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Benefits of services trade liberalisation in the Asia Pacific region

By Dr Sherry M. Stephenson, Member, PECC Services Network and Senior Fellow, International Centre for Trade and Sustainable Development (ICTSD)

Services as a new driver of economic growth

Services are at the top of the list of new sources of growth recently identified by APEC, together with digital trade and increasing the participation of women in the work force. As services have become pervasive throughout the entire economy, achieving more efficient services will unlock economic potential, not just in the tertiary sector but in all areas, including manufacturing and agriculture. Because services are a key contributor to innovation, they have been demonstrated to account as well for a major share of productivity growth in many advanced economies.[1]

Services have gone from being viewed largely as a non-tradable, neglected sector to a transformational force. They are now key to economic performance both at the national level and in international markets. Roughly 50 per cent of all services are now considered to be traded, thanks to advances in information and communications technology.

Services industries play a critical role in sustaining and growing other parts of the economy, including manufacturing, construction, agriculture and mining. Services are particularly dominant in downstream industries and act as essential links in integrated production networks, allowing for components of production to be dispersed around the world and brought together into final products in a cost-effective, timely manner. Due to these numerous inputs and linkages, services now represent fully half of world trade when measured on a value-added basis.[2]

More efficient services enhance the competitiveness of the whole economy due to the extensive role that they play as inputs into all other economic activities. Achieving a more efficient services sector results in better internal and external competitiveness, measured as a share of services in GDP and the share of services exports in GDP, respectively. Research has shown that services are the only sector of the economy where improvements to both internal and external competitiveness take place simultaneously.[3]

Benefits to be derived from services liberalisation

The potential income and efficiency benefits that can be derived from services liberalisation and reform are tremendous. A study by the Peterson Institute of International Economics estimated that a modest liberalisation of services - a 10 per cent reduction in the level of existing restrictions plus trade facilitation reforms - would result in income gains for developing countries of US$135 billion, or 1.3 percent of their GDP. Importantly, the potential GDP gains from services liberalisation and trade facilitation for developing countries are over six times larger than the gains from the proposed formula cuts in tariffs on goods and market access liberalisation for agriculture in the Doha context (US$135 billion compared with US$21.5 billion). This is likewise true for trade, where services liberalisation would result in export gains that are 3.7 times greater than liberalisation of tariffs on goods and agriculture (US$132 billion compared with US$35 billion).[4]

The Centre for International Economics in Australia has also estimated the benefits from services liberalisation on a global basis. They take a very ambitious liberalisation scenario that assumes the complete removal of all barriers to services trade in Modes 1 and 3 (cross border services trade and commercial presence, or foreign direct investment in services) in all countries and regions. Developing countries are the big winners in this liberalized scenario, experiencing a nearly 1 percent gain on average to real GDP over the long-term, while developed countries gain 0.2 percent on average. Putting this on an annual basis would allow developing countries to enjoy gains of A$238 billion per year in additional income.[5]

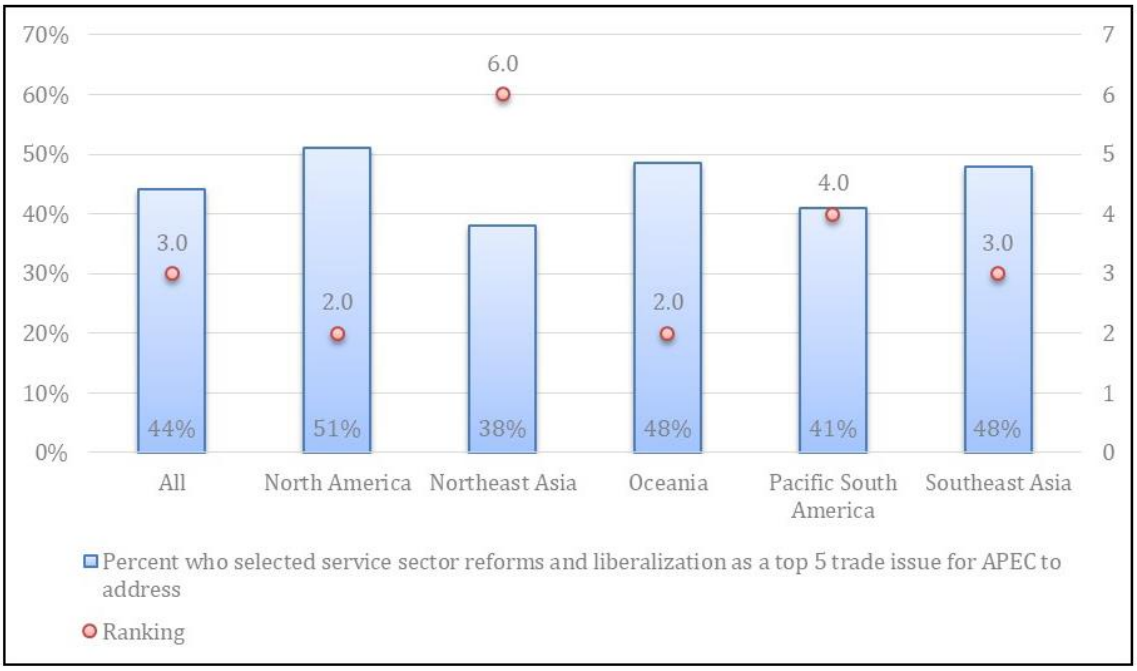
These potentially very important gains in GDP and trade will only come about through liberalising existing restrictions on services and undertaking accompanying structural or regulatory reforms. This is because restrictions on services trade are much higher on average than on trade in goods, which has led to higher costs for trade in services, estimated to be two or even three times as high (in ad valorem terms) as the trade costs of goods.[6] Many studies indicate that those countries with the highest initial barriers to trade in services stand to gain the most from liberalisation.[7]

Policies affecting services competitiveness encompass regulatory policies, trade barriers (that affect cross-border trade, investment and labor mobility in services) and domestic enabling factors that include human capital, infrastructure and the quality of institutions, among others. Services liberalisation and regulatory reform comprise two of these three areas and are thus vital in terms of outcomes.

Services are still highly restricted in the Asia Pacific

The importance of taking action and concrete steps towards greater services liberalisation in the Asia Pacific is underscored by the high levels of services restrictiveness that still exist across the region. While tariff and at-the-border barriers have been reduced significantly through unilateral steps of autonomous liberalisation and within preferential trade agreements, services trade barriers have remained more elusive to policy makers. These impediments to services trade are standing in the way of greater regional integration as they block the ability of services providers and consumers to export and import services. In fact, the restrictive impact of services regulations was highlighted by the PECC State of Trade in the Region Report for 2015 as the top impediment cited by respondents to their ability to trade in the Asia Pacific and as one of the top priorities for APEC to address.[8] Notably, the importance of services sector reforms and liberalisation was a view broadly shared across all APEC sub-regions, as highlighted in Figure 1, with 44 percent on average for all respondents.

Figure 1: Views on Services Liberalisation as a Top Trade Issue for APEC

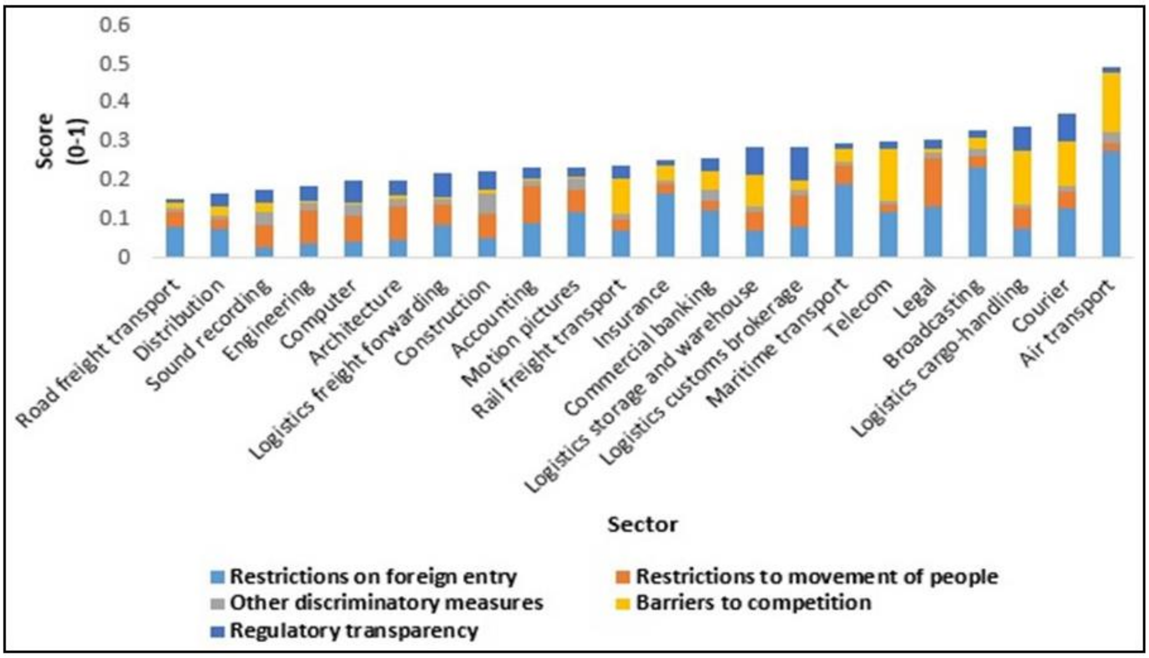


Measuring the extent of services restrictiveness has become easier with the availability of two databases published by The World Bank and the OECD detailing the restrictive impact of services regulations. While the country and sector coverage of these two Services Trade Restrictiveness Index (STRI) databases vary, both of them show results of concern.[9]

An indication of the average level of restrictiveness of services regulations in 11 APEC economies is shown in Figure 2 for the various sectors covered in the OECD STRI database (2015 data). The chart divides up the overall level of restrictions into five categories according to the way they affect services, namely:

- Restrictions on foreign entry;
- Restrictions to movement of people;
- Other discriminatory measures;
- Barriers to competition; and
- Regulatory transparency.

Figure 2: Average Level of Restrictiveness of Services Regulations in Asia-Pacific by Sector and Type of Restrictive Policy (based on OECD STRI)



The highest levels of restrictions shown on the right hand side of the chart for the Asia Pacific region are found in the sectors of transportation (air, maritime and rail), logistics (courier, cargo handling, customs brokerage and warehousing), broadcasting, telecoms and legal services. The type of regulations affecting these service sectors varies, although barriers to competition together with restrictions on foreign entry (investment) appear to be the most prevalent.

A complementary index has been developed by the OECD to assess the restrictiveness of policy on foreign direct investment, including for services. The information in this database shows that investment restrictions are higher on services than overall in nearly all the APEC economies shown, and in many cases by a very significant amount.[11]

Not all of the economies in the Asia Pacific are currently covered in these various databases that help policy makers and analysts to assess the restrictiveness of regulations affecting services and investment. APEC economies have agreed to take steps to increase the number of member economies with STRI and FDI restrictive indexes so that there will be baseline measures against which existing policies on services and investment can be evaluated and reviewed at present and in the future.

Services liberalisation and reform would provide tremendous benefits to Asia Pacific economies

There is no better way to unleash economic potential in Asia Pacific economies than to focus on improving the quality and performance of the service sector. Below summarises the multiple and far-reaching potential gains to be derived from regulatory and structural reform in services.

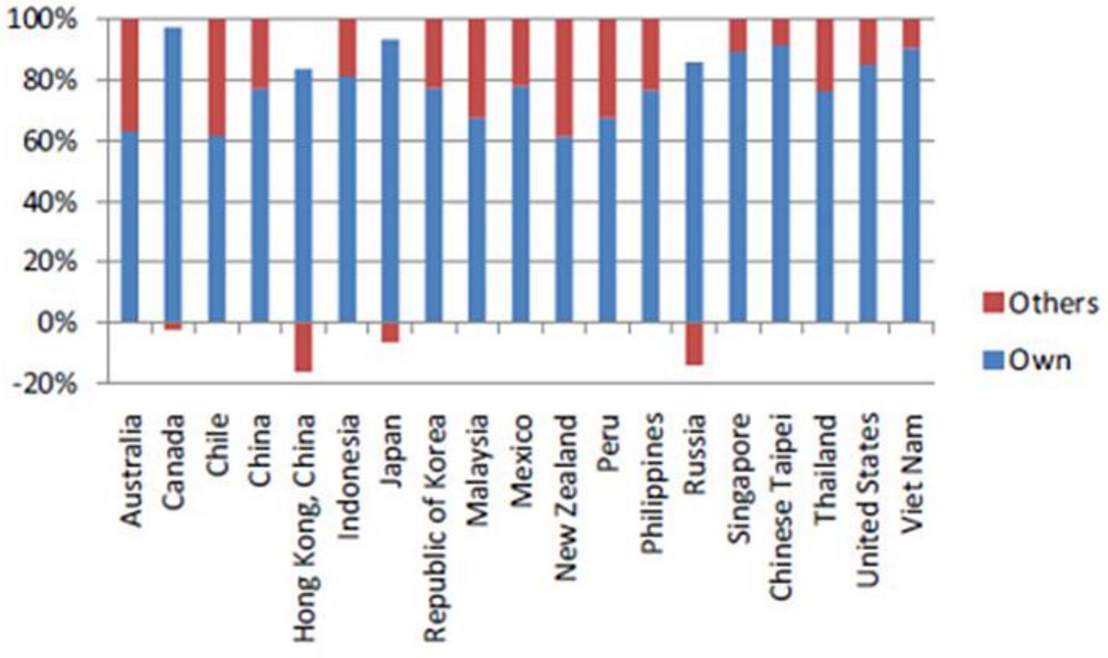
Benefits Deriving from Services Liberalisation

- **Export competitiveness.** Reducing trade costs deriving from services results in an increase in overall productivity as many sectors use services inputs intensively. Therefore, the reform will also enhance export competitiveness.
- **Private sector development and foreign direct investment.** Lower trade costs and entry barriers in services attract foreign direct investors, thus creating jobs and providing local producers and consumers with more and better products. This is particularly true for services, which account for over 60 per cent of global FDI stock, according to the UN World Investment Report 2016.
- **Market integration.** As trade costs fall, it is easier for economies to integrate regionally. If services reform is undertaken through regional trade agreements and reform of services regulations is founded on reasonable and objective criteria, the result will be not only positive for those in the region but also for those outside. In this case, such reform will not imply any welfare lose or artificial trade diversion.
- **Economic growth and employment.** Services liberalization has the potential to boost economic productivity and employment due to the significant contribution that the sector enjoys in GDP and employment and taking into account the fact that services is the most dynamic sector in the world economy
- **Other positive spillover effects.** Improvements in services can contribute to help attain overall development objectives, including many of the sustainable development goals (SDGs), in particular SDG 1 to end poverty, SDG 3 on good health and well-being, SDG 4 on quality education, SDG 6 on clean water and sanitation, SDG 7 on affordable and clean energy, SDG 8 on decent work and economic growth, SDG 10 on reduced inequalities within and between countries, among others.

Source: Adapted from WEF, *The Global Enabling Trade Report 2014*, Geneva: WEF, 2014.

The relevance of the services sector in the Asia Pacific in terms of its contribution to GDP, employment, trade and inclusive growth is already significant. However, there remains a huge potential to be untapped through services liberation and reform. It is important to underscore that the vast majority of the potential gains to be derived from structural reform in services will be realized from unilateral action. Figure 3 breaks down total gains into two parts: those deriving from domestic reform and those deriving from others' reforms. For all APEC economies, more than 60 percent of the gains derive from their own reforms.

Figure 3: Largest Welfare Gains from Structural Reform in Services for APEC Economies comes from Unilateral Action (percentage of total)



Thus, it is clear that the primary urgency for action on structural reform lies with national governments, although APEC action can certainly help to provide emphasis to unilateral policy decisions. However, to generate benefits, there is actually no incentive for governments to wait for others to make the first move. Correlations are shown for APEC economies between expected gains and the extent of services reform undertaken.[12]

Future challenges

Due to the highly restrictive content of regulations combined with the lack of policy focus on services that was the case for many years, services still do not provide the potential they could and should for economies in the Asia Pacific to enhance their growth and improve their competitiveness.

To advance on this path it will be critical for APEC to progress the targets contained in the Services Competitiveness Roadmap adopted in 2015 in order to move closer toward the Bogor Goals of free and open trade in services and investment by 2020 and beyond. Many future challenges remain for the Asia Pacific in the area of services liberalisation and structural reform that need to be met through well-targeted work in this context. Given the potential benefits that services can generate in terms of employment, enhanced productivity and innovation, generating more efficient outcomes in all sectors of the economy, and achieving more inclusive growth patterns, services should and must remain a high priority focus of the Asia Pacific region.

1 Adapted from chapter 2 of the *PECC State of the Region 2016-2017*
2 Uppenberg, K. & Strauss, H., Innovation and Productivity Growth in the EU Services Sector, Luxemburg: European Investment Bank, 2010, pp. 12-13.
3 WTO-OECD Trade in Value Added Database
4 Sebastian Sáez et al., *Valuing Services in Trade: A Toolkit for Competitiveness Diagnostics*.
Washington, DC: The World Bank, 2014, page 20.
5 Gary C. Hufbauer and Jeffrey Schott, Figuring out the Doha Round, Washington DC: Peterson Institute for International Economics, 2010.
6 Centre for International Economics, *Quantifying the benefits of services trade liberalization*, prepared for the Department of Foreign Affairs and Trade, 2010, Canberra
7 Sebastian Miroudot, Jehan Sauvage, and Ben Shepherd, Measuring the Cost of Trade in Services, 2010
8 Martin Molinuevo and Sebastian Saez, *Regulatory Assessment Toolkit : A Practical Methodology for Assessing Regulation on Trade and Investment in Services*,
Washington DC: The World Bank, 2014.
9 See PECC 2015 Report on the State of the Region
10 In terms of the methodology, the OECD STRI database information was compiled through the collection of regulations in force, which were then verified by the government individual economy in question. Only after this verification process was the information publicly released. The World Bank STRI database was compiled by collecting information on policies in place based on extensive consultations with government officials and private sector representatives. The OECD STRI database is broader in terms of sectoral coverage, while the World Bank STRI database is broader in terms of country coverage. The intention of the OECD is to periodically update the information in its STRI database and to broaden coverage as well.
11 The FDI restrictions in the OECD database are assessed in four areas on the basis of policies in place, namely: foreign equity limitations; discriminatory screening or approval mechanisms; restrictions on the employment of foreign personnel; and other. The information is drawn from Investment Codes and Investment Agreements.
12 The APEC economy that would have to undergo the most extensive reform in services but that would also derive the largest benefit would be Vietnam, with welfare and real GDP gains of around 5 percent.

Thailand and Malaysia would also realise significant gains of around 3 percent of GDP after undertaking structural reforms in services, with several economies showing potential gains of around 2 percent of GDP (China, Hong Kong China, Indonesia, Philippines and Chinese Taipei). See study by Philippa Dee, Priorities and Pathways in Services Reform, Part I: Quantitative Studies, Singapore: World Scientific Publishing Company, 2013.