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30 January 2017

Online at <https://mpra.ub.uni-muenchen.de/82009/>
MPRA Paper No. 82009, posted 23 Oct 2017 09:16 UTC

**THE SIGNIFICANCE OF WTO'S TRADE RELATED INVESTMENT
MEASURES (TRIMs) AGREEMENT FOR INWARD FDI IN SUB-
SAHARAN AFRICA**

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The Significance of WTO's Trade Related Investment Measures (TRIMS) for Inward FDI in Sub-Saharan Africa

ABSTRACT

The significance of a crucial WTO accession agreement component, that is, Trade Related Investment Measures (TRIMs) agreement in increasing Sub-Saharan African developing country's appeal for investors from abroad is assessed over here. Conventional FDI location determinants like macroeconomic stability, market size, infrastructure, trade openness and economic development are also considered. Utilising yearly data for 38 Sub-Saharan developing nations over the time period from 1988 to 2015 in a panel form, the researcher found that removal of market distortions through TRIMs, sound macroeconomic management, infrastructure availability, liberalisation of investment and trade regime have plausible significant effects on FDI inflows. Contrary to the empirical FDI literature economic development is found to be insignificant and market size sensitive to the addition of explanatory variables, especially, WTO led TRIMs. Time invariant features such as language, geographical location and sea access cannot be evaluated as fixed effect panel estimation technique does not support them.

Keywords: FDI, WTO, TRIMs, Panel Data and Sub-Saharan Economies

JEL Classifications: C230, F130, F140, F150, F210, F230 and K330

INTRODUCTION

The increasing proportion of multinational's affiliates in international trade demand for probing the factors responsible for this consistently upward trend (Shah, 2011e). Recent empirical research indicates that increased liberalisation and elimination of market interventions positively affect FDI inflows (Sánchez-Martín, Escribano & De Arce, 2015). The role of World Trade Organisation (WTO) is given inadequate attention in the empirical FDI literature (Zhang & Yang, 2016) and so far researchers have not examined its impact on inward FDI in general and that of Trade Related Investment Measures (TRIMs) agreement in particular as advocated in this paper. Understanding the effect of TRIMs on overseas investment is vital both for national governments and firms in formulating suitable business, investment and trade liberalisation policies (Sane, 2015). A WTO member is required to reduce tariffs as well as eliminate any sort of market interventions effecting the operation of local and foreign investors (Beladi & Chakrabarti, 2008). This liberalisation of economic policies needs to be extended to every member state devoid of any preferences (Dreher, Mikosch & Voigt, 2015).

Foreign investors are offered incentives in most of the developing countries to attract FDI in the desired sectors, activities and locations (Shah, 2012c). These may include tax holidays, tax credits, import privileges, accelerated depreciation on plants and machinery, tax concessions and export subsidies (Shah & Khan, 2016). They at times limit and regulate the economic and business activities of multinationals in the country (Collins, 2016). These controls comprises of export bounds, indigenous employment, local

content requirements, restrictions on foreign equity ownership and limitations on transferring profits earned by the foreign affiliates to the source country (Brooks, Roland-Holst & Zhai, 2008).

The aim of trade related invested measures (TRIMs) is to remove, universalise, institutionalise and streamline this selective “rewards and punishment” approach that since ages has been a feature of the regulations outlining the operations of multinational firms in the host developing countries (Milner, 2014). If there is a dispute between two member countries, WTO has a state to state dispute settlement mechanism. It renders binding decisions on the violator (Shah, 2010). Unlike most of the other decision making in the organisation the decision of the dispute settlement panel does not require unanimity among members (Shah, 2011a).

The internationalisation of multinational production activities has shifted the competition for FDI from rent seeking to create a business friendly economic atmosphere, consistent with WTO objectives, for the commercial activities of the multinational enterprises (Paul, 2015). Thus in order to craft an investment promoting, free of market distortion environment in the host economy it seems logical to keep exploring the current and potential future factors that has some influence on FDI movements (Sutyryn, Efinova & Trofimenko, 2016). The present study by specifically probing the possible effect of TRIMs on overseas investment in a set of 38 Sub-Saharan African (SSA) economies for 28 years from 1988 to 2015 will enable us to understand, grasp and further our knowledge of the subject. The relative importance of other variables including market size, infrastructure, economic development, macro-economic stability and so on is also taken into account. The findings support the fact that TRIMs have a positive significant influence on inward investment.

The existing FDI literature will certainly get enriched from this paper because for the first time the role of this WTO component in influencing foreign investment inflows in SSA developing economies is examined. The next part discusses the relationship between inward FDI and TRIMs. In section three the empirical equation and econometric issues are examined. Part four presents and discusses the results. The paper concludes with section five.

LITERATURE REVIEW

The literature review comprises of two parts. The first one synthesise the conventional FDI location pull factors. The second thoroughly explore and discusses the trade related investment measures (TRIMs) agreement and foreign direct investment relationship.

Conventional FDI Determinants

In FDI literature the importance of market size (Shah, 2009; Blonigen & Piger, 2014), economic development (Loungani, Mody & Razin, 2002; Maskus, 2015; Shah, 2015), trade openness (Baltagi, Demetriades & Law, 2009; Shah, 2011c; Guesmi & Teulon, 2013), macroeconomic stability (Balasubramanyam, Sapsford & Griffiths, 2002; Blonigen, 2005; Xing & Wan, 2006; Shah, 2013b) and

infrastructure availability and quality (Morisset, 2000; Asiedu, 2004; Shah, 2011f; Robbins & Perkins, 2012; Shah, 2014b) are empirically established as significant location FDI pull factors. In order to gauge the significance of TRIMs for FDI inflows in SSA the researcher have to first control for these conventional FDI determinants in the results and analysis section.

Trade Related Investment Measures (TRIMs)

TRIMs are a collection of incentives and restrictive measures, designed usually but not exclusively by a developing country to influence FDI (Balasubramanyam, 1991). Recognising that these measures are inconsistent with article III of the General Agreement on Tariffs and Trade (GATT) which necessitate it for the members to extend national treatment and similarly, article XI prohibiting them to levy quantitative limitations TRIMs were included in WTO to prohibit such practices (Beladi & Chakrabarti, 2008). Explicitly identified as inconsistent with the two articles are measures related to balancing trade, substituting imports, domestic content procurement, export restrictions and foreign exchange requirements (Brooks, Fan & Sumulong, 2003).

The primary instrument under international law for controlling the use of performance requirements imposed on foreign investors is the WTO's Trade-Related Investment Measures Agreement (Collins, 2016). TRIMs agreement includes both new and existing investments and equally covers local and foreign firms (Shah, 2011b). It disallow local content requirements such as obligatory purchases or use of domestic products; trade balancing issues, that is, attaching the use or procurement of imported items to a sum proportional to the value or volume of exports of local products; foreign exchange balancing restrictions e-g binding use of foreign currencies to the overseas investor's earnings of foreign exchange (Kennedy, 2003). These restrictive measures limit a multinational's control over its affiliate operations and weaken its competitiveness in the host market (Shah & Qayyum, 2015). Ramirez (2006) attributes Chile's and Paul (2015) considers India's increased FDI inflows to their structural reform program, in consonance with their WTO membership, liberalising FDI laws regarding the repatriation of profits, local content and export requirements.

TRIMs agreement depends solely on country to country arbitration system and lacks any investor to state set-ups for ensuring the appraisal of investors' grievances. However, in case of a violation a dispute settlement panel is established between the two states which give a binding judgement.

WTO requires member states to notify all measures that do not conform to the TRIMs agreement within three months of accession. The developed members are given two years, developing five and least developed seven years to eliminate all distortions (Balasubramanyam, 2016). However, if a developing or least developed country is unable to implement TRIMs in the cut-off time, under article 5.3 they can apply for an extension and many have done so varying from 7 years by Pakistan to just less than a year by Chile (UNCTAD, 2012).

The researcher have utilised the number of trade agreements (TAs) signed by a developing country as a proxy for TRIMs from the WTO regional trade agreements information system database. Unlike the universality of the TRIMs agreement, TAs involves only two or a few partner economies nonetheless their focus and commitment to business liberalisation usually go beyond that of WTO especially in the context of tariff and service liberalisation (Bora, 2002). Although like TRIMs most trade agreements do not have any explicit provisions dealing with the management of FDI in host economies. Still, in principle these agreements whether bilateral or regional, are associated with the steady decrease of measures restricting the entry and operations of foreign firms and application of positive treatment standards with an outlook to discourage discrimination against them (Banga, 2016). Similarly, according to Dee and Gali (2007) and Medvedev (2012) the third wave of trade agreements signed from late 1980s, early 1990s onwards contain investment provisions which are useful for FDI due to a number of reasons for example investment protection, liberalisation, market access, investment promotion and cooperation. They also indirectly facilitate overseas investors by streamlining and removing impediments associated with excess bureaucracy and improving the overall business and investment environment (Shah & Samdani, 2015). In addition, the signatory regimes in order to provide a credible assurance to their partners of an open policy on trade and investment, on a minimum not only has to maintain but also strengthen liberal business friendly policies domestically to optimise the conceivable benefits of these international agreements for example in Mexico following NAFTA (Shah, 2011d). Trade agreements vary from one another but in sum they institutionalise and set standards for liberal economic policies (Dreher, Mikosch & Voigt, 2015). Thus they may be considered as a less comprehensive but more rigorous version of WTO.

The TRIMs agreement is important for FDI because it is instrumental in abolishing non-tariff barriers connected to foreign trade especially those related with overseas investment. It assures investors from abroad to freely export, import buy and sell goods for the optimal utilisation of their investment and repatriate profits. It also ensures the provision of level playing field for all investors irrespective of their nationality because most favoured nation treatment requires the local government to provide similar beneficial investment environment to investors from all the members. Similarly, national treatment mandates no discrimination between foreign and domestic investors. Therefore, the researcher postulates that impartial investment enhancing policies are by design better suited for attracting overseas investors and expects a positive relationship between TRIMs implementation and FDI inflows. The extent of the net impact however depends on the interaction of several variables including the effect of different existing TRIMs which coexist to varying degrees in each developing country (Shah, 2012a).

Hypothesis of the Study:

The following hypotheses are set to answer objective of this study:

Ho: FDI inflows to Sub-Saharan developing economies are not affected by TRIMs

H₁: FDI inflows to Sub-Saharan developing economies are affected by TRIMs

Table 1: Expected Effect of the Explanatory Variables on Inward FDI in SSA Countries

Variables	Expected effect
Market Size	Positive
Economic Development	Positive
Trade Openness	Positive
Exchange Rate	Positive
Infrastructure	Positive
TRIMs	Positive

ESTIMATION METHOD AND EMPIRICAL CONCERNS

The complexities associated with the theories governing overseas trade and investment flows make it quite cumbersome to theoretically derive an empirical model (Shah, 2013a). Nonetheless, based on the discussion in the previous section the researcher postulate equation one to gauge the effect of TRIMs implementation under WTO on inward Foreign Direct Investment (FDI) in Sub-Saharan African developing economies:

$$FDI_{it} = f \left(\begin{matrix} \text{Market Size, Economic Development, Openness,} \\ \text{Macroeconomic Stability, Infrastructure, TRIMS} \end{matrix} \right) \dots \dots \dots (1)$$

In equation one subscript *i* is used for representing a Sub-Saharan African nation varying from 1 to 38. *t* denotes the time period from 1988 to 2015 varying from 1 to 28, giving me a total of 1064 (28*38) observations per variable. *FDI_{it}* is used for the dependent variable representing the yearly stock of *FDI* in each of the host economy *i*.

Putting the proxies for the dependent as well as the independent variables and log linearizing equation one gives equation two:

$$\ln FDI_{it} = \alpha_0 + \beta_1 \ln GDP_{it} + \beta_2 \ln GFCF_{it} + \beta_3 \ln Trade_{it} + \beta_4 \ln Exchange Rate_{it} + \beta_5 \ln Tele Density_{it} + \beta_6 \ln (WTO Membership * Trade Agreements)_{it} + \epsilon_{it} \dots \dots \dots (2)$$

Here, *ln* represents natural log, which also reduces the likely heteroscedasticity (Resmini, 2000). Gross domestic product (*GDP*) is used for market size, gross fixed capital formation (*GFCF*) proxies' development level, aggregate trade measures the degree of openness of the economy, exchange rate is utilised for macroeconomic stability and infrastructure availability is captured through telephone density. The product of WTO membership and the trade agreements signed and enforce will proxy for TRIMs implementation. The data for TA's and WTO membership was taken from the WTO website, exchange rate from Penn World Table 7.0 whereas for all the other variables it was collected from World Bank, World Development Indicators. Summary statistics like minimum and maximum values, standard

deviation, mean as well as number of observations for each variable used in the empirical estimations are given in table two.

Table 2: Descriptive Statistics

Variables	Proxy	Obs.	Mean	Median	Std Dev	Min	Max
FDIStock	Ln FDI	1064	19.6886	19.6098	1.7401	13.3212	25.4275
Market Size	Ln GDP	1064	21.9571	21.9250	1.2531	18.8039	26.3713
Economic Development	Ln GFCF	1064	20.1577	20.1803	1.6680	14.9866	25.5626
Trade Openness	Ln Trade	1064	4.1112	4.0676	0.5411	1.9906	5.5363
Exchange Rate	Ln Xrate	1064	3.9896	4.6296	2.4538	0.0024	12.9921
Infrastructure	Ln Tele	1064	10.7945	10.7538	2.6218	0.0297	17.6621
TRIMs	WLneTa	1064	0.3937	0.6231	0.4733	0.0000	1.6094

Values are rounded off to four decimal places

Empirical Estimation Method

Having observation from 38 countries for 28 years a longitudinal panel seemed to be the appropriate way to arrange the data (Shah, 2012b). To choose between the random and fixed effect panel estimation technique the Hausman (1978) specification test was carried out which suggests the use of fixed effect model with the following results $\text{Chi}^2(6) = 36.38$, Probability $> \text{Chi}^2 = 0.0000$. The test fails to reject the existence of correlation between α_i and X_{it} that is the individual component and the explanatory variables (Nonnenberg & Mendonca, 2004).

Heteroscedasticity

Breusch - Pagan / Cook - Weisberg test for heteroscedasticity indicates its presence by out rightly rejecting the null hypothesis of homoscedastic standard errors or constant variance with these statistics $\text{Chi}^2(1) = 8.03$, Probability $> \text{Chi}^2 = 0.0046$ (Carr, Markusen & Maskus, 2001). This issue is tackled by applying the robust option with all the regressions and values that are robust to heteroscedasticity are reported throughout the study.

Multicollinearity

To measure the extent of collinearity between the independent variables the researcher have calculated the correlation between all the explanatory variables as well as used variance inflation factor $VIF = \left(\frac{1}{1 - R^2} \right)$ as an indicative statistic. It shows the effect of linear associations between the explanatory variables upon the variances of the estimators as measured by the coefficient of determination (Shah, 2012d). In other words the VIF's of the respective explanatory variables shows the increase in the variance of the model due to the fact that they are not orthogonal to one another (Shah & Faiz, 2015).

The estimations from VIF with a mean value of less than 5 show the absence of problematic multicollinearity between the explanatory variables. The same is evident from the correlation matrix given as Table three.

Table 3: Correlation Matrix

Serial No	Variable Name	1	2	3	4	5	6	7
1.	FDI Stock	1.00						
2.	Market Size	0.61	1.00					
3.	Economic Development	0.59	0.79	1.00				
4.	Trade Openness	0.25	-0.28	-0.06	1.00			
5.	Exchange Rate	-0.05	-0.13	-0.13	0.101	1.00		
6.	Infrastructure	0.45	0.46	0.47	0.134	0.09	1.00	
7.	TRIMs	0.38	0.22	0.21	-0.208	0.28	0.49	1.00

Values are rounded off to two decimal places

FINDINGS AND DISCUSSION

Using STATA 11 software for annual data from 38 Sub-Saharan African Developing Countries from 1988 to 2015 the following results were obtained through Fixed Effects Panel Estimation Technique. Model one i.e. the third column in table four shows the coefficient for market size variable (GDP) being positive and significant as expected. The result is in accordance with the theory as bigger markets offer economies of scale, supplementary opportunities of diversification and additional possibilities to make an optimal use of the imported technology (Shah, 2016). Gross fixed capital formation (GFCF)¹ used for economic development in model two, though positive, is insignificant contrary to the theoretical expectation. Normally the availability and growth of domestic entrepreneurship is directly associated with the degree of development and FDI in joint ventures need a certain level of existing local capacity as a pre-requisite (Shah, 2014a).

Table 4: Results: Fixed Effect Panel Regression Method

Variable	Proxy	1	2	3	4	5	6
Market Size	Ln GDP	1.1432*** (0.2476)	0.9601*** (0.3311)	1.0074*** (0.2922)	0.8647*** (0.2732)	0.2861 (0.3540)	0.2765 (0.3539)
Economic Development	Ln GFCF		0.1897 (0.1618)	0.0827 (0.1041)	0.0679 (0.0792)	0.0479 (0.0713)	0.0552 (0.0749)
Trade Openness	Ln Trade			1.4980*** (0.3150)	1.1029*** (0.2973)	0.8493*** (0.3110)	0.8187** (0.3110)
Exchange Rate	Ln Xrate				0.2938*** (0.1076)	0.1912** (0.0859)	0.1593* (0.0843)
Infrastructure	Ln Tele					0.2739*** (0.0858)	0.2008** (0.0877)
TRIMs	WLneTa						0.3502** (0.1689)
Number of Observations		1064	1064	1064	1064	1064	1064
Probability > F		0.0000	0.0000	0.0000	0.0000	0.0000	0.0000
Coefficient of Determination / R-Squared							38.36%

Values are rounded off to four decimal places. * signifies significance at 10%, ** at 5%, and *** at 1% significance level respectively. The coefficients for all the variables are reported with the respective standard errors robust to the detected heteroscedasticity in parenthesis.

1. According to WDI Gross fixed capital formation includes land improvements (fences, ditches, drains, and so on); plant, machinery, and equipment purchases; and the construction of roads, railways, and the like, including schools, offices, hospitals, private residential dwellings, and commercial and industrial buildings.

Aggregate trade that is the sum of the imports and exports of goods and services as a percentage of GDP proxy's the liberalisation of economy in model three. The array of positively significant coefficients for openness throughout table four reveals that multinationals prefer open economies.

Macroeconomic stability is gauged by direct exchange rate (1US\$ = units of host country's currency) in model four. The positive coefficient at 1% significance level shows that FDI in Sub-Saharan Africa is primarily export oriented as depreciation of the local currency makes their products relatively cheaper in the world market. However, if they would have importing raw materials from abroad the result would have been less profound due to the decrease in profits accruing as a result of devaluation of the host currency. The significantly positive coefficient for tele-density in model five, proxying infrastructure quality and availability supports the notion that multinationals consider it essential for their smooth functioning in terms of their affiliates production and trade activities.

In table four model six, the researcher include the number of trade agreements signed and enforced by a host developing country times World Trade Organisation membership ($ETA * WTO$), used as a proxy for TRIMs. It's significant and positive coefficient shows that an increase in the number of trade agreements signed by the host (better TRIMs implementation) causes additional inward FDI.

Also evident from the model is the decrease in the openness coefficient from 0.8493 to 0.8187 with the inclusion of the TRIMs proxy. This signifies that in addition to harmonising the treatment of foreign firms among the signatories it also has a role in providing preferential access, which was earlier manifested in the liberalisation variable. The preferential treatment under a trade agreement makes it easier for the multinational to import raw material or intermediate inputs and export manufactured goods back to the developed or other countries. In this aspect it can be even termed as a mini WTO in itself. The researcher have also checked for the number of trade agreements signed but not enforced to see whether enforcement has any additional effects. The significance level remains the same with a slightly reduced coefficient. Therefore, the researcher have presented the results only for enforced trade agreements as assuming that it will show the effect of the enforced TRIMs agreement in the host economies.

CONCLUSION

The objective of this paper is to gauge the possible effect of TRIMs implementation on FDI inflows in Sub-Saharan African Developing countries. Using fixed effect panel estimation technique for annual data from 1988 to 2015 it was found that presence of larger domestic market attracts multinationals (Shah & Afridi, 2015). However, it is sensitive to the addition of other explanatory variables. It may also be due to the fact that with the WTO steered decrease in tariffs and other trade restrictions the earlier importance of host market size has significantly reduced. Now multinationals are not solely dependent on the local market and can sell their products in the neighbouring countries due to trade liberalisation.

Infrastructure, trade liberalisation and exchange rate proves to be important locational pull factor for FDI. They seem to be significantly influencing overseas investors' investment decision because the presence of such prospects facilitates multinationals in these countries.

The results confirm that dismantling and reducing TRIMs related market distortions positively affects multinationals. This is because of the resultant liberalisation of the trade and investment environment adding to a country's prospects of hosting additional FDI.

Economic development though an important conventional FDI determinant is insignificant. This may be due to the relative backwardness of the economies under consideration. Still, this does not entail that it can be left out of a comprehensive mechanism implemented/envisioned for the purpose of increasing the attractiveness of a developing country for the overseas investors. Similarly, it need to be kept in mind that these results are relevant to the 38 Sub-Saharan African countries only and shall not be generalized universally to other countries. Moreover, future researcher can provide better insights with the availability of micro industrial or firm specific data.

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