

Review of Economics 1518-1: "What Determines Whether Preferential Liberalization of Barriers Against Foreign Investors in Services are Beneficial or Immiserizing: Application to the Case of Kenya"

General Comments

1. This paper addresses the important and under-researched question of the welfare effects of liberalizing foreign investment barriers in services sectors. It mobilizes a general equilibrium model applied to the case of Kenya. In my reading, the key result is that preferential investment liberalization in services is more likely to be welfare enhancing when it is in favor of a technologically advanced country or region. This finding has important policy implications in terms of the pattern of intra- and inter-regional integration in developing countries.
2. The paper is clearly written and apparently well executed, although Appendix F (referred to on page 8) was not supplied, so my assessment of the model relies on the verbal explanations provided in the paper (which references a variety of previous work by the authors). In so far as I can tell, the assumptions used are reasonable in terms of model structure. The sensitivity analysis for model parameters is carefully done, using set values as well as probability distributions and a large number of simulations. This last approach has the virtue of highlighting the fact that considerable uncertainty surrounds many aspects of the paper's analysis, but that the qualitative results are generally robust to a wide range of assumed parameter values.
3. I believe this paper is a useful addition to the existing literature on services trade liberalization, and deserves a wide readership both for its substantive results, and its methodological approach.

Specific Comments

1. Page 6ff: The estimation of restrictiveness is a key part of the paper, and I feel this sector could be expanded a little. It is reasonable to use the APC work as a starting point, but applicability to a country at Kenya's income level is questionable. Nonetheless, it might be the best that can be done at the present time. More fundamentally, the paper is about investment, but the APC approach captures a range of additional barriers to services trade, including in Modes 1 and 4 (in addition to Mode 3). Doesn't the paper need to isolate the Mode 3 effects in order to focus in later sections on investment effects of liberalization? Or is the argument that barriers in other modes still affect investment decisions? These points need to be clarified, and an argument made that the APC methodology is appropriate as a measure of restrictiveness of services investment policies, not just services trade policies in general. Also, the APC work is quite old now: how does it compare with the World Bank and OECD Services Trade Restrictiveness Indices? In particular, Kenya is included in the World Bank database, so why was it necessary to conduct a separate exercise for this paper? Why not just use the World Bank STRI directly, all the more so since it isolates Mode 3 restrictions?

2. Page 7: A crucial question for me is just how discriminatory Mode 3 liberalization in fact is. Are we dealing with policies that (for example) ease quantitative restrictions on services suppliers from partner countries only? Or allow them to compete for licenses when suppliers from other countries cannot? In the services trade liberalization literature, some argue that reforms of services policies—more broadly than investment—are typically less discriminatory than we might expect, even when undertaken in the context of a PTA. Could the authors give some examples of the sorts of preferential policies they are considering in their reform scenarios? Drawing from actual practice in EPAs would be an advantage for the EU scenario.
3. Page 14: The paper states that the trade data come from Comtrade. Where do the services trade (including investment) data come from? These data are notoriously piecemeal and unreliable, in particular for developing countries, so how were they constructed for Kenya? Also, why use MFN tariffs and then apply corrections rather than taking effectively applied tariffs (i.e., inclusive of preferences) directly from WITS?
4. Page 16: The focus on rent capture is appropriate and interesting. It would be good if the paper could say something—even briefly—about the policy and political economy implications of the two scenarios (rent capture and no rent capture). It seems to me also that there needs to be a balance between rent loss effects through liberalization in the capture case, and the “rectangle” gains that can come from reducing the cost of doing business for all firms—reforms that typically accompany investment reforms, and which in any case are included in the APC-style restrictiveness index used by the paper. Although welfare effects are typically positive even in the rent capture case, my feeling is that the paper’s estimates may be somewhat of a lower bound for this case.
5. Page 16: The contrast between the EU and Africa cases is important. We hear a lot about South-South integration, but this paper makes clear that when productivity gains are an issue, the likelihood of large gains is higher with South-North integration. The issue is then how to design agreements that maximize those gains. The authors could perhaps expand the section contrasting the outcomes between the EU and African cases, and discussing how far this result may be applicable to other contexts.
6. Page 17: The result that non-discriminatory liberalization results in much larger gains than either of the preferential scenarios deserves more airtime. Although PTAs are a fact of life, it is good to stress that they are at most a second best approach, and may indeed be of limited benefit relative to multilateral liberalization, as is the case here, particularly for the African scenario.
7. Page 17-18: The result that reforms to non-discriminatory policies give larger welfare gains than those to discriminatory policies is well known. It comes out of the APC work, for example, which refers to these gains as “rectangles” compared with Harberger-like triangles. Some situation of this result with reference to the broader previous literature would be helpful.
8. Page 21ff: The systematic sensitivity analysis is helpful and important, but I am not sure how informative it is when the basis for parameter selection is a uniform distribution. Is it possible to be more precise in terms of priors? Some of

the parameters have been econometrically estimated in other work, so couldn't the estimated standard errors and basic theory be used to construct a more informative prior?

9. Figures 1 and 2: I assume these will be inserted in the text, which explains them adequately. If they are to be left as standalones, a paragraph on each page explaining how to read the graphs would be useful.