

Foreign Direct Investment and the Liberalisation of Trade of Services: an Evaluation of the Euro-mediterranean Partnership (EMP) Influence

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Trade in services positively and significantly impacts foreign direct investment in Mediterranean Non-EU Member Countries (MNMCS). Prevailing high barriers to trade give scope for significant welfare gains through liberalization of trade in services, which will enhance trade, foreign direct investment (FDI) and employment, and boost economic growth. Controlling for the effects of various economic, political and cultural variables, the findings show that liberalization of trade in services leading to a 100% increase in trade will result in a further increase of foreign direct investment in the range of 110% to 260%.

These results and policy implications are important for harnessing the Euro-Mediterranean Partnership for prosperity, growth and employment and are of particular relevance to policy-makers, trade-negotiators, civil society and businesses.

Policy Recommendation 1: Deepen commitments within the WTO framework

Given the extent of barriers to trade in services and investment in MNMCS, as well as the existence of many such barriers between EU member states themselves, it is recommended that in the short term liberalization of trade should focus on existing international agreements. Particular focus should be given to the removal of barriers to trade in services and investment through legal undertakings of the World Trade Organization (WTO) General Agreement on Trade in Services (GATS). Liberalization should aim at locking-in existing reforms, deepening existing commitments in particular service sectors and specific modes of services' provision, as well as the extension of commitments to new sectors. Negotiation of new undertakings in trade in services and investment within the current WTO Doha Development Trade Round provides the scope for further gains in other economic sectors that would lead to greater increases in trade and investment.(see recommendation 4 for sectorial and mode of supply negotiation focus).

As for MNMCS non-members of the WTO (Algeria, Syria, Lebanon, Libya and Palestine), they should take significant steps to bind future commitments.

Policy Recommendation 2: Negotiation of a Free Trade Area (FTA) in services

An FTA in services is likely to have a profound impact on liberalization of trade and the associated welfare and trade gains, since it will encompass almost all service sectors and modes of services provision. Therefore negotiations should commence on a regional FTA in trade in services between the EU and MNMCs in accordance with the objectives of the Euro-Mediterranean Partnership and the Framework Protocol of Istanbul for the Liberalization of Trade in Services.

In addition, short-term deepening of commitments in the GATS will advance the long-term goal of a FTA in services that is in conformity with WTO requirements.

It is important to note that the EU and MNMCs differ in their level of development and their ability to exploit many of the economies of scale associated with trade and investment in various services. As a consequence, the EU is likely to enjoy an increase in its exports and investment to the MNMCs. In some areas first-mover-advantage effects may take place, in the sense that they restrict future market access for potential competitors. These adverse effects can be minimized through regulation and legislation aimed at ensuring competition and access to infrastructure and networks in, for example, marketing, power supply, communication and distribution. MNMCs will benefit from EU exports and investment through greater price competition, increases in product variety and supply, and expansion of employment.

MNMCs are likely to increase exports towards the EU in specific sectors (particularly non-networked services) and can increase their attractiveness to EU markets through greater convergence with EU standards. Such convergence to the *Acquis Communautaire* will also render MNMCs markets more attractive for EU firms. In addition, a regional FTA will boost South-South trade between the MNMCs themselves.

Policy Recommendation 3: Negotiation of an investment agreement

Investments are an important aspect of trade in services when trade is supplied through commercial presence; that is, foreign service suppliers establishing and servicing abroad. An investment agreement between MNMCs and the EU would complement and secure the benefits of trade in services liberalization.

Such an investment agreement would reassure foreign investors of their property rights, regardless of changing governments and political preferences. It could also serve to provide foreign investors with investment opportunities that are not accorded to third countries. The agreement, however, should also define and specify a dispute settlement mechanism to address investment disputes arising between foreign investors and host countries.

Policy Recommendation 4: Focus liberalization on cross-border trade and commercial presence

Liberalization of trade in services should be focused on the provision of cross-border services or through commercial presence. While the latter involves the cross-border movement of service providers, the former concerns only the cross-border movement of the service, without movement of either service providers or consumers. Most cross-border trade is carried out through the internet or telephony systems. Other modes of trade are either less restrictive, such as consumption abroad of services, for example with tourism; or politically-challenging as with the movement of foreign labor.

Liberalization should focus on the removal and simplification of unnecessary and cumbersome business and establishment regulation. The removal of barriers to cross-border trade in services can allow for exploitation of economies of scale as a result of decreasing marginal costs of servicing additional clients. Furthermore, cross-border trade has both substitute and complementary relations to

commercial presence as it enhances existing commercial presence trade, and replaces high levels of investments required for commercial presence provision.

Particular gains are likely to accrue from liberalization of financial services, telecommunications and transportations. While the EU has a comparative advantage in these sectors, their nature in terms of providing a backbone and infrastructure makes them an imperative for the domestic economic development and growth of local services and manufacturing industries in the MNMCs.

Policy Recommendation 5: MNMCs liberalization should maintain regulatory flexibility to address market failures

As part of the liberalization process, due consideration should be given to the creation of a dynamic competitive environment, while maintaining regulatory benchmarks and flexibility. Thus, MNMC governments need to balance the desires of consumers in terms of low prices and adequate supply, with those of European firms that seek stable and sufficient profits, and the need to attract FDI in general. Since some service markets are characterized by imperfect competition, such as economies of scale, due consideration must also be given to the prevention of future market concentration or the erection of de-facto market entry barriers for new entrants as a result of liberalization.

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