POLICY FRAMEWORK FOR INVESTMENT USER'S TOOLKIT

Chapter 3. Trade Policy

Introductory note

The PFI User's Toolkit responds to a need for specific and practical implementation guidance revealed from the experience of the countries that have already undertaken a PFI assessment.

Development of the Toolkit has involved government users, co-operation with other organisations, OECD Committees with specialised expertise in the policy areas covered by the PFI and interested stakeholders.

This document offers guidance relating to the PFI chapter on Trade Policy.

The PFI User's Toolkit is purposely structured in a way that is amenable to producing a web-based publication. A web-based format allows: a flexible approach to providing updates and additions; PFI users to download the guidance only relevant to the specific PFI application being implemented; and a portal offering users more detailed resources and guidance on each PFI question. The website is accessible at www.oecd.org/investment/pfitoolkit.

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Trade Policy

Trade policies determine the size of markets for the output of firms and hence strongly influence both foreign and domestic investment. Over time, the influence of trade policies on the investment climate is growing. Changes in technology, liberalisation of host country policies towards trade and investment and the growing organisation of global production chains within multinational enterprises (MNEs) have all served to make trade policies in home and host countries alike a crucial ingredient in encouraging both foreign and domestic investment and in maximising the contribution of that investment to development.

This chapter does not prescribe trade policies but rather focuses on their efficiency in terms of implementation, predictability and transparency. The chapter also discusses the impact of restrictions on imported inputs of goods and services in a world of increasingly globalised production, the potential role of home country trade policies and the ways in which trade and hence investment might be facilitated through export finance and risk mitigation.

The seven PFI questions on Trade Policy relate to:

- Customs procedures
- Trade policy uncertainty
- International trade agreements
- Reviews of trade policies
- Trade restrictions on imported inputs
- Home country trade policies
- Export finance and risk mitigation

Customs procedures

3.1 What recent efforts has the government undertaken to reduce the compliance costs of customs, regulatory and administrative procedures at the border?

Rationale for the question

Customs, regulatory and administrative procedures at the border are a necessary cost of doing business. They ensure effective compliance with national and international laws, protect consumers of foreign-produced goods and provide tariff receipts – one of the largest sources of government revenues for many developing countries, particularly least developed ones. The focus of this question is on the benefits of simplification of procedures which can significantly reduce costs of compliance for all businesses, while continuing to satisfy the policy objectives of these procedures. Unnecessarily complicated procedures make it harder for host countries to harness fully the efficiency gains resulting from global supply chains, potentially discouraging both domestic and foreign investment. There is considerable empirical evidence showing how a country's overall level of competitiveness and trade growth are linked to the efficiency and effectiveness of its customs procedures.

Related PFI questions:

Question 1.1 on laws and regulations concerning investment
Question 2.4 on streamlining administrative procedures
Questions 10.1—10.5 on regulatory barriers (particularly 10.5)

Key considerations

Transactions costs can be reduced by more transparent and predictable procedures, impartial and uniform administrative border requirements, simplified clearance systems, harmonising administrative requirements, suppressing and streamlining unduly burdensome procedures, the application of internationally-agreed standards and by regulatory co-operation (*e.g.* to enable pre-arrival clearance of shipments), co-ordination, risk management and by introducing electronic customs clearance systems. Another issue is the preparation, adoption and application of standards, as well as the testing and certification procedures for imported products. Beyond customs procedures and technical regulations, better infrastructure for air, land and sea transport – particularly port logistics – are associated with higher trade.

Compliance with myriad technical regulations involving various agencies in the importing country is a fact of life for exporters in all countries. If regulation is not administered efficiently, it can create unnecessary trade and investment obstacles and involve potentially significant transaction costs. These costs arise from the need to translate foreign regulations or to hire legal and technical

experts as advisers and from any changes in production methods or facilities in order to comply with regulations. Such costs, including in some places demands for illicit payments (see Chapter 10), not only discourage firms from trying to sell or establish abroad but also affect local firms.

Customs and border procedures should be designed and implemented to provide consistency, predictability, simplicity and transparency so as to avoid unnecessary burdens on the flow of goods, services and business people. This might include: measures doing away with unnecessary or outdated requirements, such as requesting information that has already been provided to other government agencies or is readily available elsewhere; updating domestic regulatory requirements through periodic audits or built-in sunset clauses so as to take account of changed contexts, technologies and markets; ensuring that the regulatory compliance burden remains broadly proportional to the underlying policy objectives; and by replacing some border controls with post-clearance audits.

Policy practices to scrutinise

Governments seeking to improve the efficiency of customs administration should: 1) assess actual performance; 2) benchmark against international best practices; 3) identify priority areas for building capacity; and 4) consider, where appropriate, the adoption of international standards.

1) *Assessing actual performance*

- The time required to release imported (and exported) goods has increasingly become the main measure for assessing the effectiveness of a host country's customs administration. A Time Release Study prepared by the World Customs Organisation (WCO) provides guidance to customs administrations on the best way to apply this method of internal review. More rapid clearance procedures allow firms to plan ahead for the shipment of goods across borders in order to meet tight production schedules and just-in-time deliveries.

- Internal benchmarking helps identify and implement best practices in customs procedures within the same jurisdiction. It could, for example, compare how different customs offices perform. Benchmarking frequently includes measures of performance, which might encounter resistance among customs officials, but it can also be qualitative by comparing working methods rather than actual performance.

- Business surveys or country studies by international organisations or others can also provide an external assessment of a country's customs procedures.

2) International benchmarking

A domestic benchmarking exercise is typically a first step before a host country will consider international benchmarking. International benchmarking is also a collaborative process involving customs administrations in other countries; it is not just about measuring performance.

- To assist countries in carrying out international benchmarking in customs procedures, the WCO has developed the Customs International Benchmarking Manual which helps administrations improve their efficiency and effectiveness by comparing procedures or processes with similar ones elsewhere. It relies on collaboration between customs authorities by sharing information on processes and measures to encourage innovative practices and improve performance.

3) Capacity building

The need for capacity building in this area is now increasingly recognised and has been discussed in the context of aid for trade within the Doha Development Round. Considerations include the scope for inter-governmental cooperation, assistance offered by international organisations in this area (see the resources section) and how the private sector can contribute to the process.

- A policy statement by the International Chamber of Commerce (ICC) on Capacity Building to Improve Trade Facilitation addresses issues such as coordination, management capacity, common standards, confidence building and the contribution of the private sector to capacity building. Summary findings of a private sector study on progress under a Europe-Asia trade facilitation action plan are featured in an annex, while another outlines ICC recommendations for a WTO Agreement on Trade Facilitation.

4) International standards

- The Kyoto Convention on the Simplification and Harmonisation of Customs Procedures entered into force in 1974. The revised Kyoto Convention from 2006 calls for new technologies and a business-friendly approach towards customs controls and asks the private sector to cooperate with customs administrations. Chief among the new governing principles is the commitment by customs administrations to improve transparency and predictability, use risk management techniques, co-operate with other relevant authorities and the business community and adopt appropriate international standards.

- A major policy objective of the WTO Agreement on Technical Barriers to Trade (TBT) is to ensure that technical regulations and standards and conformity assessment procedures do not create unnecessary obstacles to international trade. The Agreement targets procedures that would give

domestically-produced goods an unfair advantage and encourages countries to recognise one another's procedures for assessing whether a product conforms to technical regulations and standards, thereby encouraging the adoption of international standards. It also sets out a Code of Good Practice for both governments and non-governmental or industry bodies to prepare, adopt and apply voluntary standards (see Annex 3 of the TBT Agreement). The Agreement also provides for technical assistance to developing countries.

Resources for further study

- OECD: Tool Kit for Trade Policy Makers – Responding to the Doha Development Agenda contains OECD work on trade facilitation.
- World Bank: *Reforming the Regulation Procedures for Import and Export: Guide for Practitioners*. This policy toolkit offers detailed information on best practices in clearance processes, export and duty deferral regimes (exemptions, drawback, free enterprise zones, etc.).
- WTO: Trade Facilitation Web page contains updated information and other documents on ongoing multilateral negotiations on trade facilitation. A 2001 briefing entitled *Trade Facilitation: Cutting Red Tape at the Border* summarises discussions among WTO Members on reducing the vast amount of red tape that still affects the cross-border movement of goods.
- Asia-Pacific Economic Cooperation (APEC): The Committee on Trade and Investment has recently endorsed the Second Trade Facilitation Action Plan, which lists collective actions to reduce transaction costs by 5% by 2010 (an initial 5% reduction target was met for the 2001-06 period). The Action Plan provides for a comprehensive review of progress in implementing this business facilitation agenda.
- APEC: A Guidebook addresses the key substantive provisions of the revised Kyoto Convention; features a situation analysis of a country's current position in relation to the Convention, helps countries to undertake a gap analysis and to implement an action plan that will enable a country to become fully compliant with, or accede to, the Convention.
- Asian Development Bank: *Simplification of Customs Procedures, Reducing Transaction Costs for Efficiency, Integrity and Trade Facilitation* discusses the fiscal and governance dimensions of customs procedures, initiatives of international organisations to simplify customs, and papers on systems and procedures for improving service and efficiency in customs.

Trade policy uncertainty

3.2 What steps has the government taken to reduce trade policy uncertainty and increase trade policy predictability for investors? Are investors and other interested parties consulted on planned changes to trade policy?

Rationale for the question

Trade policies which are predictable, consistent and transparent lower the risks for investors, implying a lower hurdle rate for any given project and hence more investment overall. This applies to all investors but is particularly important for foreign firms. Many empirical studies find that FDI is lower when policies are unpredictable. Policy certainty does not necessarily imply that policies should never be changed, merely that they should be done so in a transparent manner with ample prior consultation with all interested stakeholders, including foreign businesses.

Related PFI questions:

Question 1.1 on investment policy predictability and transparency
Questions 2.5 and 10.4 on public consultation mechanisms and procedures

Key considerations

Question 3.2 highlights the importance of the quality of a host country's regulatory culture and the degree to which the process of policy-making is sensitive to the effects of domestic regulatory conduct on the investment climate. It echoes many of the broader regulatory issues in Chapter 10. Uncertainty in trade policies may result from undue administrative discretion and non-transparent regulatory regimes (Question 3.1) and from a host of governmental actions and decisions that can obstruct the smooth functioning of international supply chains and generate instability in pricing structures.

Promoting transparency and predictability in trade and investment policies involves institutionalised forms of external stakeholder consultations with business and other civil society constituents, better communication of policy announcements and locking-in of policy changes under legally-binding instruments (see Question 3.3).

Policy practices to scrutinise

To what extent has the government established effective public consultation mechanisms and procedures, including prior notification requirements before enacting new laws and regulations affecting the climate for doing business?

- Well-publicised, well-organised, highly accessible and well-timed opportunities for public comment on proposed regulatory changes, as well

as clear guidelines of accountability showing how comments from interested constituencies have been handled, are important features of a well-designed system of stakeholder consultation. Such consultations should not be limited to insiders (incumbents) but should be open to all interested parties. Clear guidance to regulators on how such consultations are to be conducted encourages good practice in this area.

Do public consultation mechanisms allow sufficient access for all interested parties, including foreign stakeholders?

For any given regulatory proposal, too much discretion on whom to consult and how can dilute the intended benefits of a broad-based consultation mechanism. New entrants, small and medium-sized enterprises (SMEs) and foreign (particularly non-established) stakeholders might be at a disadvantage if consultations are informal in character. Specific attention might need to be paid to the difficulties of these latter investors in participating in consultations. Although responsibility for policy decisions ultimately rests with the host country government, it can significantly enhance the credibility of the process and the prospects of regulatory compliance through transparency in the way comments are solicited and received and by providing timely information on regulatory decisions as well as access to administrative tribunals if decisions are challenged by private operators.

Resources for further study

- The APEC-OECD Integrated Checklist on Regulatory Reform is a voluntary tool for governments to evaluate their regulatory reform process, focussing on regulatory, competition and market openness. Market openness is addressed through questions regarding how regulations are developed and implemented. The goal is to ensure that regulatory policies reinforce the ability of economies to benefit from globalisation and international competition.

- A European Commission report on *Consultation with Stakeholders in the Shaping of National and Regional Policies Affecting Small Business* provides several case studies and includes 12 recommendations for national and regional governments on how to establish a more efficient dialogue with stakeholders and improve consultation procedures.

International trade agreements

3.3 How actively is the government increasing investment opportunities through market-expanding international trade agreements and through the implementation of its WTO commitments?

Rationale for the question

Trade measures and legally-binding commitments entered into in multilateral and preferential trade and investment agreements can help to attract investment. These agreements can create larger markets, allow for greater scale economies and hence lower costs and, more broadly, lock in recent policy changes or signal future policy changes so as to promote an orderly adjustment to evolving competitive conditions. More recent preferential trade agreements typically feature a comprehensive set of disciplines on investment protection and liberalisation that complement domestic efforts to create a sound investment climate. They also often include provisions on services, intellectual property or competition policy which can also significantly affect both trade and investment.

Related PFI questions:

Chapter 1 contains several questions which touch upon international investment agreements, notably Question 1.7.

Key considerations

Governments need to formulate, negotiate and implement trade and investment agreements and to evaluate their impact with a view to maximising their benefits on overall host country performance. While unilateral liberalisation is extensive in many countries, particularly with regard to foreign investment and service sector policies, several countries or country groupings are also seeking to speed up their economic development through faster and broader liberalisation commitments scheduled under preferential trade and investment agreements. For some countries, particularly the least developed ones, a lack of capacity and resources severely impedes their ability to negotiate, implement and derive concrete benefits from this greater engagement.

Engaging in formal trade negotiations at the bilateral, regional and multilateral levels allows private sector stakeholders to pursue enhanced trade and investment opportunities such as through integration into regional and global supply chains and distribution networks. Identifying such opportunities is a particularly daunting challenge for SMEs in both developed and developing countries.

Policy practices to scrutinise

The Doha Development Agenda has helped crystallise a growing awareness worldwide that the ability of governments durably to improve their capacity to formulate, negotiate and implement trade agreements in the broader context of national development goals requires channelling significant resources towards capacity-building initiatives. This calls for an examination of the following criteria and performance indicators:

- For developed and (especially) developing countries, a key challenge is to strengthen trade-related analytical and negotiating capacity, both at home and in their permanent representations at the WTO, so as better to monitor developments, participate more actively in ongoing negotiations and in the WTO's dispute settlement mechanism, and understand better the link between multilateral and preferential developments in trade and investment policies.

- Most LDCs have only limited or no permanent representation at the WTO. These countries should try to take maximum advantage of the trade-related capacity-building activities on offer at various levels to strengthen their ability to identify and defend their interests at the negotiating table and to mainstream trade policy into national development plans. By building capacity, they can: (*i*) address key bottlenecks in trade infrastructure; (*ii*) durably enhance analytical and negotiating skills within governments; (*iii*) strengthen the regulatory institutions involved in implementing commitments undertaken in trade agreements; and (*iv*) enhance the capacity to supply liberalised markets with goods and services that meet market demands and product standards. The latter challenges – those of regulatory strengthening and enhancing supply capacities – may be of direct relevance to many higher income developing countries.

To help stakeholders, particularly SMEs, to identify and pursue trade and investment opportunities opened up through trade agreements, governments should consider the following measures:

- Prepare a list of preferential trade agreements currently in force and identify:
  - The share of total trade covered by each agreement;
  - The share of total investment originating from parties to the preferential agreements;
  - The nature of key tariff and non-tariff barriers governed by the various agreements and the sectors involved;
  - The stage of implementation of each agreement and bottlenecks within key regulatory agencies or ministries;

- For customs unions, the share of regional trade subject to the common external tariff; and
- Remaining obstacles regarding the right of establishment and other investment restrictions.

- Encourage greater communication among countries participating in preferential trade agreements, as well as cooperation among relevant government agencies, industry associations and chambers of commerce.
- Encourage further cooperation between investment and trade promotion agencies, especially by providing various forms of market intelligence to SMEs in priority sectors.
- Identify capacity-building priorities in relevant government ministries and agencies and direct attention to the capacity development needs of SMEs.
- Help businesses to benefit from trade and investment promotion activities, such as through participation in trade fairs.

Resources for further study

- The WTO Trade and Development Web page provides recent information on WTO-related work that takes place, *i.a.* in the Committee on Trade and Development and the Sub-Committee on Least Developed Countries. It links to various initiatives aiming at building trade capacity: Aid for Trade, the Enhanced Integrated Framework, and the Joint Integrated Technical Assistance Programme.
- The OECD Tool Kit for Trade Policy Makers helps governments to understand trade policy issues and negotiating procedures in the context of the Doha Development Agenda. It presents OECD work on strengthening trade-related technical assistance and capacity building.

Reviews of trade policies

3.4 How are trade policies that favour investment in some industries and discourage it in others reviewed with a view to reducing the costs associated with these distortions?

Rationale for the question

Governments sometimes use trade policy instruments, such as import tariffs (including tariff peaks and escalating tariffs) and subsidies (investment incentives) to promote investment in targeted industries. Considerable care must be taken to ensure that such measures do not distort resource allocation and damage the overall investment climate. Favoured industries, typically domestically-controlled, compete for resources with foreign and other domestic enterprises, and any policy-induced favours can crowd out investment and production in more productive activities. Moreover, where the output of the targeted industry is an input to others, competitiveness in final products and in world markets may be harmed, reducing firm profitability and hence further investment in export-oriented sectors. These costs are typically long-lived, since they are often non-transparent and spread among many producers which reduces the incentive for governments to reform such practices.

The promotion of investment in specific industries through trade policies should be both transparent and consistent with existing international obligations. A first-best approach is to maintain a trade regime that allows competitive industries to develop and flourish as much as possible without discrimination, rather than to try to nurture competitiveness behind trade policies that tilt competitive conditions in favour of incumbents (be they domestic or foreign). This does not necessarily imply removing all forms of import protection, nor does it assign a completely passive role to domestic policy. What it entails is a keener sense of the costs and benefits of using trade policy to achieve objectives that other domestic policy instruments may be more suitably equipped to pursue, such as labour market, education, innovation and SME development policies.

Related PFI questions:

Non-discrimination is a core principle of the PFI, whether between foreign and domestic firms or among shareholders or industries. See in particular Question 1.6.

Question 4.5 on the competitive implications of industrial policies

Question 10.3 on regulatory impact assessments

Key considerations

The economy-wide effects of proposed trade measures favouring particular industries should be examined to ensure that the terms of reference of reviews

of existing measures pay proper attention to potential effects on trade and investment activity. These reviews should also help to minimise the risk of nullifying or impairing liberalisation commitments scheduled under international trade agreements.

Reviews can apply regulatory impact assessment (RIA) analysis, a tool used today in most developed countries and in several developing countries to measure better the economic and social welfare impacts of regulation and to identify the most efficient and least trade- or investment-restrictive alternatives. RIAs are widely recognised as contributing durably to improving the business environment and to promoting regulatory efficiency.

This is particularly relevant for highly-regulated sectors, such as electricity, energy, telecommunications, transport and financial services, which have historically been subject to various trade, investment and broader competition restrictions on the grounds of market failure. Technological advances and far-reaching reassessments of the shifting borders between the market and the state (resulting in increasingly liberal and competitive environments) have seen trade restrictions come under increasing challenge resulting in an unprecedented wave of pro-competitive regulatory reform, privatisation and market liberalisation in most parts of the world. Several key infrastructure services sectors that were until recently state-owned monopolies are today supplied competitively in markets governed by independent regulatory authorities whose decisions and rules affect domestic competitive conditions, consumer choices and prices.

Policy practices to scrutinise

The following measures should be considered:

- Identify the underlying policy objective of existing or proposed trade policy measures (*e.g.* to what type of market failure or policy demand is the proposed measure responding?).

- Describe the options available to meet the underlying policy objective in the least restrictive manner for trade and investment. Explain how each option would fulfil regulatory requirements, as well as the associated risks and how they might be mitigated.

- Identify groups disproportionately affected by regulatory interventions, including business sectors and members of society.

- Consider the costs and benefits to consumers/individuals and to the economy at large of proposed measures, taking account of their likely economic, social and environmental effects.

- Summarise who or what sectors bear the costs and benefits of each option. Consider any unintended consequences and indirect costs.

- Engage in public consultations relating to proposed regulatory changes and publish the results on dedicated websites.
- Encourage government agencies to review existing regulatory regimes periodically and conduct RIAs.

Several WTO Members, particularly developing countries, worry that possible requirements to conduct RIAs under the WTO's various transparency provisions could represent a heavy administrative burden in light of limited governmental capacities and resources. These concerns are legitimate, but lighter approaches – such as a simpler requirement to publish the rationale for new or proposed regulations rather than engaging in extensive stakeholder consultations – might not help host countries durably to improve governance in their regulatory institutions and decision-making processes. Targeted technical assistance and capacity strengthening in this area could yield large dividends.

Resources for further study

- A conference hosted by the Centre on Regulation and Competition (UK) presented several papers and case studies on how RIAs can be used in developing economies to appraise the costs and benefits of new regulatory proposals and evaluate the performance of existing regulations.
- A World Bank (FIAS) paper describes how RIAs can be effectively applied in developing countries, providing a framework and strategy for implementing RIAs in resource-constrained environments and urges a flexible, pilot-driven, step-by-step approach.
- *Current Trends in Regulatory Impact Analysis: The Challenges of Mainstreaming RIA into Policy-making* by Jacobs and Associates.
- *Regulatory Impact Assessment in Developing and Transition Economies: A Survey of Current Practice* surveys governments on their use and understanding of RIAs and finds that while such assessments are being performed, both the process and attendant benefits from RIAs would be enhanced if officials were more familiar with RIAs and the various stages of the RIA process were more standardised and thorough. The process could also be improved by providing examples of economic, social and environmental regulatory proposals and by increasing transparency.
- *Designing a Regulatory Impact Assessment for South Africa* evaluates several international models of RIA for their relevance to South Africa's regulatory practices, identifies principles for success and makes suggestions on how RIAs can be implemented.
- The *WTO Web page on Subsidies and Countervailing Measures* contains updated information on the Subsidies and Countervailing Duties Committee and a collection of related documents.

Trade restrictions on imported inputs

3.5 To what extent do trade policies raise the cost of inputs of goods and services, thereby discouraging investment in industries that depend upon sourcing at competitive world prices?

Rationale for the question

Much of international trade involves business to business transactions. Modern business supply chains involve hundreds of domestic and international producers in locations that are best suited to such activities. This specialisation of production raises productivity and hence any trade policies that hinder reliable access to intermediate goods and services and which raise their cost can durably affect the ability of local firms to participate in such networks or of the host country to attract new investment in these activities.

Internationally traded services are a key input for many industries and an increasingly strategic component of global value chains in manufactured and service markets alike. The four modes of supplying services – across borders, through the movement of consumers, through an established presence (*i.e.* investment) or through the movement of service suppliers (business people) – are intrinsically linked. Trade in services has expanded rapidly in recent years in both developed and developing countries and is one of the fastest growing components of world trade. Far-reaching changes in technology and in approaches to regulation have spawned a new international division of labour in services. Despite the rising tradability of many new services, a local presence is still often necessary in services markets, hence the onus placed on progressively liberalising FDI regimes in services, often unilaterally, in recent decades.

Key considerations

More liberal trading and investment regimes, combined with technological developments and productivity advances, have made it possible to fragment supply chains on a worldwide basis. Host countries seeking to insert themselves into such networks and wishing to attract more efficiency-seeking investment in both manufacturing and service industries need to reduce distortions on trade in intermediate products (parts and components) and in services. Some countries, for example, require that a minimum share of investment project inputs be sourced locally, regardless of their cost competitiveness. Such policies may be inconsistent with WTO obligations arising from the Agreement on Trade-Related Investment Measures (TRIMs), and policy makers should consider evaluating their potential dampening effects on investment.

Policy practices to scrutinise

The growth of trade in intermediate inputs, including services, highlights the importance for trade and investment policy of accurately measuring these flows, as well as the effective rates of protection on intermediary inputs and their

determinants. To assist this process, the following measures could be implemented:

- Establish a database on intermediary goods by using import data from the United Nations COMTRADE database which provides annual trade flows disaggregated by commodity and partner countries up to a 6-digit level. For this, the import data would need to be divided into intermediate goods, parts and components and final goods. The list of products in the first category is available in Table A1 of OECD (2007) mentioned below.
- From the database, compute a series of indicators of trade in intermediate products by year, importing country or region and sector. More detailed indicators could compare production and employment data with corresponding intermediate import data, see OECD (2007).
- Identify trends in the exported goods that enter into other countries' supply chains and trends in imported goods used in domestic supply chains.
- Identify the intermediate goods, parts and components at the 8-digit level in a country's customs tariff and their corresponding tariff rates. Compare the tariff of the final product with that imposed on its inputs to identify situations of tariff inversion in which the tariff rate on an input is higher than that applied to the final good. Tariff inversion encourages imports of finished products and hence discourages domestic manufacturing.
- Develop a database and reliable analytical indicators of trade and FDI performance across all modes of supply so as better to understand the appropriate regulatory and institutional framework needed for effective liberalisation across services sectors, particularly infrastructural services that are inputs into most final goods and services.

Resources for further study

- An OECD note on Detailed Empirical Evidence and Measures of Trade in Intermediate Goods discusses some specific measures of outsourcing and an associated data set used to assess developments in the growth of trade in intermediate goods, parts and components from 1989 to 2004.
- An OECD (2007) paper entitled The Internationalisation of Production, International Outsourcing and Employment in the OECD reviews some of the possible changes in labour markets in OECD countries as a result of international trade and the internationalisation of production by multinational companies, with a particular focus on the impact of outward direct investment from OECD countries on employment in the home country of investing firms.
- The WTO Trade and Investment Web page contains updated information on the (currently suspended) Working Group on the relationship between trade and investment and other related documents.

Home country trade policies

3.6 If a country's trade policy has a negative effect on developing country exports, what alternative means of accomplishing public policy objectives has the government considered, taking into account the dampening effect that such a restrictive trade policy also has on investment?

Rationale for the question

An importing country's trade policy may, if it is unduly restrictive, reduce the exporting country's sales abroad and therefore its ability to purchase imports and attract investment. Export-oriented investment by domestic or foreign firms in developing countries depends upon market access in developed countries or other countries with large markets. If host country firms face high trade barriers to their main markets, there will be less investment by local firms and MNEs in that country. Even developing countries' traditional advantages of low labour costs and abundance of natural resources can be negated. Home country governments should consider such external costs when evaluating specific domestic trade policy measures.

Key considerations

How can domestic policy makers safeguard the need of regulatory authorities to address legitimate domestic policy objectives without recourse to needlessly burdensome trade measures? This question is addressed in several WTO provisions and in many preferential trade and investment agreements:

- Article XX states that nothing in the GATT shall be construed to prevent the adoption of measures necessary to protect human life or health, relating to the conservation of exhaustible natural resources and necessary to attain other legitimate objectives listed in the Article. It also requires that such measures not be applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail or a disguised restriction on international trade.
- The Technical Barriers to Trade (TBT) and the Sanitary and Phytosanitary Measures (SPS) Agreements require WTO Members to ensure that regulatory measures shall not be more trade restrictive than necessary to fulfil legitimate objectives and to notify other Members of the objectives and rationale of proposed measures. The SPS Agreement also states that each Member shall ensure that an enquiry point exists to provide answers to all reasonable questions from interested Members and information concerning risk assessment procedures, factors taken into consideration and the determination of the appropriate level of sanitary or phytosanitary protection.
- The General Agreement on Trade in Services (GATS) also provides a mandate to the Council for Trade in Services to develop disciplines pursuant

to Article VI:4 so that measures relating to qualification requirements and procedures, technical standards and licensing requirements do not constitute unnecessary barriers to trade in services. Such disciplines aim to ensure that those regulatory measures are, *inter alia*: (*i*) based on objective and transparent criteria such as competence and the ability to supply the service, (*ii*) not more than necessary to ensure the quality of services and (*iii*) in the case of licensing procedures, are not in themselves a restriction on the supply of the services. These disciplines have yet to be agreed among WTO Members or in preferential trade agreements.

- The WTO dispute settlement regime also provides for the right for a Member to seek consultation with another Member on WTO matters.

Regarding more procedural matters, do specific provisions exist in the context of an RIA that would require or encourage regulators to avoid unnecessary trade restrictiveness with a view to minimising potentially adverse effects on trading partners? The concern is similar to that noted under Question 3.4 about using RIAs to assess the impact of proposed trade policies. Moreover, the question of whether and how foreign interested parties are consulted with regard to proposed policy changes is also a relevant consideration, one that was already addressed under Question 3.2.

Policy practices to scrutinise

The following measures should be considered:

- For relevant trade policy measures, adapt the RIA procedures to include a requirement to avoid unnecessary trade restrictiveness with a view to minimising potential adverse effects on trading partners. The following steps are basically the same as elaborated under Question 3.4 except for steps c and d which are shown in italics:

  a) Identify the policy objective;

  b) Describe the available options to meet the objective, explain how each option would meet the requirements and the risks associated with the options, and whether these can be mitigated;

  c) Identify who is affected, particularly the developing countries on which there may be a disproportionate impact;

  d) Assess all available options to avoid unnecessary or needlessly burdensome trade and investment restrictions

  e) Consider the costs and benefits to consumers/individuals and to the economy at large, taking account of the economic, social and environmental effects;

  f) Summarise who or what sectors bear the costs and benefits of each option;

g) Consider any unintended consequences and indirect costs;

h) Set out how the policy will be announced and monitored; and

i) Conduct and summarise the results of consultations with external stakeholders.

Resources for further study

- The OECD Web page on integrated market access and the regulatory process surveys practices in applying six efficient regulation principles, including the avoidance of unnecessary trade restrictiveness.
- The WTO Web pages on Technical Barriers to Trade and the Sanitary and Phytosanitary Measures contain updated information on their respective committees and related documents.
- See also the references mentioned above under Question 3.4.

Export finance and risk mitigation

3.7 To what extent does trade policy support and attract investment through measures that address sectoral weaknesses in developing countries (e.g. export finance and import insurance)?

Rationale for the question

Markets that facilitate cross-border transactions, including those that hedge and transfer risks attached to exchange rate movements and payment defaults as well as those for transit insurance and export finance, can all enhance both trade and FDI. These sophisticated markets are often largely absent in many countries, and their development can take considerable time. In the interim, correcting for market failures in host countries may require help from home countries. For example, in the absence of a developed financial sector, and while being careful to avoid trade distortions and to ensure a level playing field, trade financing and insurance can often best be provided by home country firms to users in developing countries.

Trade financing and insurance can create the risk of "moral hazard" where insurance or other public guarantees distort the behaviour of economic agents, prompting them to take excessive risks on the basis that any direct losses or negative externalities will be socialised through public intervention. As a result, the provision of insurance and guarantees from developed country trade and investment partners might remove some of the urgency to enact policies conducive to a better investment climate in host developing countries. (Selected issues relating to the development of the financial sector are discussed in Chapter 9.)

Key considerations

One dimension of Question 3.7 relates to the access by financial institutions in developing countries to guarantees covering payments risk on trade transactions and the technical assistance that developing countries may require to help speed up the introduction and implementation of related measures and financial instruments.

In this connection, the International Finance Corporation (IFC) of the World Bank Group has set up the Global Trade Finance Programme (GTFP) to provide partial or full guarantees covering payments risk on banks in emerging markets for trade-related transactions. These guarantees are transaction-specific and involve a variety of underlying instruments: letters of credit, trade-related promissory notes, accepted drafts, bills of exchange, guarantees, bid and performance bonds and advance payment guarantees. Through the GTFP bank network, local financial institutions can establish working partnerships with the many major international banks participating in the programme, thus broadening access to finance and reducing cash collateral requirements. Trade finance training is also

offered, and the IFC may place experienced trade finance bankers with issuing banks to help them develop trade finance and other banking skills.

The WTO-UNCTAD International Trade Centre (ITC) has set up a technical assistance programme to strengthen schemes and mechanisms offered by both private and public financial institutions in the field of export finance, short-term trade credit and credit insurance and guarantees. The programme also aims to build up the capacity of entrepreneurs and credit officers in dealing with credit and financial risk management. It is targeted at three distinct levels where constraints and needs require a different set of activities: (*i*) public and private manufacturers and traders; (*ii*) financial institutions, export-import banks, export credit insurance and guarantee agencies; and (*iii*) the financing environment, including organisations that have a direct impact on the availability and cost of trade finance.

Many governments provide official export credits through dedicated Export Credit Agencies (ECAs) in support of national exporters competing for overseas sales. ECAs provide credits to foreign buyers either directly or via private financial institutions benefiting from their insurance or guarantee cover. Reflecting differences in financial resources, some countries might provide officially-supported export credits through their ECA on terms that competing ECAs, especially in developing countries, are unable to match, thus distorting trade. The OECD has developed disciplines in this area (the Export Credit Arrangement) and provides a forum for discussion and coordination of national export credit agencies. The main purpose of the Export Credit Arrangement is to provide a framework for the orderly use of officially supported export credits. In practice, this means providing a level playing field where exporters compete on the basis of the price and quality of their products rather than the financial terms provided and reducing subsidies and trade distortions related to officially-supported export credits.

Policy practices to scrutinise

The following measures should be considered:

- Establish consultations among government, financial institutions and traders on national practices in export finance and export and import insurance measures in order to identify potential training needs and legislative updates.

- Assess and adapt the guidelines to decision-makers and bankers on setting up credit insurance schemes and institutions contained in the ITC's *Export Credit Insurance and Guarantee Schemes: A practical guide for developing and transition economies*. The Guide analyses the needs and constraints related to export credit insurance, outlines the organisational structure of an export credit agency, the legal infrastructure required for its activities and the range of policies on offer.

- Consider taking up the training opportunities offered under the Global Trade Finance Programme by the IFC.
- Gradually build up national expertise on export credit matters, *e.g.* official financing support, maximum repayment terms, minimum risk premiums and trade-related aid for projects, and goods and services sold on credit terms of two years or more. Set up an information database on export credit matters for countries that are not parties to the OECD Export Credit Arrangement.
- Assess the main criteria of 'major player' and 'mutual benefit' that an applicant for observership status to the OECD Export Credit Arrangement must satisfy by taking into account the following indicative questions:
  - Does the applicant have in place a medium- and long-term export credit programme providing officially-supported export credits that may be covered by the disciplines of the Arrangement?
  - What is the experience and performance that the applicant has demonstrated in export credit matters, on the basis of the following quantitative and qualitative indicators: main characteristics of the export credit programme (objectives, technical features), annual flows of officially supported medium- and long-term export credits (minimum figure), and types of goods supported, in comparison with ECA participants?
  - Are the export credit programmes of the applicant in competition with those of Participants, in a specific sector or more generally?
  - To what extent is the applicant willing to exchange information with Participants on its officially supported export credits programmes?
  - For regular observers: to what extent is the applicant willing to apply the relevant disciplines and procedures of the Arrangement.
- Keep abreast of political risks, *e.g.* risk of political violence, FDI protectionism, geopolitical risk and government instability, with a view to building up domestic expertise in political risk assessment.

Resources for further study

- The IFC Web page on Global Financial Markets provides details about its Global Trade Finance Programme.
- The OECD Web page on export credits provides to access to the work of the Export Credit Group and other related work and documentation.
- The ITC Web page explains its technical assistance programmes designed to facilitate access to finance by SMEs exporting from developing and transition countries.