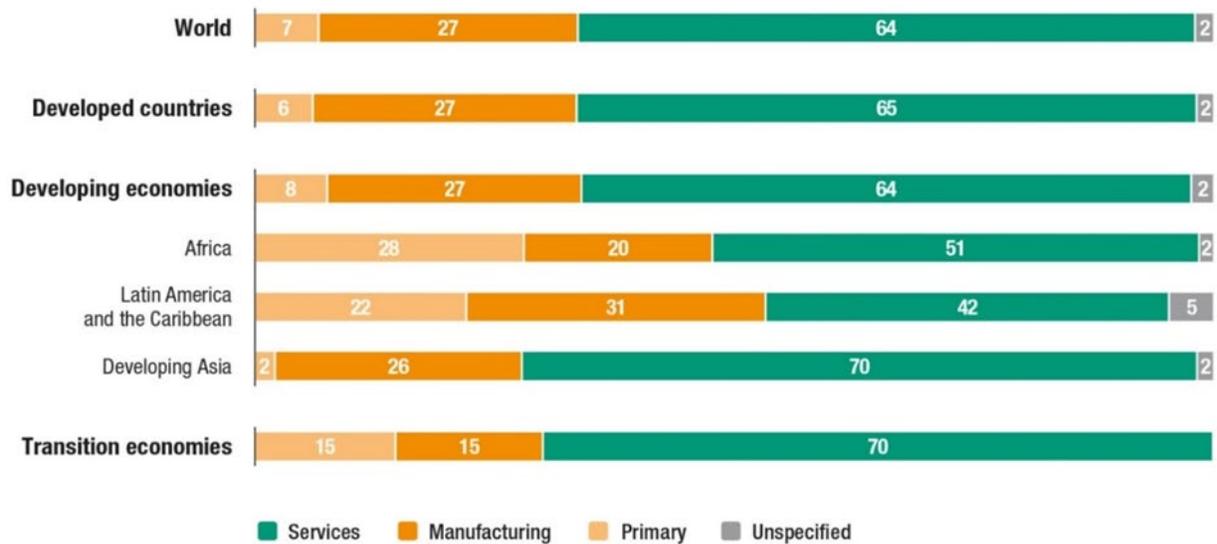
Figure 1. Estimated global inward FDI stock by sector, 2001, 2007 and 2015 (US\$ trillions)



Source: UNCTAD FDI/MNE database (at www.unctad.org/fdistatistics)

The predominance of services in FDI stocks is a constant across most regions of the world. As shown in Figure 2, services accounted for more than half of the total FDI stock in developed, developing and transition economies in 2017. The only exception is Latin America and the Caribbean, where services account for less than 50 percent of aggregate FDI stocks (while still representing the leading source of FDI stocks).

Figure 2. Sectoral breakdown of FDI stock, selected country groupings, 2017

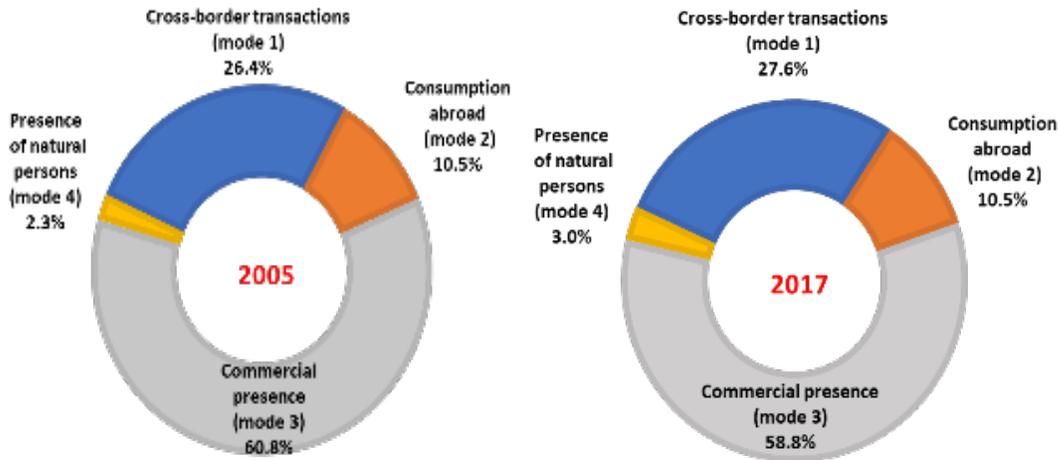


Source: UNCTAD (2018)

A more appropriate measure of the value of services supplied through Mode 3 comes from statistics tracing the sales of services firms operating abroad as foreign-owned or controlled enterprises (so-called FATS, or foreign-affiliated trade in services, data). Measured this way, Mode 3 is estimated to account for approximately 59% of world trade in services, compared to 28% for cross-border supply (Mode 1), 10.5% for consumption abroad (Mode 2), and less than 3% for the movement of natural persons supplying services (Mode 4; WTO, 2019). The slight drop observed in the relative share of Mode 3 trade over the 2005-17 period parallels the rise observed in remotely supplied services (cross-border or Mode 1 trade), offering evidence of technology-induced substitution effects across modes of supply (see Figure 3).

The OECD estimates that services account for 43% of sales of foreign affiliates globally. However, this share increases to 58% when expressed in value-added terms, that is considering the services inputs embodied in the output of manufacturing firms (Andrenelli *et al.*, 2018; Cadestin *et al.*, 2018).

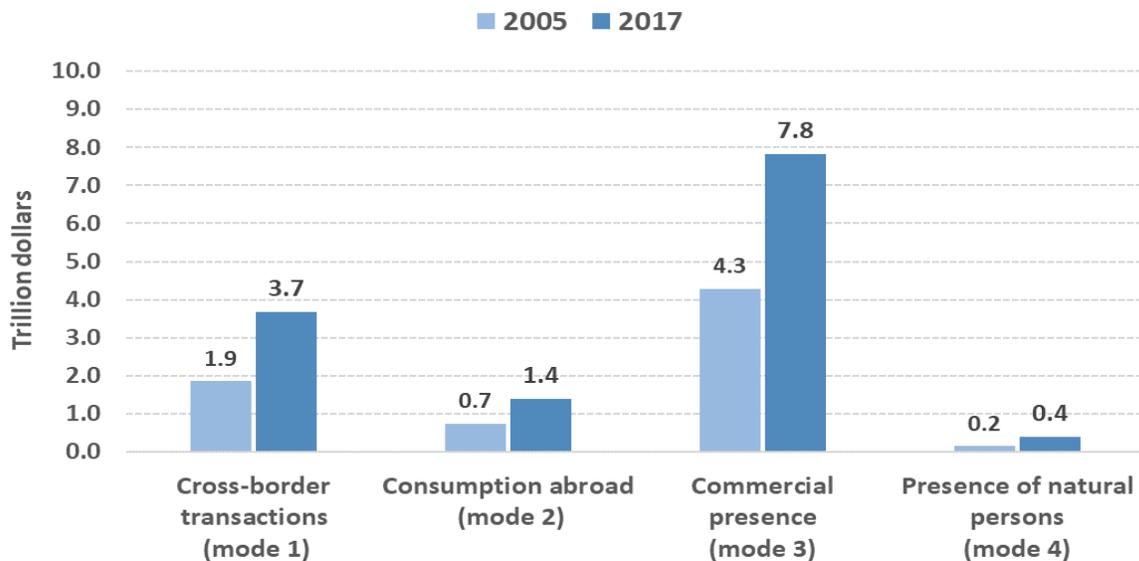
Figure 3. World trade in commercial services by mode of supply: relative shares, 2005 and 2107



Source: WTO (2019)

Services exports under Mode 3, measured as the output of foreign affiliates in services industries (FATS), stood at an estimated US\$7.8 trillion at the end of 2017, a figure higher than services exports captured by BoP statistics. Figure 4 shows that Mode 3 exports almost doubled between 2005 and 2017, paralleling the growth observed for all four modes of supply. As a multiple of the value of Mode 1 trade, Mode 3 sales were slightly lower in 2017 (2.1) than in 2005 (2.3), pointing once more to the modal substitution effects noted above.

Figure 4. The value of world trade in commercial services by mode of supply, 2005 and 2017



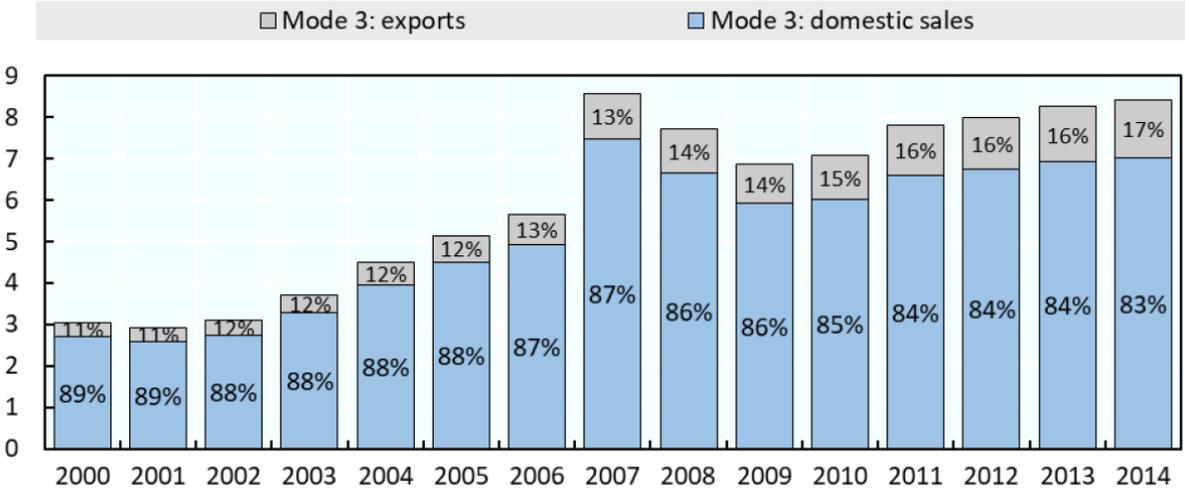
Source: WTO (2019)

Figure 5 shows that Mode 3 exports increased markedly between 2000 and 2014, more than doubling in absolute terms, even as sales of foreign affiliates were strongly impacted by the 2008-09 financial crisis (Andrenelli *et al.*, 2018). More importantly, the data reveal the extent to which foreign affiliates supply services for the host market or for export, highlighting that a growing proportion of their output is exported. This is an important finding, as it suggests that successful efforts at investment facilitation, attraction and retention can generate growth-inducing export gains (Rouzet *et al.*, 2017).

Retail and wholesale trade and financial services are the sectors where the output of foreign affiliates is highest in absolute terms. Together, the two sectors account for around half of Mode 3 exports, with \$2,636 billion and \$2,464 billion in sales respectively, equivalent to 19.5% and 18.6% of total services trade in 2017. World trade in financial and distribution services takes place predominantly through the establishment of a commercial presence in other countries. In 2017, around 77% of financial services, or some \$1,942 billion, and over 70% of distribution services (\$1,853 billion), were traded worldwide through foreign affiliates (WTO, 2019). However, increased digitalization, mobile banking and online sales are reshaping the business models for the finance and distribution sectors. As a result, the share of services exports through branches and subsidiaries established in other countries is declining in leading developed traders.

Foreign affiliates operating in developing countries tend to have a lower share of activities in services and focus more on manufacturing than foreign affiliates established in OECD economies. However, the foreign affiliates of developing country firms focus more on services than on other sectors (Andrenelli *et al.*, 2018; Cadestin *et al.*, 2018).

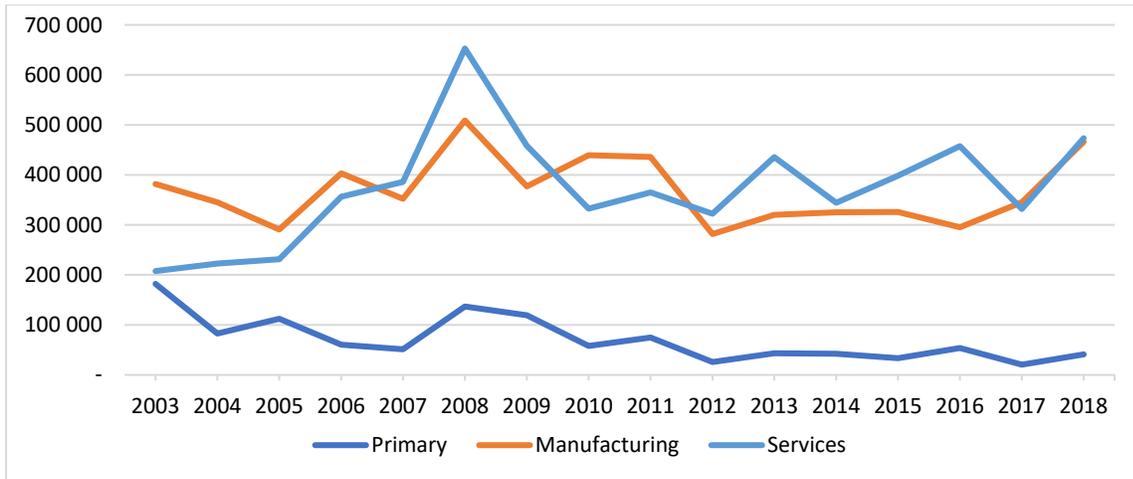
Figure 5. World Trade in Services under Mode 3 (output), USD trillion, 2000-2014



Source: Andrenelli *et al.* (2018)

Offering further evidence of the rising salience of services to cross-border investment activity, hence of effective investment facilitation support, Figure 6 shows that the value of greenfield FDI projects in services has exceeded that in manufacturing and primary activities for most years between 2006 and 2018.

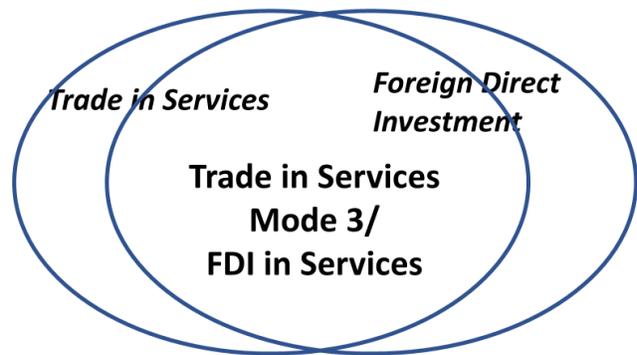
Figure 6. Greenfield FDI projects by sector (USD million), 2003-2018



Source: UNCTAD (2019)

The data shown above clearly show the deep inter-relationship between trade in services through Mode 3 and foreign direct investment (FDI). While a predominant share of services are supplied globally through a commercial presence, services also account for the bulk of total FDI stocks worldwide. This trend, graphically shown in Figure 7, holds important implications for policy makers when discussing trade facilitation in services as well as investment facilitation. Despite the fact that not all services transactions involve cross-border investment activity and that not all investment is directed to services, the overlap between trade in services and FDI remains highly significant. Therefore, despite their own particularities, policy discussions on services trade facilitation on the one hand, and investment facilitation on the other, should be closely coordinated and framed in such a way as to enable policy makers to discuss their interaction in an integrated manner.

Figure 7: Graphic Inter-relationship between Trade in Services and FDI



The latter observation assumes particular prominence when one considers that the discussion of trade facilitation in services and of investment facilitation took root in different fora,

each within its own policy context. Although both subjects have now converged at the WTO, both topics are pursued in a segmented manner, each with different mandates, interested Members, policy agendas and negotiating dynamics. As will be explained in more detail in Section 3, while aspects relating to trade facilitation in services are being discussed by all WTO Members within the Working Party on Domestic Regulation established by the Council for Trade in Services in 1999 and by a subset of like-minded Members under the Joint Statement Initiative on domestic regulation for services launched at MC11, discussions of investment facilitation proceed in an exclusively plurilateral manner among like-minded

Members under the “Structured Discussions on Investment Facilitation for Development” launched at MC11.⁷

3. Facilitating trade in services and investment: Converging conceptual strands

The sheer importance of Mode 3 as a means of delivering services to markets implies that the notion of trade facilitation in services, as discussed in rule-making circles, relates centrally to steps taken to facilitate *foreign investment* in services. Facilitating investment has to date been conceptualized as making it easier for investors to establish, conduct their day-to-day business and expand their existing investments in host countries. Investment facilitation encompasses the full life-cycle of the investment process – attraction, establishment, retention/expansion and linkages to the domestic economy.⁸

A company seeking to expand its global presence will assess its options before deciding on a location for its investment. One of the first locational determinants is whether the company is allowed entry and operating rights in a specific market. Though most economies have progressively liberalized their foreign investment regimes in recent decades, some sectors continue to enjoy protection, wholly or partly, from foreign competition. While primary and, especially, manufacturing sectors are largely open to foreign investment,⁹ many industries, particularly in services such as media, transportation, energy, finance and telecommunications, remain restricted in most economies. This includes a broad range of host nations, particularly the larger and more advanced ones that rank among the world’s leading FDI destinations.

Post-establishment impediments cover a broad range of limitations, among which are quantitative restrictions on the scale of commercial presence, limits placed on the ability to acquire or lease land, limitations on the nature and geographical scope of operation, restrictions on the hiring of foreign personnel, limits placed on payments and transfers, local sourcing obligations, etc. All can easily deter entry or inflate the cost of operating abroad. All are amenable to the (currently dormant) progressive liberalization mandate foreseen under GATS Article XIX (Negotiation of Specific Commitments).

Recent research conducted at the World Bank Group has further shown that a significant number of investment projects – as much as one in every four -- are either withdrawn or their expansion curtailed in host developing countries. This is so not because of firm-specific factors or macro-economic variables but

⁷ It should be noted that the lack of consensus on GATS Article VI discussions within the Working Party on Domestic regulations prompted a number of WTO Members to launch a parallel, plurilateral, process of discussions on domestic regulation with a view to “advancing negotiations on the basis of recent proposals as set out in WT/MIN(17)/7/Rev.2 and related discussions in the Working Party on Domestic Regulation and future contributions by Members to deliver a multilateral outcome.” See ICTSD (2018).

⁸ For a more detailed depiction of the investment life-cycle concept, see WBG (2017), Investment policy and promotion diagnostics and tools : Maximizing the potential benefits of foreign direct investment (FDI) for competitiveness and development, at <http://documents.worldbank.org/curated/en/666341500008847215/Maximizing-the-potential-benefits-of-foreign-direct-investment-FDI-for-competitiveness-and-development>.

⁹ It is not uncommon for foreign investors in manufacturing to enjoy better than national treatment relative to domestic firms, notably as regards the provision of various tax and non-tax investment incentives.

rather in light of problems deriving from the irregular or erratic conduct of subnational governments or specialized regulatory agencies. Examples of such conduct include a lack of transparency, arbitrary regulatory changes, contract breaches, expropriations or currency convertibility restrictions.¹⁰ All are issues potentially at play in discussions of strengthened disciplines on domestic regulation in services sought under both the GATS Article VI:4 mandate and its plurilateral Joint Statement Initiative brethren.

That none of the above measures is subject to the investment facilitation discussions currently underway in the WTO is arguably unfortunate. This flows from the decision taken by proponents of the Joint Statement Initiative on Investment Facilitation for Development to focus investment facilitation talks on matters *other* than the lifting of discriminatory investment restrictions (e.g. investment liberalization). By also excluding discussions of investment protection and the settlement of investment disputes, the investment facilitation discussions imply that a wide range of investment measures, whose absence, poor design or inadequate implementation can deter FDI and pose potentially costly post-establishment risks, will go unaddressed.

3.1 Background on the concept of Trade Facilitation in Services (TFiS)

The WTO's General Agreement on Trade in Services (GATS) addresses the trade-restrictive impacts of government measures through disciplines on market access and national treatment applicable in sectors where specific commitments have been undertaken by WTO members. However, even in sectors, sub-sectors and/or modes of supply where full market access and national treatment are committed, foreign services suppliers may still find it difficult to provide services according to prevailing regulations in the host market.

Regulatory compliance burdens are often greater in services than in goods trade given the typically higher doses of regulation applied to products that often display intangible characteristics and in light of the intrinsically close – and often simultaneous - relationship between buyers and sellers in services transactions.¹¹ Recognizing the importance of the domestic regulatory environment as a context for trade, the Council for Trade in Services was given a negotiating mandate under Article VI:4 of the GATS calling for the development, in appropriate bodies, of any necessary disciplines to prevent non-discriminatory domestic regulations (understood as qualification requirements and procedures, technical standards, and licensing requirements) from becoming unnecessary barriers to trade. On this basis, the Working Party on Professional Services reached agreement on regulatory disciplines for the accountancy sector in December 19. In April 1999, the Council for Trade in Services established the Working Party on Domestic Regulation to develop generally applicable disciplines and disciplines for individual sectors as appropriate.¹²

Within this context, the Working Party on Domestic Regulation (WPDR) started to focus on developing general disciplines on measures relating to GATS Article VI:4: licensing requirements, licensing procedures, qualification requirements, qualification procedures, and technical standards. Article VI:4

¹⁰ See World Bank Group (2019).

¹¹ The simultaneity of production and consumption characteristic of many services makes them akin to “experience goods” whose attributes cannot be known prior to consumption. Such a characteristic justifies the need for significant ex ante regulation in services markets.

¹² See WTO Note (S/L/70).

stipulates that any agreed disciplines should ensure that domestic regulations are, *inter alia*: (a) based on objective and transparent criteria, such as competence and the ability to supply the service, (b) no more burdensome than necessary to ensure the quality of the service; and (c) in the case of licensing procedures, not in themselves a restriction on the supply of a service.¹³

Some two decades later, negotiations are still proceeding with unequal progress across the various issues at play.¹⁴ Although most WTO Members tend to agree on fostering transparency (though some bemoan the administrative burden and costs of complying with more stringent disciplines), impartiality, objectivity and certainty in the application of regulatory requirements and procedures, other agenda items remain contentious, in particular the question of whether a normative standard in the form of a “necessity test” should be included as part of agreed disciplines.

Within an international political context that has not proven particularly favorable to multilateral cooperation and in light of the demise of the Doha Round, the successful conclusion of the Trade Facilitation Agreement (TFA) in December 2013 shed useful light on alternative ways of advancing multilateral trade agendas. The issue of trade facilitation appeared on the multilateral trade policy agenda at the WTO’s 1996 Ministerial Conference in Singapore. The TFA concretized the notion that beyond the WTO’s focus on trade liberalization, important progress could also be made by streamlining processes and procedures relating to existing levels of market-access concessions. The TFA negotiation thus represented an effort at simplifying required paperwork, modernizing procedures and harmonizing customs requirements, all of which were seen as means to reduce the costs and time needed to export and import goods¹⁵ (WTO 2019).

Once the notion of “trade facilitation” had gained currency in goods trade, it was likely just a matter of time before such a concept was transposed to the field of trade in services. In 2016, the Government of India submitted a concept note to the GATS WDPR calling for an initiative on Trade Facilitation in Services (TFiS), following up with a full-fledged draft TFiS Agreement in 2017. India’s original proposal stated that:

“The Trade Facilitation Agreement (“TFA”), adopted by WTO Members in 2014, was a significant milestone in relation to trade in goods. Its overall purpose is to expedite the movement, release and clearance of goods as well as co-operation on customs compliance issues. Like the TFA, there is need for a counterpart agreement in services, an Agreement on Trade Facilitation in Services, which can result in a reduction of transaction costs associated with unnecessary regulatory and administrative burden on trade in services. The TFiS Agreement will address the key issues that are pertinent to facilitating trade in services, such as transparency, streamlining procedures, and eliminating bottlenecks.”¹⁶

¹³ For a detailed discussion on the discussion on GATS Article VI see: Delimatsis, P. (2007), Due Process and “Good” Regulation Embedded in the GATS –Disciplining Regulatory Behavior in Services Through Article VI of the GATS, *Journal of International Economic Law*.

¹⁴ For more detail on the current state of play of the negotiations:

https://www.wto.org/english/tratop_e/serv_e/dom_reg_negs_e.htm.

¹⁵ https://www.wto.org/english/tratop_e/tradfa_e/tradfa_introduction_e.htm.

¹⁶ Communication from India, Concept Note for an Initiative on Trade Facilitation in Services, Working Party on Domestic Regulation, 27 September 2016, S/WPDR/W/55. Text available at: www.wto.org.

India proposed that a TFIS Agreement could be based on the TFA in goods, with modifications and adaptations made to suit the services context as required. Such adaptation and modification of the concept of trade facilitation to the services context is a point to be stressed. This is so both because trade in services is not only qualitatively different from trade in goods, but also, if the rationale of the TFA is to reduce trade costs, because relevant trade costs will differ depending on the way services are traded across various modes of supply.¹⁷ As will be explained in Section 4, the relative weights of the different cost components of services trade supplied via Mode 3 differ markedly from those applying to the three other modes of supply.

3.2 From the G20 to the WTO: Emerging strands of the global investment facilitation agenda

The TFA generated policy externalities beyond the WTO, prompting several Members to explore how to translate the notion of “facilitation” of trade into the investment field. Significant attention was devoted to investment matters during China’s presidency of the G20 in 2015-16. This was evidenced by the creation of a G20 Trade and Investment Working Group (TIWG) which saw Members adopt a set of non-binding principles for investment policy making.¹⁸ In addition, the Chinese presidency circulated a text introducing the idea of a G20 “investment facilitation package”. During Germany’s presidency of the G20 in 2016-17, the TIWG followed-up by discussing a set of concrete actions that could effectively facilitate investment along all stages the investment lifecycle.¹⁹ During that period, various international organizations active in the investment law and policy fields – the OECD, UNCTAD, the WBG, the IMF and the WTO — shared insights on work being undertaken within their respective work programs on selected aspects of investment facilitation, how they matched up against their respective operational experience and tools and the policy realities governments faced.²⁰

While no text on investment facilitation was formally agreed in the G20 context, there was growing consensus within the TIWG that facilitating investment is about making it easy for investors to establish

¹⁷ See Sauvé (forthcoming) for a fuller discussion of the differences between goods and services trade that justify differentiated legal provisions.

¹⁸ See <https://www.oecd.org/daf/inv/investment-policy/G20-Guiding-Principles-for-Global-Investment-Policymaking.pdf>.

¹⁹ The G20 German Presidency found particularly useful the notion of the “investment lifecycle”, a key element of the Investment Policy Framework Developed by the Investment Policy & Promotion team of the WBG that visualizes FDI as a relationship between investors, host States and local stakeholders, and comprising the phases of investment attraction, including instruments such as promotion and locational incentives, investment establishment, investment permanence and expansion, and linkages and spillovers between FDI and the local economy. See: World Bank (2017): Investment policy and promotion diagnostics and tools: Maximizing the potential benefits of foreign direct investment (FDI) for competitiveness and development, available at: <http://documents.worldbank.org/curated/en/666341500008847215/pdf/117475-PUBLIC-WP-13-7-2017-12-8-30-SPIRAToolKitGuide.pdf>.

²⁰ See OECD (2018) Towards an International Framework for Investment Facilitation, available at: <https://www.oecd.org/investment/Towards-an-international-framework-for-investment-facilitation.pdf>; UNCTAD (2017) Global Action Menu for Investment Facilitation, available at: <https://investmentpolicy.unctad.org/>; and WBG: Investment Policy & Promotion: <https://www.worldbank.org/en/topic/investment-climate/brief/investment-policy-and-promotion>.

and conduct their day-to-day business and expand their existing investments without however limiting the right (indeed, the sovereign duty) of host countries' to regulate in the public interest and without undertaking commitments to liberalize the establishment of FDI. Documents discussed within the TIWG referred to four key areas to organize potential actions to promote investment facilitation.²¹ These were:

- (i) **Transparency:** Understood as the promotion of accessibility and transparency of policies, regulations and procedures relevant to investors, including actions such as:
 - Making clear and up-to-date information on the investment regime publicly available, including the timely and relevant notice of changes in applicable standards, procedures, technical regulations, and conformance requirements;
 - Making screening guidelines and clear definitions of criteria for assessing investment proposals publicly available, where applicable;
 - Maintaining or establishing easily accessible registries of laws and regulations, and making these available electronically; and
 - Publishing the outcomes of periodic reviews of the investment regime, where they are undertaken.

- (ii) **Predictability and Consistency:** Understood as enhancing predictability and consistency in the application of investment policies and other policies that have an impact on investment, including actions such as:
 - Systematizing and institutionalizing the common application of investment laws and regulations;
 - Ensuring the consistency of national policies with applicable international obligations;
 - Ensuring equitable treatment in the application of laws and regulations on investment, and avoiding the discriminatory use of bureaucratic discretion;
 - Establishing clear criteria and transparent procedures, wherever possible, for administrative decisions affecting investments;
 - Establishing and ensuring access to effective, fair, open and transparent mechanisms for the prevention and settlement of investor grievances before escalation; and
 - Establishing or maintaining a mechanism allowing investors to request an interpretation of laws and regulations (e.g. 'no action letter').

- (iii) **Efficiency:** understood as reducing unnecessary red tape in administrative procedures, including actions such as:
 - Improving the efficiency and effectiveness of administrative procedures;
 - Streamlining and simplifying application, registration, licensing, and other investment related administrative procedures;
 - Promoting, where appropriate, the use of time-bound approval processes or no objections' processes within defined time limits;
 - Keeping investor costs relating to administrative procedures to a minimum;
 - Encouraging and fostering institutional governance and cooperation, and clarifying roles and accountabilities between different levels of government, whenever necessary;
 - Simplifying, to the extent possible, the process for connecting to essential services

²¹ G20 (2017), Trade and Investment Working Group, Revised draft deliverable on Investment Facilitation, Document Prepared by the German Presidency. Not publicly circulated, on file with the authors.

- infrastructure; and
- Expanding good administrative practices applied or piloted in special economic zones to the wider economy.

(iv) Stakeholder Relations, understood as building constructive stakeholder relationships and engaging the private sector in assessing *de jure* and *de facto* barriers to investment, including actions such as:

- Establishing and maintaining mechanisms for regular consultation and effective dialogue with investment stakeholders throughout the life-cycle of investments, including approval, impact assessment, operation and expansion stages, to identify and address issues encountered by investors and affected stakeholders.
- Establishing, to the extent possible, a mechanism to provide interested parties (including the private sector and investment stakeholders) with an opportunity to comment on proposed new laws and regulations, or changes to existing ones, prior to their adoption and implementation.
- Establishing or maintaining contact points for enquiries, complaints and suggestions concerning investment policies and applications to invest. To the extent possible, enabling such contact points to provide practical assistance to investors in appropriate cases.

In addition to the four key areas noted above, the WBG has repeatedly underlined the importance of measuring impacts through effective monitoring and evaluation metrics using key performance indicators to gauge the actual impact of investment facilitation actions – for instance on investment flows, jobs generated, cost compliance savings for private investors as well as levels of investment retention or expansion. Impact assessment is critical not only to enable better informed and evidence-based policy-making but also to demonstrate the concrete benefits deriving from measures aimed at facilitating investment attraction, establishment, retention, expansion and domestic linkages to civil society stakeholders.

The G20 TIWG discussions on investment facilitation underpinned the subsequent push by a group of 70 WTO members, many of which developing countries (led by Brazil and China), to launch structured plurilateral discussions on investment facilitation at the WTO at the organization's 11th Ministerial Conference (MC-11).

As explained in the previous section, the Joint Statement on Investment Facilitation for Development agreed in Buenos Aires and the preparatory discussions leading to it paralleled (and ultimately overshadowed) attempts by the Government of India to propose the negotiation of a stand-alone agreement on Trade Facilitation in Services whose remit also covered Mode 3 transactions.²²

²² While the call for crafting IF disciplines has generated notable negotiating traction among WTO members, the Indian proposal on TFS has met with far more tepid support, with several developing and least developing country members pointing to the administrative burden such additional disciplines would represent. Such a view is also voiced in discussions of IF for Development, though the plurilateral nature of these discussions means that they are predominantly populated by Members that are genuinely interested in a negotiated outcome.

3.3 Evolution of the investment facilitation discussions at the WTO

Discussions on investment facilitation for development have registered steady progress at the WTO since the topic was first mooted in 2016. From the Informal Dialogue held throughout 2017²³ to the Joint Ministerial Statement co-sponsored by 70 Members at MC11 later that year, to the current Structured Discussions, the initiative has gathered increased support and momentum among Members, many of which regard it as a development-enhancing rule-making journey divorced from the more contentious elements of investment governance (i.e. investment protection, investment liberalization and investor-state dispute settlement) and aimed at improving investment climates and reducing regulatory compliance costs in a manner analogous to the WTO's landmark TFA for trade in goods. At latest count (March 2020), 100 of the WTO's 164 Members were participating in JSI discussions on investment facilitation.

The goal laid out in the Joint Statement Initiative on Investment Facilitation for Development is to develop a multilateral framework on investment facilitation. In keeping with the first part of that goal, the Structured Discussions first sought to identify the possible elements of such a framework before moving on to develop textual language on identified elements. Meetings during the first year (2018) of the Structured Discussions were organized thematically in accordance with the Joint Ministerial Statement. They addressed elements of a multilateral framework by focusing on:

- (i) Improving the transparency and predictability of investment measures;
- (ii) Streamlining and speeding up administrative procedures and requirements (APRs); and
- (iii) Enhancing international cooperation, information sharing, the exchange of best practices, and relations with relevant stakeholders, including dispute prevention.

The issue of development has been at the core of investment facilitation discussions, with discussions centred on ways of facilitating greater developing and least-developed Member participation in global investment flows.

In November 2018, the IF Coordinator produced a "checklist of issues" identified by members in the five meetings held during the year. In producing the checklist, in which eighty-one distinct elements of investment facilitation were identified by members under the three broad headings noted above as well as a fourth category of cross-cutting issues, the Coordinator described it as a "living document" that would be updated in light of Members' inputs throughout the structured discussions. Beyond the checklist, discussions were underpinned by a series of background "non-papers" circulated under the Coordinator's responsibility and examining existing WTO provisions of direct or indirect relevance to investment facilitation.

As noted above, and following the guidance made explicit in the Joint Ministerial Statement, discussions of investment facilitation at the WTO do not address market access, investment protection, and Investor-State Dispute Settlement. Rather, the Structured Discussions have focused on the possible elements of a WTO-anchored investment facilitation framework, addressing its interaction with existing WTO

²³ In 2017, the WTO Informal Dialogue on Investment Facilitation for Development held six meetings (24 May, 28 June, 18 July, 25 September, 23 October and 10 November).

provisions, with current investment-related commitments made by Members, and with the investment facilitation work of other international organizations.²⁴

The current (second) phase of the Structured Discussions has been focusing on developing the possible elements of a multilateral framework on investment facilitation for development. Discussions have been anchored in text-based examples submitted by Members (rooted for the most part in bilateral investment instruments and in the investment chapters of preferential trade agreements) on how to develop the possible elements of the framework, drawing additionally on the "Checklist of Issues raised by Members" noted above.

As was done in 2018 for the checklist, the investment facilitation Coordinator prepared under his responsibility a compendium of the text-based examples submitted for discussion at the meetings.²⁵ This compendium aims at organizing the examples submitted in a coherent and user-friendly manner. It is a tool intended to facilitate open, transparent and inclusive discussions. While the content, structure, and wording of the compendium do not prejudge the position or views of Members on any of the elements and issues under discussion, the compendium serves a useful 'living document' purpose that stands to be updated in light of Members' submissions of examples and inputs put forward during the ongoing structured discussions.

4. Assessing the agenda on investment facilitation and Mode 3 trade in services: Relevant considerations

The evolution of discussions on services trade and investment facilitation described in the previous section shows how important it is to ensure greater coordination and negotiating synergies between the two currently distinct services-related facilitation discussions taking place at the WTO. Talks in both areas have centered on generic objectives that guided the negotiation of the TFA – i.e. transparency, process simplification, and promotion of certainty and predictability in customs and other border-related procedures. The decision to focus exclusively on the above principles responded to the reality and challenges affecting trade in goods. Such principles are clearly also relevant for trade in services. However, it is important that policy makers also consider the additional step of exploring what drives trade costs in services (across all modes of supply) and investment (in both goods and services). In so doing, policy makers would ensure that factors other than those at play in the TFA discussions that can exert even

²⁴ Work on investment facilitation has been conducted in cooperation with – and drawing on the expertise of – international organizations such as the ITC, OECD, UNCTAD and the World Bank Group, all of which were invited to participate in the meetings and make presentations on the topics under consideration.

²⁵ For the meeting on "elements aimed at improving the transparency and predictability of investment measures" held on 4 March 2019, 14 submissions containing text-based examples were put forward by the following 45 Members: Australia; Brazil; Canada; China; Costa Rica; the European Union (29); Hong Kong SAR, China; Guatemala; the Republic of Korea; Mauritius; Pacific Alliance (Chile, Colombia, Mexico and Peru); Panama; Switzerland; and Uruguay. For the meeting on "streamlining and speeding up administrative procedures and requirements (APRs)" held on 11 April 2019, nine submissions were put forward by the following 37 Members: Australia; Brazil; Canada; China; European Union (29); Guatemala; Hong Kong SAR, China; the Russian Federation; and Switzerland. In addition, examples were provided by the Arab Republic of Egypt at the meeting on 11 April 2019.

greater effects (and impose greater costs) on cross-border flows of services trade and investment are not overlooked. The section that follows explores this issue.

4.1 Recent findings on trade costs for services trade for Modes 1, 2, and 4

Empirical research devoted to the trade costs resulting from barriers to services trade and investment typically regard such costs as high and often exceeding the average tariff on traded goods. Such costs are further seen to potentially concern all modes of supplying services abroad, including via Mode 3, though most empirical attention tends to be devoted (largely for reasons of data availability) to cross-border transactions (Miroudot et al., 2013; van de Marel and Shepherd, 2019). Beyond factors relating to infrastructure, geography, language, culture, and institutional characteristics, trade costs in services sectors relate chiefly to regulatory measures that either create entry barriers or increase the cost burdens facing firms (Miroudot et al., 2013).

Many factors distinguish trade in services from other sectors (Sauvé, 2019). The fact that services transactions confront complex regulatory regimes, coupled with the requirement for physical proximity characteristic of many interactions between buyers and sellers of services - often referred to as the “proximity burden” (Christen and Francois, 2013) -- tend to significantly increase the cost of trading services.

In the latest (2019) edition of its *World Trade Report* devoted to trade in services, the WTO Secretariat introduced a novel measure of trade costs which builds upon a recent study on trade costs in the global economy (Egger et al., 2018, see Box 1).

Box 1: Services trade costs and their decomposition: WTO methodology

Estimates of trade costs for Modes 1, 2 and 4 featured in the World Trade Organization’s *World Trade Report 2019* are derived from multiregional input-output data found in the World Input-Output Database (WIOD 2016) and experimental data from the Asian Development Bank (ADB-MRIO). The results are based on data for 44 countries across 34 sectors.

Trade costs are estimated using a sector-level gravity model specification proposed in Egger et al. (2018). First, the coefficients on country-pair dummies (\widehat{d}_{ij}) are obtained from a fully saturated gravity model with appropriate parameter constraints. Second, these estimates are transformed using a sectoral elasticity of substitution (θ):

$$T_{ij} = (\widehat{d}_{ij})^{-1/\theta}$$

To obtain the estimates of T_{ij} , international and domestic trade data from the World Input-Output Database (WIOD) is used and an experimental data set from the Asian Development Bank (ADB-MRIO). The parameter θ is estimated for each sector in Egger et al. (2018). A higher θ means a more elastic reaction of demand to prices, and hence a higher responsiveness of import demand to trade frictions. Generally, θ takes on lower values for services than for manufactures, implying that trade in services reacts less to changes in trade costs.

In the subsequent analysis, the factors which explain T_{ij} , are identified by running a regression analysis and using the results to decompose the explained variation in T_{ij} into different types of trade costs.

The estimated equation is:

$$\ln(T_{ij}) = \alpha + \beta \cdot \text{Transport}_{ij} + \gamma \cdot \text{Infrastructure and border cost}_{ij} + \delta \cdot \text{Information and transaction costs}_{ij} + \varphi \cdot \text{Governance quality}_{ij} + \rho \cdot \text{Trade policy}_{ij} + \epsilon_{ij}.$$

To capture the impact of **transportation costs** on total trade frictions, the set of variables in *Transport_{ij}* includes the log of population-weighted distance, and a binary variable indicating if both trading partners are landlocked.²⁶

To capture the impact of **infrastructure and border costs**, *Infrastructure and border costs_{ij}* includes the average quality of trade- and transport-related infrastructure,²⁷ the average quality of port infrastructure,²⁸ the average share of population using the Internet,²⁹ the average lead time to import and the average Trading across Borders index.³⁰

To capture the impact of **information and transaction costs**, the set of variables in *Information and transaction costs_{ij}* includes having common ethnic language, having common religion, previously having a common coloniser, previously being in a colonial relationship, previously being the same country,³¹ the average bilateral stock of migrants in 2013,³² the difference in rule of law,³³ the difference in GDP per capita and the average GDP per capita.

To capture **trade policy barriers and regulatory measures**, the set of variables *Trade policy_{ij}* includes being in a free trade agreement and being part of the European Union.³⁴ They also include the difference in regulatory quality³⁵ and, where applicable/available, the OECD's and World Bank's STRIs and OECD's STRI heterogeneity.

Governance Quality³⁶ includes the average rule of law and the average regulatory quality.

The regressions are run on data from 2017 and include 30 countries, which is the largest sample for which all variables are available. The estimation is based on within-2-digit-sector variation. The R-squared decomposition is computed using Shapley and Owen values.

Source: WTO (2019), *World Trade Report 2019: Services – The New Trade Frontier*, Geneva: World Trade Organization.

²⁶ Both variables come from the Centre d'études prospectives et d'informations internationales (CEPII).

²⁷ World Bank Group.

²⁸ World Economic Forum.

²⁹ International Telecommunications Union.

³⁰ World Bank Group.

³¹ Centre d'études prospectives et d'informations internationales (CEPII).

³² CESifo.

³³ Worldwide Governance Indicators (WGI).

³⁴ Both variables are taken from the Regional Trade Agreements Database from Egger and Larch (2008).

³⁵ Worldwide Governance Indicators (WGI), World Bank Group.

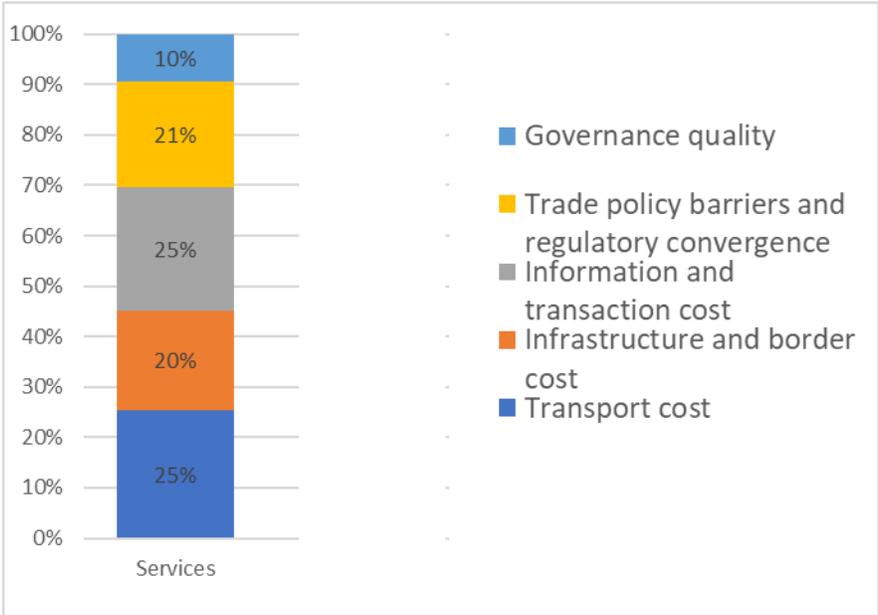
³⁶ Worldwide Governance Indicators (WGI), World Bank Group.

The WTO cost estimates focus on Modes 1 (cross-border trade), 2 (consumption abroad) and 4 (movement of service suppliers). However, they do not cover Mode 3 transactions, owing to data availability challenges flowing from the small number of countries reporting services trade transactions conducted by foreign affiliates (so-called FATS data).

Relevant trade costs will likely differ depending on the way in which services are traded. However, the WTO’s identification of key factors driving trade costs for the three other modes of supplying services yields useful insights when considering the impacts that regulatory conduct can exert on cross-border investment activity. The WTO’s identification of the key components of trade costs affecting services trade under Modes 1, 2 and 4 sheds useful light on the relevant importance of the different trade cost components affecting investment in services.

Figure 8 presents the breakdown of trade costs used in the WTO’s 2019 *World Trade Report* for Modes 1, 2 and 4. Such a breakdown draws attention to five components: (i) information and transaction costs; (ii) governance quality; (iii) trade policy barriers and regulatory convergence; (iv) infrastructure and border costs; and (v) transport costs. The analysis captures the extent to which different components of trade costs account for observed cross-country variations in bilateral trade costs.

Figure 8. The breakdown of trade costs in services in 2017



Source: WTO estimates. WTO World Trade Report 2019.
 Note: The figure shows to what extent various factors contribute to explaining the variance in trade cost across trade partners.

Among all the trade costs estimated by the WTO for services trade under Modes 1, 2 and 4, information and transaction costs and transport-related costs stand out as two most important sources of bilateral trade costs, each accounting for an estimated 25 percent of total trade costs in services. Transport costs,

measured by the distance between trading partners, are moot in a Mode 3 context insofar as establishment-based trade reduces distance to zero in substituting for cross-border transactions. Information and transaction trade costs include hurdles that firms confront in establishing trade relations. These include costs incurred in searching for trading partners and local suppliers, acquiring information about tastes, regulations and technical requirements, and enforcing contracts in a foreign country. Such costs are found to increase with cultural and linguistic distance. Furthermore, transaction costs - those associated to compliance with regulatory requirements and procedures - are high for cross-border trade in services because of heterogeneous institutional frameworks and the need for cross-border financial transactions involving currency conversions.

The next two categories of trade costs for Modes 1, 2 and 4 include government institutions and regulations. Governance quality measures the quality of regulation and the rule of law in trading partners. They capture perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development and perceptions of the extent to which economic agents have confidence in - and abide by - societal norms and rules, in particular the quality of contract enforcement, property rights, police, courts, as well as the likelihood of crime and violence. WTO estimates suggest that the quality of governance accounts for one-tenth of overall trade costs in services. This is likely an underestimate given the regulatory intensity of services trade and indicative of difficulties in assigning empirical measurements to highly qualitative metrics of state conduct. Meanwhile, trade policy barriers and regulatory convergence are seen to account for 21 percent of overall trade costs. This category, which measures policies that make access to domestic markets relatively more onerous for foreign firms, looks at cross-country differences in regulatory quality and trade barriers specific to service sectors. The last category of trade costs – that relating to infrastructure and border costs, captures the cost of delivering services under Modes 1, 2 and 4 from suppliers to customers. Such costs remain significant, accounting for a fifth (20 percent) of trade costs in services.

Figure 9 offers a sectoral breakdown of trade costs, once more solely for services trade under Modes 1, 2 and 4. As can be seen, trade cost components show considerable cross-sectoral variance. For instance, the effects of information and transaction costs are more pronounced in sectors such as transport and logistics, as well as for post and telecommunication services. Governance quality and trade policy barriers play a major role in the trade costs of telecommunications, financial intermediation and professional services. Meanwhile, infrastructure, transport and border costs matter more for construction, real estate activities, education, health and social work.

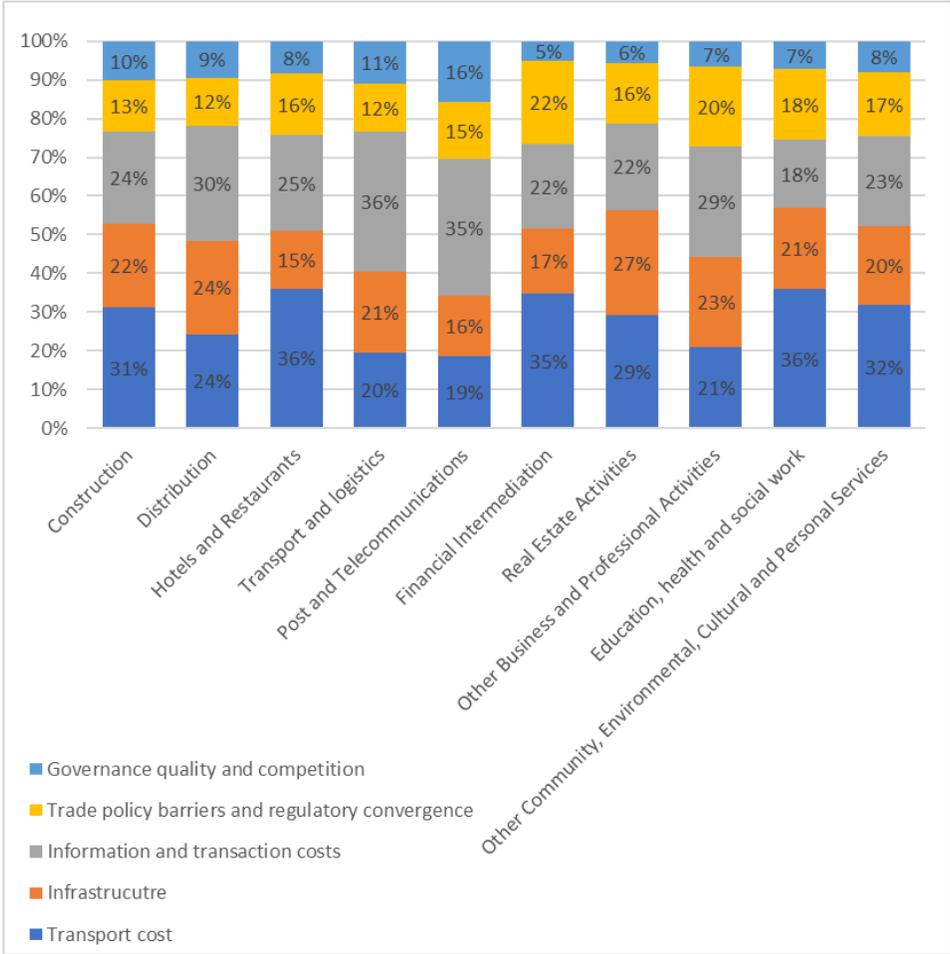
The WTO's analysis of the different cost components affecting trade in services under Modes 1, 2 and 4 inevitably raises the question of how best to measure trade costs for Mode 3 transactions. This question is all the more important since establishing a commercial presence in a host country often entails not only the adoption of a different (i.e. adapted) business model for services suppliers, but also compliance with differing economic, political, social and even environmental requirements in host country markets, all of which are likely to affect the cost of trade or, in this case, the cost of serving clients through an established presence abroad.

Contrary to the other three modes of supplying services, where WTO estimates show cost components associated with the quality of governance to be of lesser significance, recent research undertaken by the World Bank Group shows that the opposite holds true for Mode 3 trade (Echandi, 2019). Indeed, as noted earlier, firm-level surveys reveal that as much as one-quarter of all FDI projects in services may be totally

discontinued or their expansion cancelled or curtailed owing to irregular or erratic host government conduct.³⁷

Differences between goods and services transactions further suggest that the relative weight of the different trade cost components identified by the 2019 WTR for Modes 1, 2 and 4 may be differ for Mode 3 transactions. While the 2019 WTR identifies information, transaction and transport costs as the most important influences of trade costs for Modes 1, 2 and 4, the above three cost components may be relatively less important from a trade/investment cost perspective than factors such as the quality of regulatory governance, policy barriers as well as the impacts of regulatory heterogeneity.

Figure 9: Trade costs in services: a sectoral breakdown



Source: WTO (2019).

³⁷ “Irregular” or “erratic” governmental conduct is understood as the antonymous of “regular” government action. The latter being defined as the normal, habitual, standard and expected actions and policies undertaken by public authorities in accordance with the applicable laws and regulations of the host country. Thus, “irregular” government conduct would entail the adoption of policies and actions that do not conform with the substantive or procedural standards expected by affected investors based on their reading of applicable treaties, laws and regulations in the host country. This definition of “irregular” government conduct is investor-centric in the sense that it is the latter who would determine the “irregularity” of the measure. The reason for following this approach stems from the fact that in the end, it will be the perception and level of tolerance of the investor affected that will determine whether a specific FDI project is or not at risk of being discontinued because of a governmental action or measure.

The latter observation holds important implications for the nascent discussions on services trade and investment facilitation. As noted in Section 3, recalling the approach taken towards trade in goods under the WTO’s Trade Facilitation Agreement, discussions on investment facilitation held in the G20 and at the WTO have centred on issues relating to transparency and transaction costs. This suggests that the current discussions on investment facilitation, like the (currently dormant) negotiating proposal made by the Government of India on Trade Facilitation in Services (TFIS) arguably fail to address some of the most important measures affecting the cost of conducting services trade through an established presence abroad.

4.2 Unveiling the significance of cost components for Mode 3 Trade in Services

This section does not purport to replicate for Mode 3 trade the analysis undertaken by the WTO in measuring the weight of the different trade cost components for Modes 1, 2 and 4. Absent available data with which to produce such estimates, a more modest aim is pursued – that of advancing a conceptual framework showing why information and transaction costs, currently the main foci of discussions on both services trade and investment facilitation, may not be the most critical or exclusive drivers of Mode 3 trade costs. This is not to deny the importance and relevance of the various factors affecting trade costs in Modes 1, 2 and 4, most of which (other than transport-related) are clearly at play in Mode 3 transactions. There is, nonetheless, a need to focus trade and investment facilitation discussions in services on factors other than those on which current discussions are centred.

For starters, the JSI decision to divorce questions of investment (and Mode 3) facilitation from those affecting market access, rooted as it is in the rising policy controversies surrounding investment rule-making more broadly, implies that a significant subset of potentially cost-increasing policy measures that impede market entry and operation of foreign investors in services markets may go unaddressed.

Furthermore, it is important to connect the evidence deriving from empirical research to an action-oriented policy-making agenda. With this objective in mind, Table 1 focuses on the three cost components associated with government action/inaction identified by the WTO and further disaggregates them into five cost component categories. Doing so appears desirable for three main reasons. First, the more disaggregated the identified cost factor is, the easier it may be to link it to specialized research addressing the relative weight of each of the cost components affecting Mode 3 trade in services. Second, such disaggregation can also help identify concrete policy elements of a facilitation agenda in services trade and investment. Third, doing so helps to identify specific diagnostic and impact indicators.

Table 1. Mode 3 Trade in Services Cost Components and Corresponding Items in the Trade in Services Facilitation Agenda

<i>Trade in services cost component</i>	<i>Market Failure/ Problem to be addressed</i>	<i>Investment in Services Facilitation Agenda Item</i>
1.Information costs	1.Information asymmetry	1. Transparency
2.Transaction costs	2. Red tape	2. Process streamlining
3.Governance quality	3.Uncertainty and unpredictability from regulatory risk	3. Consistency and predictability in the application of regulatory frameworks
4.Discriminatory Policy Barriers	4. Distortion to competition	4. Standstill of existing discriminatory measures affecting commercial presence

5.Regulatory Heterogeneity	5. Economies of scale	5.Inter-governmental cooperation fostering regulatory convergence through negotiation
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4.2.1 Information costs

Seen from a Mode 3 perspective, information costs include obstacles that firms confront in finding optimal locations and developing sustained ties with competitive local suppliers. This may also include costs incurred in acquiring information about local market characteristics and tastes; information relating to land lease or purchases, compliance with domestic regulatory, tax and technical requirements; as well as regulatory risks and risk mitigation strategies.

Information asymmetries are pervasive in cross-border investment activity, a reality that has long been recognized by investment policy makers. In addressing such a market failure, an increasing number of host countries have established or expanded the substantive remit of investment promotion agencies, which among other functions, provide information services to investors considering investments in a particular host country.

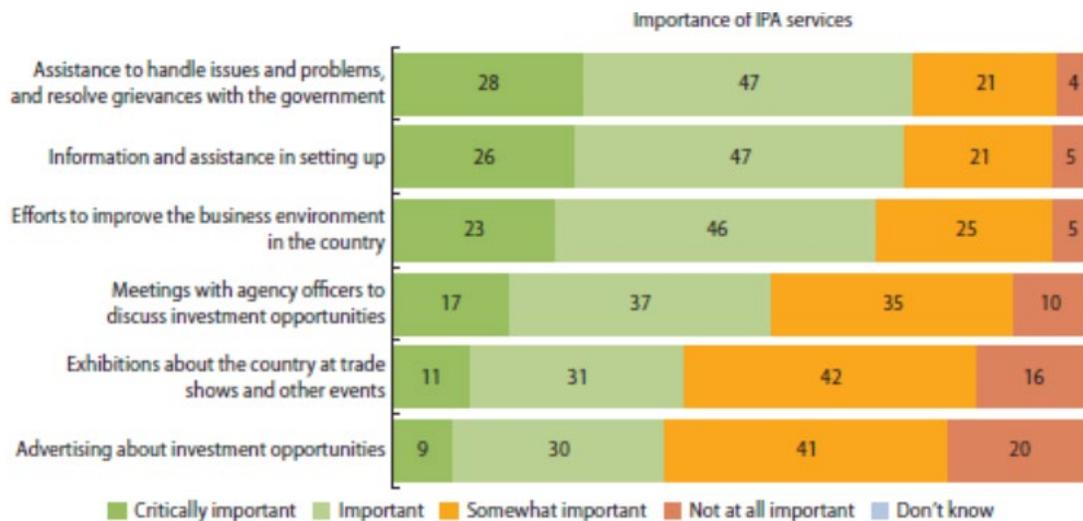
As information asymmetries between host countries and potential foreign investors constitute a significant obstacle to cross-border investment activity, an important policy question is what aspiring FDI destinations can do to reduce such obstacles or their perception by would-be foreign investors? Harding and Javorcik (2011) collected data on 124 countries to examine the effects of investment promotion on FDI inflows. They tested whether sectors explicitly targeted by investment promotion agencies in their efforts to attract FDI received more investment in the post-targeting period, relative to the pre-targeting period and to non-targeted sectors. Their research offered conclusive evidence that investment promotion efforts decreased information asymmetries and led to higher FDI inflows to developing countries. No such link was found for industrialized countries, where relevant information was more readily available, leaving investment promotion agencies in these countries with a lesser role to play in this regard. Harding and Javorcik (2011) also found that, under certain circumstances, investment promotion efforts could be reasonably cost-effective.³⁸

While information asymmetries are seen as a relevant cost component that service suppliers confront when trading through Mode 3, no precise cost estimates exist to measure their importance relative to other pertinent Mode 3 trade cost components. However, as is explained in subsection 4.2, investor surveys do not tend to rank information gaps at the top of the most binding constraints affecting investment decisions. Today, specialized information services available on various mobile platforms and disseminated through specialized investment location advisory firms furnish investors (particularly larger ones with deeper pockets for advisory services) with significant amounts of pertinent data regarding potential locations and attendant regulatory requirements.

³⁸ Harding and Javorcik (2011) found that a dollar spent on investment promotion leads to 189 dollars of FDI inflows. In other words, bringing a dollar of FDI inflows costs half a cent in investment promotion expenditures. An alternative approach leads us to conclude that an additional job created by a foreign affiliate requires 78 dollars in investment promotion spending.

Because governments have long recognized the importance of providing information to would-be investors, this challenge, though still important, may not appear as pressing as others to investors. This may explain why, as shown in Figure 10, recent WBG surveys suggest that investors value IPAs more in helping them resolve problems with host governments than as a source of information about host country conditions.

Figure 10: Which IPA services investors tend to value more? (share of respondents)



Source: Computation based on the GIC Survey.

Note: The questions on IPA services were answered by 632 respondents. These respondents answered somewhat important, important, or critically important on the question, "How important are high-quality services and support from the country's IPA in your decision to invest in developing countries?". IPA = investment promotion agency.

4.2.2 Transaction costs

Even if one puts aside the question of the level of access host countries may wish to grant foreign investors in their domestic economies, the fact remains that red tape often affects foreign investors when completing administrative requirements to apply, enter, and establish in a country. Transaction costs linked to the establishment and operation of investments are an issue whose importance policy makers have long recognized and where a series of indicators have been developed over the years by the World Bank Group. In addition to the Bank's *Doing Business* indicators, which measure different dimensions of red tape-related cost components for starting a domestic business in a given country, the WBG also piloted a project called "*Investing Across Borders*" (IAB) in 2011 focusing specifically on administrative barriers and procedures affecting the establishment and operation of FDI projects in host countries.³⁹

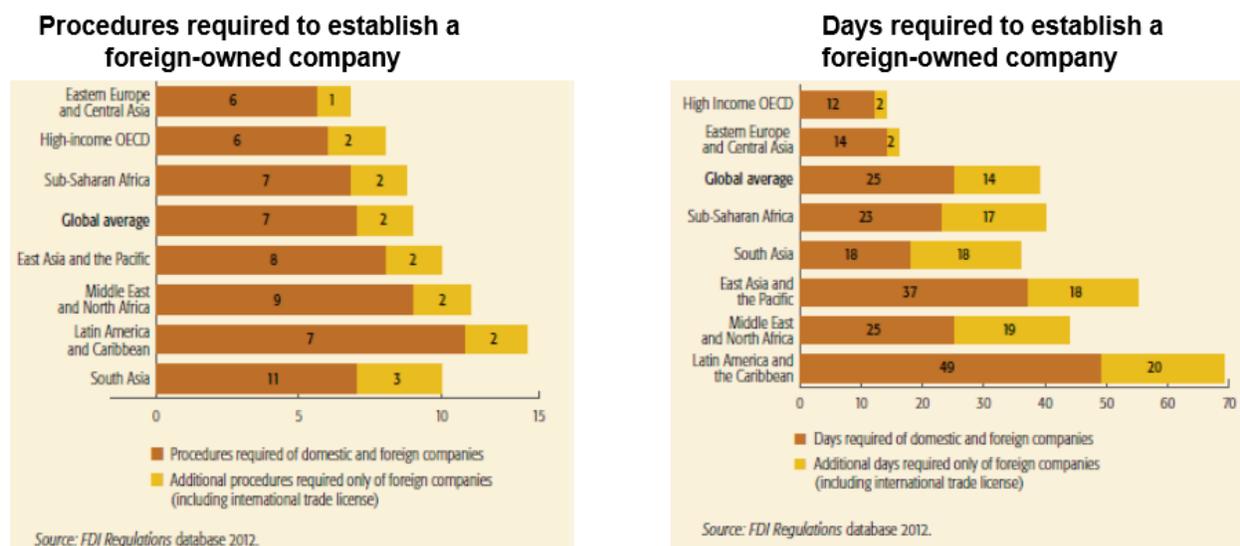
A sample of key findings from the initial (and only) IAB report are shown in Figure 11. It shows that although the number of procedures associated with the establishment of investments does not vary

³⁹ *Investing Across Borders* was a World Bank Group initiative comparing regulation of foreign direct investment around the world. It presented quantitative indicators on economies' laws, regulations, and practices affecting how foreign companies invest across sectors, start businesses, access industrial land, and arbitrate commercial disputes. See: <http://iab.worldbank.org/>.

significantly across different regions of the world, the time and associated compliance costs of establishment-related procedures show substantial cross-country variance. Such time and cost constraints can all too easily act as *de facto* barriers to potential FDI inflows.

While establishing a foreign operation takes 14 days on average in OECD countries, it may take up to 70 days to do so in many developing countries. This fact shows that in many regions of the world, there is a clear need to promote measures facilitating the establishment of investments, an issue at the very core of ongoing WTO discussions.

Figure 11: Red tape affecting transaction costs for FDI Establishment



- Examples of procedures Affecting investment entry**
- Obtaining investment project approvals;
 - Registration or notification of investments;
 - Authentication and notarization of foreign public documents;
 - Licensing and authorization procedures;
 - Obtaining work permits and visas;
 - Converting and transferring currency;
 - Opening bank accounts.

Source: WBG FDI Regulation database

While available research confirms the importance of red tape-related transaction costs in the total cost equation of Mode 3 transactions, no specific data exist to compile the relative weight associated to this cost component. However, anecdotal evidence suggests that the weight of such costs once again shows significant cross-country and cross-sectoral variance. For instance, calculations made in the context of a WBG technical assistance project in Nepal showed that an average five-star hotel project could be delayed by up to six years due to lengthy FDI approval processes, franchising, service outsourcing and management contracts, repatriation of funds to foreign investors, access to land, and building permits (Ortega, Griffin & Ahad, 2016). As with information costs, transaction costs associated with Mode 3-related red tape requirements represent one area where progress is needed in facilitating cross-border investment. This is one area host country governments have long recognized as worthy of more focused attention, leading to enlarged IPA mandates alongside programs of regulatory simplification.

4.2.3 Governance quality

Policy makers frequently focus on attracting FDI through various investment incentives, eliminating red tape affecting establishment, and proactive investment promotion. While these aspects are important, evidence gathered from recent WBG surveys suggests that investors are more concerned with irregular government conduct affecting their possibility to maintain and expand their operations in the host country (Echandi, 2019). Such an observation is consistent with recent empirical research suggesting that the bulk of trade costs for services relate to the governance performance of a host country. Indeed, van der Marel and Shepherd (2019) show that the strongest cost variable explaining services trade is captured by governance indicators. Such findings confirm that enhanced regulatory transparency and certainty matter for trade and investment facilitation in services.

A recent WBG research project found that investors - including service suppliers operating through a commercial presence, ranked regulatory risks – i.e. risks deriving from irregular or erratic government conduct - at the very top of the constraints affecting their operations in developing economies.⁴⁰ More than 75% of investors faced problems relating to government conduct in developing countries (GIC, 2017). Although most of the reported problems do not escalate into full-fledged grievances triggering investor-state litigation, the impact of unresolved grievances deriving from government conduct can generate significant adverse reputational effects for host countries.

Investor surveys conducted annually between 2009 and 2013 and again in 2017 have shown consistently that more than 25% of investors have withdrawn or canceled FDI expansion projects due to irregular government conduct (MIGA, 2009-13; GIC, 2017). Combining that figure with UNCTAD's data on the value and number of net-cross border M&A and announced greenfield FDI projects for each survey's corresponding period, a conservative estimate suggests that, focusing solely on trade in services through commercial presence in 70 developing countries where surveyed investors had operations, irregular government conduct lies behind decisions to withdraw or cancel expansion plans in up to 900 FDI projects a year valued at approximately US\$65 billion.⁴¹

The most common source of irregular governmental conduct generating investor-state conflicts relates to administrative actions, including by sub-national and specialized regulatory agencies. Up to the 1970s, expropriations used to be the most prominent and impactful source of irregular government conduct generating investor-state conflicts (MIGA 2009). Although perceived unlawful expropriations still rank among the leading types of irregular governmental conduct prompting FDI project discontinuation, the most common source of conflict today relates to a lack of transparency and predictability in dealing with public agencies and sudden/arbitrary changes in the enactment or interpretation of laws and regulations with negative effects on companies. This is followed by issues relating to payments and transfers and restrictions on currency convertibility. Although less frequent, contract breaches and expropriations perceived as unlawful constitute the most impactful types of irregular governmental conduct, leading between a third and half of investors to totally withdraw and/or cancel project expansions in 2017 (MIGA, 2009/13, GIC 2017; see Figure 12).

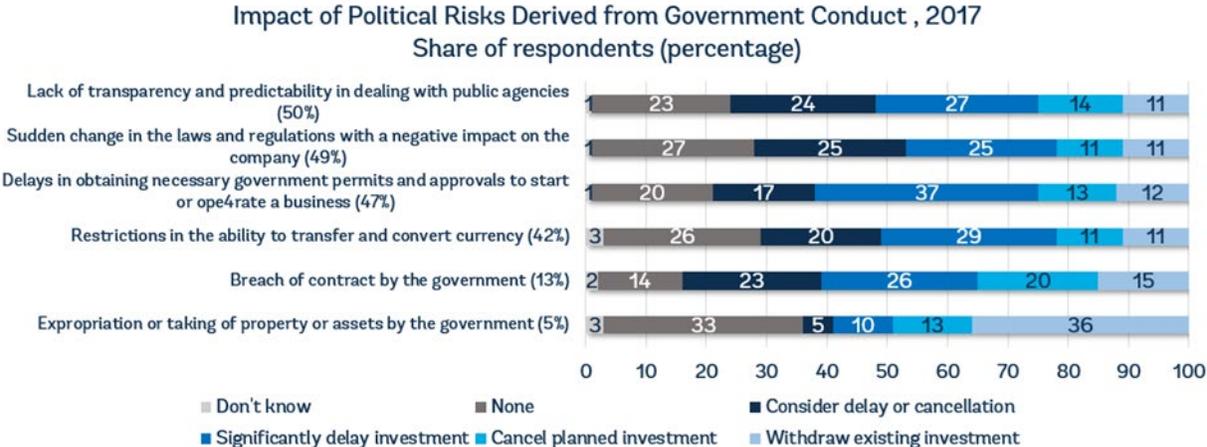
WBG research has revealed growing tensions between the single state paradigm at the core of domestic and international legal systems on the one hand, and the multilayered agency composition of

⁴⁰ See WBG (2019).

⁴¹ Authors' calculations based on data from WBG (2019).

governments on the other hand. Indeed, governments may negotiate international agreements - even on trade facilitation - which will bind state conduct in the aggregate. Yet the day to day implementation of such legal instruments will typically involve dozens of governmental agencies at both the national and sub-national levels and not always acting in a coherent manner at the domestic level.

Figure 12: Irregular Government Conduct Affecting Retention and Expansion of FDI



Source: Computation based on the GIC Survey

Recent WBG research has shown many host country governments lack the ability to respond in a timely manner to investment-related grievances arising from the irregular conduct of public administrations. The most frequent concern expressed by foreign investors investing in developing countries concerns the lack of transparency and predictability of public agencies which, alongside arbitrary regulatory changes and delays in providing operating permits, represent the most frequent sources of FDI divestments. As noted earlier, more than 70 percent of conflicts between investors and host states originate in measures adopted by sub-national or specialized regulatory agencies.

The above findings are germane to a discussion of trade facilitation in services, as it is precisely trade in services through Mode 3 - commercial presence - that tends to exhibit the greatest sensitivity to irregular governmental conduct. Indeed, investors in services are not only more frequently confronted by regulatory risks than are investors in other sectors. They are also more sensitive to such risks. Not surprisingly, available evidence shows that they tend to withdraw and cancel expansion plans more frequently (see Figures 13 and 14).

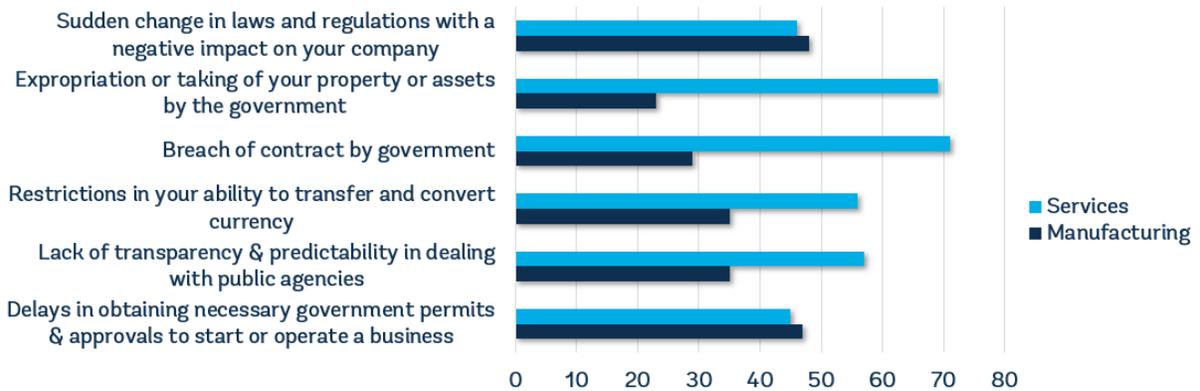
Figure 13: Frequency of FDI withdrawals in Services



Figure 14

Services tend to be more frequently affected by irregular government conduct than any other sector

Types of Government Conduct Inducing Investors to Cancel Investment Expansion Plans: Manufacturing vs. Services (percentages of total respondents affected)



Source: GIC 2017

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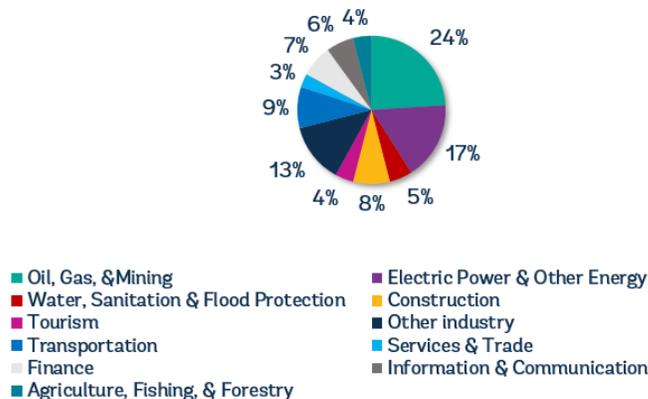
Furthermore, services are where the lion’s share of international investor-State Dispute Settlement (ISDS) cases arise (see Figure 15). Investment disputes tend to concentrate in services subsectors related to utilities, notably electricity distribution, telecommunications, construction, transport, water distribution and waste management. Foreign investment in such sectors is often governed by public-private partnership (PPP) contracts whose breach is typically the most frequent cause of FDI withdrawal. Moreover, it bears recalling that investors prosecuting contract-related matters through ISDS have a higher rate of success (i.e. benefit from more favorable arbitral rulings) than other investors - 66% vs. 48% (ICSID, 2018).

In most countries, governments and investors currently lack mechanisms to address grievances arising from irregular government conduct early on and to leverage International Agreements for non-litigious conflict management. The set of recent WBG surveys noted above reveal a paradox. On the one hand, direct engagement with governments ranks among the most frequently used tools to mitigate regulatory risks. On the other hand, when asked how effective such engagement is in practice, most foreign investors show a high degree of dissatisfaction. Investors also resort to other approaches, such as risk analysis, establishing a joint-venture with a local investor, forging connections with local politicians, and seeking the assistance of risk consultants, among others. Interestingly, the use of political risk insurance does not rank among investors' preferred mitigation tools in addressing risks associated with irregular governmental conduct (MIGA 2013).

Figure 15

Trade in Services under Mode 3 account for almost 60% of total investor-State Disputes

ICSID 1987-2017: cases by economic sector



Most common services sub-sectors:

1. Electricity, Power & Water
 2. Transportation
 3. Construction
 4. Financial services
 5. Information and Communication
 6. Tourism
- Public/private partnerships (PPPs)

All sub-sectors tend to be Domestic-market seeking FDI

Source: ICSID Caseload Statistics 2019

The trends depicted above explain why investors in most countries turn to one of three options when the various risk mitigation tools and strategies on offer do not yield expected results. These are: (i) individual or collective engagement with governments; (ii) FDI project discontinuation, a path chosen in close to 90 percent of instances; and (iii) resort to investor-state dispute resolution as a last resort, a path chosen by less than 7 percent of investors. While WBG research suggests that the first option generally fails to meet investor expectations, the second and third options, while resorted to, entail high costs and are likely undesirable for investors and host states alike (Echandi, 2019). A strong case exists to provide investment stakeholders with a minimum institutional infrastructure allowing for an early evaluation - in a non-litigious context - of grievances relating to irregular governmental conduct (see Box 2).⁴²

⁴² An important conclusion in this regard is that mechanisms to manage investor-State conflicts and prevent them from escalating into investor-State disputes should complement, rather than substitute for, investor-State legal

Box 2. Lessons from FDI Grievance Management Pilot Projects at the WBG

The WBG has piloted an FDI conflict management mechanism in eight countries, producing evidence that low-cost solutions exist to promote investment retention and expansion. The WBG developed an institutional conflict management mechanism, called SIRM (Systematic Investor Response Mechanism), to respond to the needs of governments by setting up a minimum institutional infrastructure to coordinate state-wide responses to investor grievances. In pilot projects, WBG teams have supported: (i) the composition and positioning of the Lead Agency as a coordinator; (ii) the design and deployment of the ICT tracking tool to register; (iii) the coordination protocols to ensure inter-agency coordination and collaboration in resolving grievances; and (iv) following-up and measuring the economic impacts of resolved grievances.

Although most pilots are still being implemented, 39 grievances from eight pilots have been identified which are serious enough to place investments at risk. Three FDI projects were verified according to the WBG M&E methodology, resulting in US\$200 million in investment retained, US\$20 million in reinvestments, and a conservative estimate of US\$10 million in public cost savings.

The most common issues identified by the SIRM pilots are sudden/arbitrary regulatory changes (60%), followed by contract breaches (22%) and expropriation (18%), confirming the findings of the 2009-13 MIGA/EIU and 2017 GIC surveys. SIRM pilots confirm the critical role that specialized and sub-national regulatory agencies play in generating most investment conflicts. Among the 39 contentious cases identified by the pilots, specialized agencies were involved in 64% (25) of instances and sub-national agencies for 15% (6) of them. Pilots also show that while grievances arise in all sectors, service sector cases predominate with 46% of the total, followed by primary/extractive industries (36%) and manufacturing (18%).

The SIRM pilots have also shown that institutional conflict management mechanisms can be a low-cost solution to promoting investment retention and expansion. It can also be a practical solution for countries to leverage IIAs in a non-litigious manner and induce desired patterns of behavior among domestic regulatory agencies. From this perspective, SIRMs appear as effective tools to implement IIAs on the ground, and more in tune with their original intent: to mitigate political risks in cross-border investment transactions.

SIRM mechanisms could be further adapted to focus on sectors prone to recurring investor-State conflict, such as extractives. A SIRM could also be further developed and adjusted to deal with other types of FDI-related conflicts in this sector – for example, conflicts arising among investors, local communities and governments. A similar sector-specific approach for SIRMs could be explored to deal with conflicts arising in specific highly regulated services, such as construction, telecommunications or transportation. Given the prevalence of contract-related conflicts, the exploration of contractual conflict management mechanisms (clauses embedded in contracts) to prevent dispute escalation, merits further research and consideration.

Source: WBG (2019).

adjudication mechanisms. Moreover, evidence shows that if countries want to foster the effective functioning of non-litigious mechanisms of investor-State conflict management, there is a need to enable a Lead Agency within the host country to “negotiate in the shadow of the law” with other domestic agencies and have a credible possibility for the investor invoking international adjudication as a last resort alternative. IIAs can play a key role in this regard.

Both empirical research and the experience of WBG SIRM pilots depicted in Box 2 highlight the relevance of addressing questions of FDI retention and expansion within any broader discussion of investment facilitation. Doing so would require no changes to existing host country legislation on investment protection. On the contrary, this approach would entail only pragmatic solutions to ensure the effective implementation of norms and disciplines already in force and agreed to by governments applicable in their respective jurisdictions.

4.2.4 Regulatory heterogeneity

Cross-country differences in how countries regulate the provision of the same service create additional costs for suppliers that need to adapt to new sets of rules in a multiplicity of markets. Addressing trade costs stemming from regulatory heterogeneity through strengthened international cooperation has taken center stage in the latest generation of preferential trade and investment agreements (Polanco-Lazo and Sauvé, 2017). This is so even as evidence of regulatory convergence, proxied as it can be by the conclusion of mutual recognition agreements, remains generally scant.

Regulatory cooperation makes doing business easier for exporters, and available research shows that it has a relatively large impact on trade conducted through a commercial presence. Based on an OECD data set of services trade policy heterogeneity, Nordås and Kox (2009) estimate that if all countries harmonized or recognized each other's regulations to the extent that the heterogeneity index took its lowest bilateral value for all country pairs, total services trade through commercial presence could increase by between 13 and 30 percent depending on the country. Likewise, if the business environment became more similar among the countries in the sample, total services trade through commercial presence could increase by between 2 and 60 percent, with the largest gains in India, the Republic of Korea, Poland and China (WTO, 2019).

The OECD estimates that trade costs imposed by cross-country differences in regulation range from 20% to 80%. It further recalls that lifting existing discriminatory restrictions where they are still high should be a policy priority, as the gains from regulatory harmonization, convergence or approximation are far greater when the countries engaging in such cooperative activity have already lowered their barriers to trade and investment in services (OECD, 2017). Importantly, as services restrictions are lowered and regulatory cooperation registers tangible gains, micro-, small- and medium-sized firms (MSMEs) gain proportionally most. This is so because the fixed costs of regulatory compliance weigh most heavily on smaller firms.

Much empirical research has shown how regulatory heterogeneity can represent a significant cost component for trade in services under Mode 3. However, it is worth noting that this issue, although clearly identified in the agenda of the WTO's Working Party of Domestic Regulation (WPDR) and in discussions proceeding under the Joint Statement Initiative on Domestic Regulation at the WTO, has been practically absent from discussions on investment facilitation, both at the G20 and in JSI talks at the WTO. In part, this stems from the decision to eschew the market access dimension of ongoing discussions of trade and investment facilitation, including in services. To be sure, not all sources of cross-country regulatory heterogeneity involve the maintenance of explicitly discriminatory measures (see section below), but the discussion above suggests the importance of ensuring greater substantive convergence, mutual learning and better coordination among both negotiating groups where trade and investment facilitation in services is being considered.

4.2.5 Tackling discriminatory policy barriers

Progressively opening up services markets through negotiations remains centrally important to reducing trade costs. But attention also needs to be paid to reviewing the design and implementation of sectoral regulations and associated administrative and licensing procedures to ensure they do not place an undue burden on new entrants and market operators. This latter dimension is primarily what ongoing multilateral discussions of domestic regulation in services and investment facilitation focus on as proponents of the WTO talks on investment facilitation are adamant that these not entail a market access (i.e. liberalization) component.

There is little doubt that creating such a wedge and divorcing investment facilitation from market opening reduces the effectiveness of the investment facilitation initiative and its ability to drive down investment-related trade costs. This is unfortunate given that explicitly discriminatory regulatory measures, many of which target Mode 3 transactions, account for a major share of trade costs in services (see Figure 16). Such measures include contestability-impairing foreign equity limitations, discriminatory licensing conditions, forced technology transfer requirements, data localization restrictions, or the non-recognition of qualifications acquired abroad by key personnel employed by foreign established firms.

All of the above measures impose costs on the entry and operation of foreign suppliers and make services markets less efficient and contestable. Restrictions on foreign presence are particularly damaging if they prevent local companies from accessing more and higher quality foreign inputs, therefore benefiting from linkages with foreign companies through participation in regional and global value chain production.

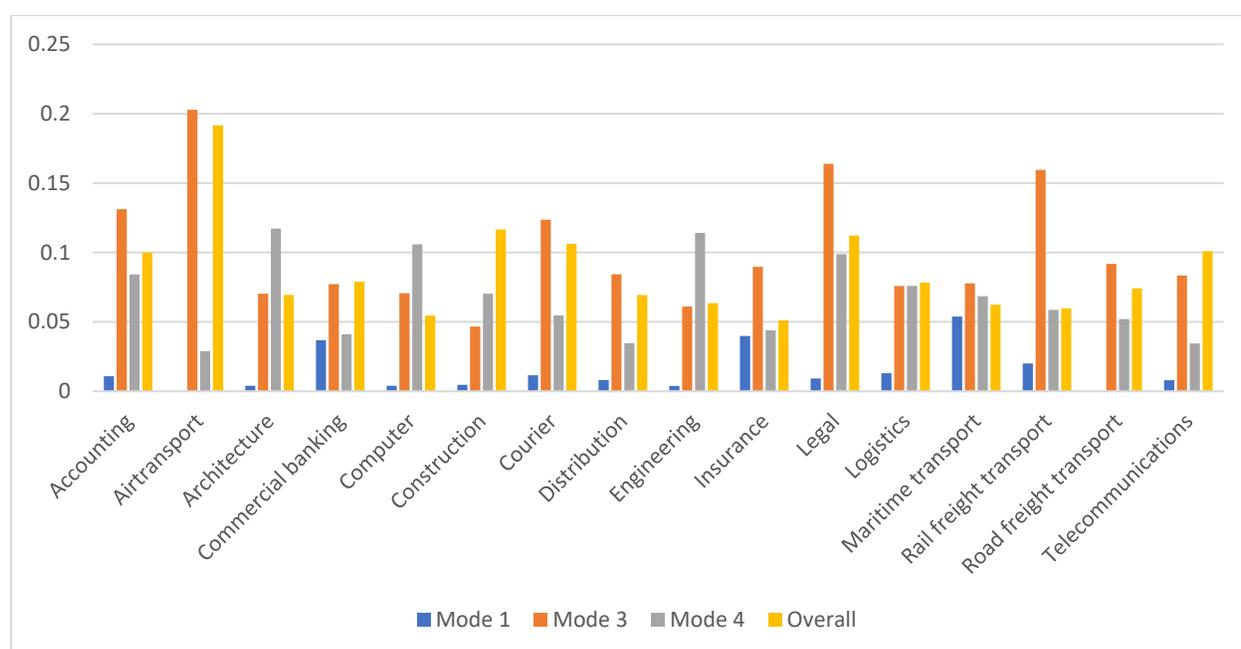
In considering the impact of divorcing investment facilitation from investment liberalization, it bears recalling that the success of the WTO's Trade Facilitation Agreement governing goods trade relates centrally to its ability to ensure that countries manage their physical borders in a manner that does not nullify or impair the legally binding market access commitments WTO members exchanged at the negotiating table. Facilitating investment may prove challenging in the continued presence of a host of measures that deter market entry, raise the costs of firms, reduce market competition and restrict consumer choice.

Regulatory costs in services show considerable modal and sectoral variance. Figure 16, which draws on the OECD's Services Trade Restrictiveness Index (STRI), documents the restrictiveness of services policies by sectors and modes of supply. Overall, cross-border supply (Mode 1) is found to face the least trade restrictions of all service sectors. Commercial presence (Mode 3), which involves setting up an office, branch or subsidiary in a foreign country, is the most restricted mode of services supply. Restrictions on foreign direct investment are particularly high in air transport, rail freight transport, as well as in legal and accounting services. The movement of natural persons (Mode 4) also faces high trade costs owing to stringent qualification and licensing requirements, especially in regulated sectors such as engineering, architecture, legal, medical and accounting services. Because of the close links between foreign investment and the deployment of key personnel, impediments to Mode 4 compound Mode 3 establishment and operating costs (Shingal, 2019).

In sum, despite the far-reaching liberalization of host country investment regimes pursued in recent decades, investment in services remains, relative to investment in primary (agriculture, mining) or secondary (manufacturing) sectors, subject to a wider range of entry and post-establishment barriers.

While such impediments are both explicitly discriminatory and non-discriminatory in character, those targeted specifically at foreign investors raise the cost of entry and limit the competitiveness of foreign invested firms once established. Such ‘trade costs’ are arguably more significant, and potentially more FDI-inhibiting, than the non-discriminatory ‘doing business’ impediments stemming from undue red tape or unduly onerous regulatory requirements that weigh equally on established foreign and domestic firms.

Figure 16. Restrictiveness of services trade policies by sector and modes of supply, 2018



Source: OECD services trade restrictive index (STRI) 2018

It bears noting that the scope and focus of the concept for trade facilitation in goods embedded in the TFA has a very different context from the discussion now emerging for trade facilitation in services and investment. While the process of liberalization of trade in goods started with GATT more than half a century ago, the process of promoting the full transparency and liberalization of measures affecting international trade in services is of more recent vintage. Furthermore, 25 years after the negotiation of the General Agreement on Trade in Services (GATS), the level of market-opening progress reached on this front has been - and remains - very tepid. The question naturally arises of why the level of ambition of any proposed negotiations on trade facilitation in services should be so narrowly drawn and limited.

Further, even if governments insisted for political reasons on not undertaking any commitment to reduce the trade costs imposed by *discriminatory* trade barriers, policy makers could at least consider undertaking the commitment of *status quo* bindings regarding discriminatory conduct. If governments are genuinely committed to facilitating trade in services, they should at least consider not worsening the already restrictive level of discriminatory barriers obtaining in many services sectors and countries. From a domestic political perspective, undertaking such a commitment should prove viable since it would not require any parliamentary approval, and no interest groups - except those keen on further obstructing trade and FDI - should be affected as no departure from current practice would occur. Yet such a step

could provide a powerful commitment to facilitating trade in services and preventing discriminatory policy reversals.

5. Conclusions, policy implications, and options for going forward

Based on a novel approach to measuring the cost of trade in services for Modes 1, 2 and 4 developed by the WTO Secretariat, this paper has reviewed available evidence on a range of factors affecting trade costs for services supplied via Mode 3. This was done with a view to answering the question of whether the current “facilitation” agendas on services and investment focus on the most important factors affecting trade costs in services supplied through a commercial presence. Such analysis yields several insights likely to inform the design of policy interventions in this field.

First, the sheer importance of Mode 3 as the dominant mode of supplying services internationally, accounting as it does for two-thirds of the aggregate stock and annual inflows of FDI and rooted as it is in the need for physical proximity between buyers and sellers characteristic of many services transactions, means that investment facilitation in services centrally concerns Mode 3 trade.

While the ongoing ICT revolution and continued advances in artificial intelligence can be expected to influence the modal structure of trade in services and increasingly favor the remote supply of services via Mode 1, the proximity burden in services places clear limits on the extent of such modal substitution effects. Meanwhile, a combination of ICT advances and growing political sensitivities towards migration-related issues limits the scope for a significant pick-up in services rendered through the temporary movement of service suppliers (Mode 4 trade). Thus, services supplied through Mode 3 are likely to remain the dominant mode of services trade for yet some time. This fact points to a significant degree of institutional and rule-making overlap between the substance of the investment facilitation agenda on the one hand, and the trade facilitation agenda in services on the other. These two conversations are currently proceeding on parallel, and wholly separate, negotiating tracks. The analysis put forward in this paper suggests that greater efforts need to be directed at ensuring overall coherence between the two sets of talks.

Second, although for historical reasons the notion of trade facilitation currently shaping the agenda for facilitating services trade and investment finds its origins in the negotiation of the WTO’s TFA, it is critical that policy makers take a step forward and explore a more focused contextualization of the facilitation negotiations based on the realities of services trade and investment. Looked at through this prism, the analysis put forward in this paper suggests that the current negotiating agendas on trade in services and investment facilitation fail to address some of the most important factors driving the cost of investment in services.

Recent research has shown that the costs associated with the quality of regulatory governance - in particular the costs deriving from the total withdrawal or cancelation of expansion plans by established service providers resulting from irregular governmental conduct - rank among the leading factors affecting trade in services through Mode 3. Addressing this problem has little to do with international litigation. Experience shows that most of the investment lost proceeds in the absence of investor-state filings. Neither does such a problem require the negotiation of any new disciplines on investment protection – a relevant consideration to the extent that WTO Members have opted to exclude both investor-state arbitration and investment protection disciplines from the trade facilitation agenda. Rather, the problem at hand arguably has more to do with governments finding appropriate mechanisms to ensure the

effective implementation of norms and principles already embedded in the GATS (in particular Article VI on Domestic Regulation) and in existing International Investment Agreements (IIAs) as well as in the domestic laws of many host countries. Despite its importance, this issue has not yet gained adequate prominence in discussions on investment and services facilitation.

Third, although discussed chiefly within the GATS Working Group on Domestic Regulation and its parallel Joint Statement Initiative, regulatory heterogeneity also appears as a critical source of trade costs affecting investment in services. However, in both negotiating settings where the impact of regulation on service and investment delivery are being discussed, this issue has been and remains overshadowed by discussions centered chiefly on transparency and regulatory simplification.

Fourth, in addition to the costs associated with the quality and heterogeneity of regulatory governance, the maintenance of a high level of policy restrictiveness embedded in discriminatory investment policy measures stands out as another key cost determinant of services delivered under Mode 3. Despite the far-reaching liberalization of host country investment regimes performed in recent decades, investment in services remains, relative to investment in primary (agriculture, mining) or secondary (manufacturing) sectors, subject to a wider range of cost-inducing entry and post-establishment barriers. Such impediments raise the cost of entry and limit the competitiveness of foreign invested firms once established. Such 'trade costs' are arguably more significant, and more FDI-inhibiting, than the non-discriminatory 'doing business' impediments stemming from excessive red tape or unduly onerous regulatory requirements that tend to weigh equally on established foreign and domestic firms. By divorcing investment liberalization from investment facilitation matters, WTO Members have chosen to address only a subset of investment climate-enhancing and trade cost-reducing investment facilitation measures.

A number of policy implications flow from the above analysis. First, if facilitating trade involves reducing the costs of undertaking cross-border transactions, then the conceptualization of trade facilitation in services and investment currently falls short of covering the most relevant cost factors affecting services delivery.

Second, the segmented nature of the facilitation discussions on services and investment contributes to rule-making overlaps. For example, by focusing on non-discriminatory measures affecting FDI, including in services, ongoing discussions on investment facilitation pursue negotiating aims that overlap with parallel talks on domestic regulation under the GATS Article VI:4 mandate and ongoing Joint Statement discussions on domestic regulation.

Third, the discussion on services trade and investment facilitation needs to be framed in such a way as to enable policy makers to address issues that are common to both sets of talks in an integrated manner and to translate evidence-based policy making into actionable deliverables, the results of which can be objectively measured under rigorous monitoring and evaluation frameworks. Measuring impacts is key not only to monitoring the effectiveness of any trade facilitation agenda, but also to show and educate private sector and civil society actors on the importance of trade and investment for development.

Based on the above analysis, Table 2 presents a preliminary sketch that could be used to organize a more comprehensive agenda on investment facilitation in services linking trade cost components with their respective market failure/problems, areas for trade facilitation policy intervention, and diagnostic and impact indicators.

Table 2. Operationalizing an Investment and Mode 3 Trade in Services Facilitation Agenda

Trade in services cost component	Market Failure/ Problem to be addressed	Trade facilitation agenda dimension	Diagnostic indicator	Impact Indicators**
Information costs	Information asymmetry	Transparency	WBG governance indicators	Trade/investment generated
Transaction costs	Red tape	Process streamlining	WBG/IAB indicators	Private time/cost savings
Governance quality	Uncertainty and unpredictability from regulatory risk	Consistency and predictability in the application of regulatory frameworks	Political risk indicators	Investment retained/expanded
Discriminatory Policy Barriers	Distortions to competition	Standstill of existing discriminatory measures affecting commercial presence	STRI	Trade/investment generated
Regulatory Heterogeneity	Economies of scale	Inter-governmental cooperation promoting regulatory convergence through negotiation	RH Index	Trade/investment generated

** Methodologies to operationalize these impact indicators have already been developed by the WBG.

While the substantive remit of the WTO investment facilitation discussions is arguably sub-optimal in scope, it nonetheless targets a range of issues where the dissemination of best practice examples in policy design, internationally-agreed rules and strengthened coordination and implementation efforts at both the international and domestic levels (including within-country (i.e. sub-national) levels of investment governance) clearly stand to enhance host country investment climates. Such rules and the norm diffusion associated with international cooperation can be expected to improve investment governance, help host countries to attract and retain higher volumes of service sector FDI and to reap the attendant spillover benefits flowing from such investments.

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