Services Trade Policy in ASEAN Countries: Where Does it Stand and Why Does it Matter?

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What do international negotiations offer?

• Deeper liberalization at home and abroad through reciprocity-based market access negotiations

• Enhanced credibility of
  – current trade regime
  – commitment to future reforms

• Regulatory cooperation

Key policy question - where are these gains best realized: in a regional or multilateral context?
Four broad questions

• Where does services trade policy stand in the ASEAN countries, and how has it changed since the Blueprint was agreed?
• Why does services reform matter?
• In principle, is a regional approach to services reform feasible and desirable?
• In practice, is ASEAN integrating faster internally than with rest of the world – in terms of legal commitments and actual policy?
Services Database covers 103 countries (of which 79 are developing)

Source: Borchert, Gootiiz and Mattoo (2013)
The ASEAN Countries are not on average more open than the rest of the world

ASEAN regional STRI (2008 and 2012) compared with the STRI of other regions (2008)

Note: Regional STRIs are based on 2008 data; W is 2008 average STRI of 104 countries
Singapore and Cambodia are the exceptions in terms of openness.

Distribution of the country-level restrictiveness scores (STRI), 2008-2012

Note: 2009 GDP per capita, PPP (constant 2005 internat US$)
Transport and professional services are relatively restricted in ASEAN (as in the rest of the world)

STRI by sector, ASEAN region compared with other regions

Note 1: Comparing regional STRIs based on 2008 data; ASEAN region has 6 countries
Note 2: EAP is excluded, as it has only CHN and MGL
Heterogeneity of restrictiveness in ASEAN: Across countries and sectors

STRIs by industry for ASEAN member countries, 2012

Note: Sectors are comparable with 2008 sectors

ASEAN Member States: Industry STRI, 2012
ASEAN countries have not become much more open since 2008

<table>
<thead>
<tr>
<th>Country</th>
<th>STRI 2008</th>
<th>STRI 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>IDN</td>
<td>46.9</td>
<td>54.4</td>
</tr>
<tr>
<td>PHL</td>
<td>51.9</td>
<td>50.7</td>
</tr>
<tr>
<td>THA</td>
<td>48.4</td>
<td>46.8</td>
</tr>
<tr>
<td>LAO</td>
<td>45.7</td>
<td>46.2</td>
</tr>
<tr>
<td>MYS</td>
<td>42.7</td>
<td>46.2</td>
</tr>
<tr>
<td>VNM</td>
<td>37.5</td>
<td>40.7</td>
</tr>
<tr>
<td>MMR</td>
<td>27.9</td>
<td>37.5</td>
</tr>
<tr>
<td>KHM</td>
<td>21.6</td>
<td>37.5</td>
</tr>
<tr>
<td>SGP</td>
<td>9.0</td>
<td>21.6</td>
</tr>
</tbody>
</table>

Note: LAO, SGP, MMR not covered in 2008
Licenses are almost always required and almost never automatic

**Transparency, accountability and predictability**

Criteria are usually public, reasons for denial are often provided, but fulfilment of publicly stated criteria does not automatically lead to a license being issued

Source: World Bank Services Trade Restrictions Database
Four broad questions

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• In practice, is ASEAN integrating faster internally than with rest of the world – in terms of legal commitments and actual policy?
Services reform as industrial policy

Services reform boosts not only productivity and exports in services, but also the performance of downstream manufacturing industries.

Study based on panel data for 4,000 Indian firms for the 1990-2005 period finds that banking, telecommunications and transport reforms all have significant positive effects on the productivity of manufacturing firms.

Similar studies on the Czech Republic, Chile and African countries present robust empirical evidence.

Source: Arnold, Javorcik, Lipscomb and Mattoo (2010).
**Services reform as trade facilitation**

More restrictive transport policies are associated with more expensive and poorer quality logistics services

Availability of competitively priced logistics services

![Partial regression graph](image1)

Quality of logistics services

![Partial regression graph](image2)

Source: Borchert, Gootiiz, Grover and Mattoo (2010)
Services reform as investment promotion

More open countries attracted more foreign investment for 2003-2009

Foreign direct investment (M&A) received in 2003-09; predicted values at group-specific means of covariates. Pooled Poisson estimation (93 countries, 8 sectors) with country and sector fixed effects.
But services cannot be mechanically liberalized

Successful reform involves introducing, in proper sequence:

- Domestic and foreign competition
- Effective and appropriate domestic regulation
- Policies to improve access to services
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• In practice, is ASEAN integrating faster internally than with rest of the world – in terms of legal commitments and actual policy?
Four broad questions

• Where does services trade policy stand in the ASEAN countries, and how is it evolving?
• Why does services reform matter?
• What role is there for regionalism in services?
• Is ASEAN integrating faster internally than with rest of the world – in terms of legal commitments and actual policy?
An important motivation: PTAs could achieve speedier liberalization.
Preferential liberalization is feasible in services

- Bilateral air service agreements: preferential allocation of traffic and passenger quotas
- Preferential relaxation of foreign equity limitations (e.g., Malaysia)
- Preferential allocation of entry licenses
- Preferential recognition of foreign qualifications (e.g., intra-ASEAN MRAs)
Assessing the welfare economics of trade preferences in services

• **Lesson from goods trade:**
  – **Trade creation:** consumers gain from lower prices
  – **Trade diversion:** consumers lose if efficient third country suppliers are supplanted as a result of the preference + loss of fiscal revenue and possible loss of quota rents

• **Preferential liberalization in services is more likely to lead to welfare gains:**
  – **Little or no (static) cost of trade diversion**, as measures typically do not generate fiscal receipts for the importing country government
    • E.g. excessive formalities, local content and ownership restrictions, unnecessary re-qualification, licensing and local establishment requirements
  – **Dynamic gains from liberalization are likely to be significant** given the intermediary (input) nature of key service industries and the fact that FDI (commercial presence) is the main mode of supplying services
But purely on efficiency grounds, MFN liberalization is preferable

- It guarantees access to the most competitive (x-efficient) service providers
- Other efficiency gains from MFN-based trade include economies of scale, more intense competition, greater factor movement-induced knowledge spillovers (K and L), all of which are likely to be bigger if liberalization is conducted along non-discriminatory lines
- It reduces negotiating complexity via economies of scale and scope in trade diplomacy (a “one stop shop” approach is of benefit to negotiators, regulators and service suppliers)
- Due to the importance of location-specific sunk costs in certain service industries, second-best providers may benefit from durable first mover advantages and exploit first mover rents, reducing consumer welfare
Why then negotiate regionally?

• For reasons of greater bargaining efficiency
  – Negotiations may be less complex with fewer players around the table
  – PTAs constrain the scope for free riding that is inherent to MFN-based market opening

• Because geography often shapes key trade patterns and offers greater scope for pursuing a trade facilitation agenda

• Because many forms of regulatory cooperation and infrastructure coordination are more feasible and desirable within a smaller group of countries (e.g. mutual recognition, harmonization; shared communication or transport infrastructure).

• Because of learning-by-doing externalities (gradualism/infant industry rationale to focus first on neighborhood arrangements before exposing local suppliers to the full force of MFN-induced competition; PTAs also offer prospects for upgrading negotiating skills)
Rules of origin: Economic Efficiency vs Bargaining Efficiency

Rules of origin determine the degree of trade preferences negotiated in FTAs.

- **Economic implications**
  - Liberal rules of origin reduce discrimination, raise economic efficiency.

- **Bargaining implications**
  - Liberal rule of origins can create “free-rider” problems.
Four broad questions

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Applied policy is generally more liberal than AFAS commitments but a long way from Blueprint goals (except in Singapore and Cambodia).

AFAS commitments, applied policy and Blueprint goals for each country.
Gaps between AFAS commitments and policy are particularly large in financial and education services.

AFAS commitments, applied policy and Blueprint goals by sector.
ASEAN countries’ GATS commitments and Doha offers are far more restrictive than their AFAS commitments

GATS commitments, Doha offers, AFAS commitments, applied policy and Blueprint goals by country

<table>
<thead>
<tr>
<th>Country</th>
<th>Restrictiveness of GATS Commitment</th>
<th>Restrictiveness of Doha Offers</th>
<th>Restrictiveness of AFAS commitment</th>
<th>Restrictiveness of applied policy</th>
<th>Restrictiveness of Blueprint goals</th>
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<tr>
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<td>100.0</td>
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</tbody>
</table>
The gap between multilateral commitments/offers and regional commitments/goals prevails across sectors

GATS commitments, Doha offers, AFAS commitments, applied policies and Blueprint goals by sector

<table>
<thead>
<tr>
<th>STRI by sector</th>
<th>Restrictiveness of GATS Commitment</th>
<th>Restrictiveness of Doha Offers</th>
<th>Restrictiveness of AFAS commitment</th>
<th>Restrictiveness of applied policy</th>
<th>Restrictiveness of Blueprint goals</th>
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<td>33.3</td>
<td>25.0</td>
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<td>57.3</td>
<td>22.8</td>
<td>10.0</td>
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<tr>
<td>Medical</td>
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<td>60.3</td>
<td>31.8</td>
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<tr>
<td>Professional</td>
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<td>67.7</td>
<td>51.2</td>
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<td>10.0</td>
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<td>Auditing</td>
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<td>44.0</td>
<td>37.0</td>
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<td>33.0</td>
<td>10.0</td>
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<tr>
<td>Engineering</td>
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<td>57.0</td>
<td>32.5</td>
<td>28.0</td>
<td>10.0</td>
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<tr>
<td>Architecture</td>
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<td>30.0</td>
<td>10.0</td>
</tr>
<tr>
<td>Management consulting</td>
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<td>57.0</td>
<td>27.0</td>
<td>18.0</td>
<td>10.0</td>
</tr>
</tbody>
</table>
In fact, both GATS and AFAS have lagged behind applied policies.
ASEAN has initiated mutual recognition agreements in professional services

### Work Experience requirement for Architectural Services via Mode 4

<table>
<thead>
<tr>
<th>Member States</th>
<th>MFN regime</th>
<th>ASEAN regime</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cambodia</td>
<td>Missing</td>
<td></td>
</tr>
<tr>
<td>Thailand</td>
<td>N/A: Closed.</td>
<td></td>
</tr>
<tr>
<td>Vietnam</td>
<td>Work experience not required</td>
<td></td>
</tr>
<tr>
<td>Indonesia</td>
<td>Work experience not required (No sector specific regulation is in place)</td>
<td>10 years of experience required, of which 5 years shall be after licensure and 2 years of which shall be in responsible charge of significant architectural work (ASEAN MRA on Architectural Services, Provision 3.1.3, page 6).</td>
</tr>
<tr>
<td>Philippines</td>
<td>2 years required</td>
<td></td>
</tr>
<tr>
<td>Myanmar</td>
<td>Work experience not required (No sector specific regulation is in place)</td>
<td></td>
</tr>
<tr>
<td>Lao PDR</td>
<td>Work experience not required</td>
<td></td>
</tr>
<tr>
<td>Malaysia</td>
<td>5 years of experience required</td>
<td></td>
</tr>
<tr>
<td>Singapore</td>
<td>2-10 years of experience required</td>
<td></td>
</tr>
</tbody>
</table>

Source: MFN regime source is the 2012 surveys and for ASEAN the Mutual Recognition Agreement on Architectural services)

- But the ASEAN regime may not yet be more liberal than the MFN regime
- Malaysia and Singapore have more far reaching MRAs with the UK and other Commonwealth countries
ASEAN countries have negotiated more liberal conditions for air transport relating to the first five freedoms of the air and community ownership (Tan 2013).

Ratification Status of 2010 Multilateral Agreement for Full Liberalization of Passenger Air Services (MAFLPAS)

<table>
<thead>
<tr>
<th>Country</th>
<th>MAFLPAS (Parent Agreement)</th>
<th>Protocol 1: third &amp; fourth freedom between all cities</th>
<th>Protocol 2: fifth freedom between all cities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brunei</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Cambodia</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Indonesia</td>
<td>[X]</td>
<td>[X]</td>
<td>[X]</td>
</tr>
<tr>
<td>Lao PDR</td>
<td>[X]</td>
<td>[X]</td>
<td>[X]</td>
</tr>
<tr>
<td>Malaysia</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Myanmar</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Philippines</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Singapore</td>
<td>✓</td>
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</tr>
<tr>
<td>Thailand</td>
<td>✓</td>
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<td>✓</td>
</tr>
<tr>
<td>Vietnam</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>

Source: Tan (2013)

But these agreements do not cover the seventh, eighth and ninth freedoms and ownership rights are not automatic.
Several ASEAN countries have liberal agreements with the US, Japan and Australia.
Services and innovation: Chilean services firms spend nearly as much on innovation as manufacturing firms

Expenditure on innovation by sector, (Average 2005-2006, using weights)

Source: Iacovone, Mattoo and Zahler (2013)
Enaex has become a global pioneer in providing rock blasting services to mining companies.

- Milodon is the world's largest truck for mixing and loading of explosives.
- Inteliblast software processes input data and determines the type of rock fragmentation strategy.
- GPS device mounted on the arm allows location of the perforation and development of customized designs of the blasting processes based on field data.

Source: Iacovone, Mattoo and Zahler (2013)
The port terminal in the region of Arica and Parinacota has innovated along multiple dimensions to increase productivity:

- Improvement of the port’s layout,
- More efficient slot allocation for management of trucks at the port,
- Automation of electronic records of the port loads entered, and
- New system to efficiently trace loads.

Source: Iacovone, Mattoo and Zahler (2013)
Cencosud has innovated in retail, creating a new client interface to enhance customers’ shopping experience

For example, in the electronics section, no more in-store brand promoters but:

• An initial adviser who advises clients on the best product suited for their needs
• An expert who is available to answer technical questions and
• Comprehensive training in-store to costumers on product use

Source: Iacovone, Mattoo and Zahler (2013)
Mutually reinforcing relationship between trade and innovation: Exporters spend much more on innovation than non-exporters

Propensity to spend on innovation of exporters and non-exporters

Trade and innovation in services are increasingly seen as a way of breaking out of the middle income trap: But are current IP and innovation assistance regimes biased against services?

Source: Iacovone, Mattoo and Zahler (2013)
Rules of origin (denial of benefits)

- From an economic perspective a liberal rule of origin is to be preferred, but then regional liberalization can be argued to approximate MFN liberalization
- Possible approaches (for commercial presence):
  - Substantial business operations (most liberal stance)
  - Local incorporation
  - Domestic ownership and control
Example 1: Mexico’s NAFTA commitment in financial services

FDI in millions of US$

- Orange line: US
- Blue line: Spain
- Green line: Holland
- Purple line: Canada

Includes investments of U.S. based European banks
Four broad questions

• Are ASEAN countries more open than other countries?
• Have ASEAN countries become more open since 2008, (when the previous survey was conducted and soon after they agreed on the far reaching ASEAN Economic Community Blueprint)?
• Is ASEAN integrating faster internally than with rest of the world?
• How far have the ASEAN countries implemented their commitments under the ASEAN Framework Agreement on Services (AFAS) and how are they from meeting the services goals set out in the Blueprint?
Assessment

• Are ASEAN countries more open than other countries?
  – In general, no. On average, more open than other Asian countries but less open than the rest of the world.

• Have ASEAN countries become more open since 2008?
  – Yes, but only to a limited extent.

• Is ASEAN integrating faster internally than with rest of the world?
  – In most sectors, no. But some steps towards mutual recognition agreements in professional services and liberalization of air transport. Possible implication: regionalism has incremental value when it focuses on areas which are not being addressed multilaterally.

• How far have the ASEAN countries implemented their commitments under the ASEAN Framework Agreement on Services (AFAS) and how far are they from meeting the services goals set out in the Blueprint?
  – Actual policy tends to be more liberal than AFAS commitments, but is still some distance from the Blueprint goals.
Doha offers improve slightly on Uruguay Round commitments but do not capture existing openness – except in Cambodia and Vietnam

GATS commitments (UR), Doha offers, applied policy by country
The gap between commitments/offers and applied policies prevails across sectors

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