Indonesian Services Dialogue

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Jakarta, Indonesia

February 25th, 2013

FOUR KEY POINTS

I. SERVICES ARE IMPORTANT FOR INDONESIA

II. SERVICES NEARLY HALF OF WORLD TRADE TODAY

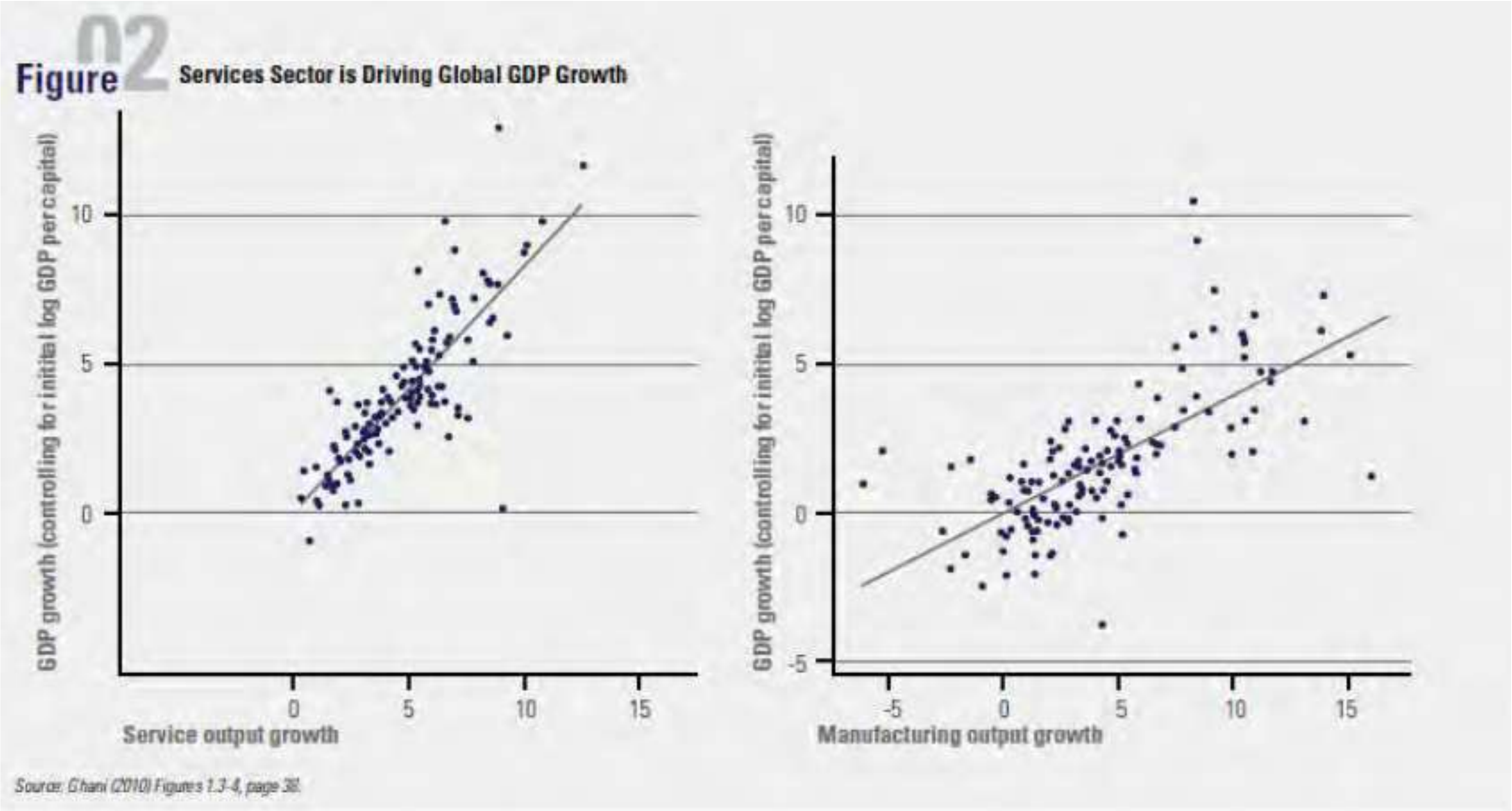
III. SERVICES OFFSHORING PLAYS KEY ROLE IN GLOBAL VALUE CHAINS

IV. SEVERAL ONGOING EFFORTS FOR SERVICES REFORM / LIBERALIZATION
ASEAN; RCEP; INTERNATIONAL SERVICES AGREEMENT

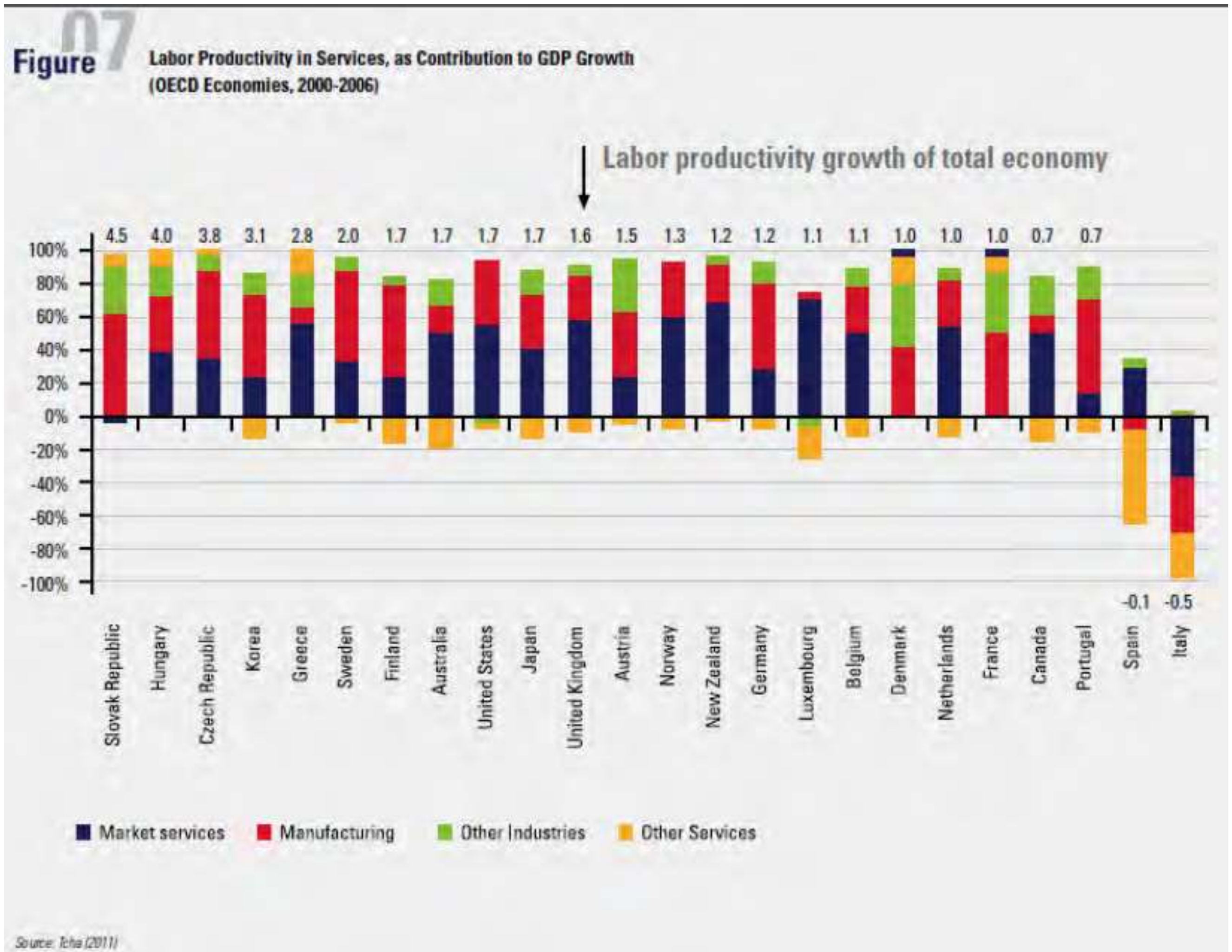
The Critical Role of Services

- Services Sector is the most rapidly growing segment of the World Economy
- Services Sector now represents:
  - 66% of World Production
  - 66% of World Employment
  - 46% of World Trade (with new Value-added Data Base)
  - 60% of Foreign Direct Investment

1. SERVICES DRIVING ECONOMIC GROWTH

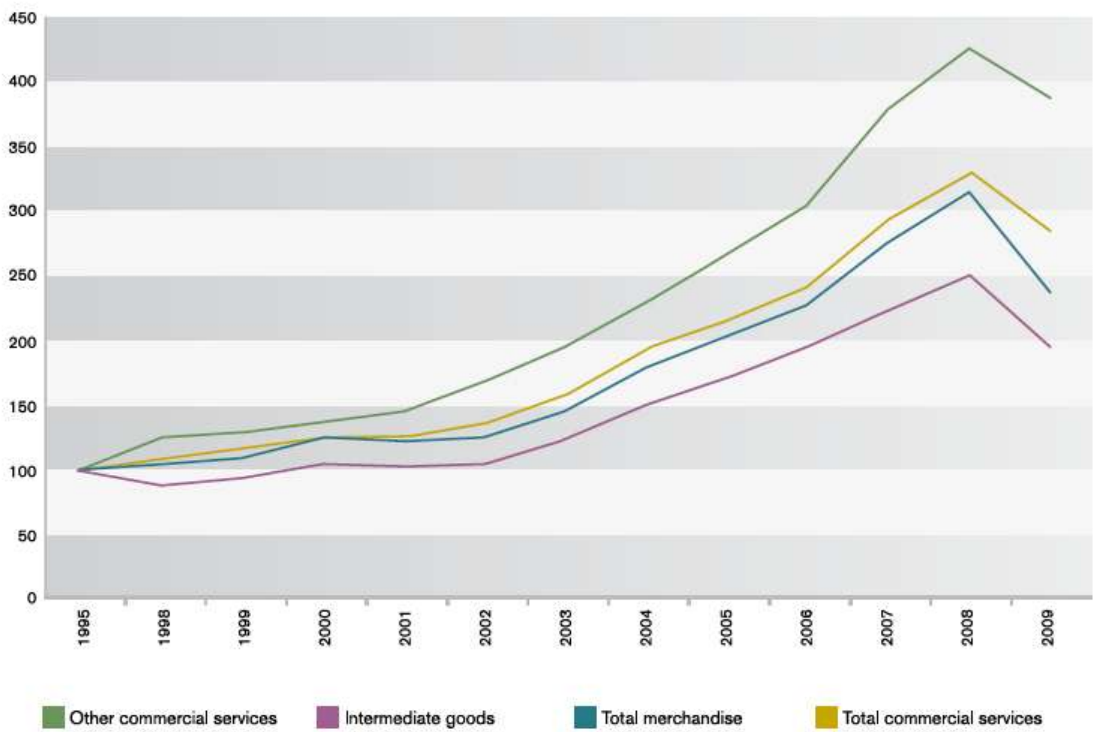


Market Services Contribute to Labor Productivity



Commercial Services are Fastest Growing Component of World Trade

Trends in world trade in merchandise and commercial services, 1995-2009 (Index, 1995=100)

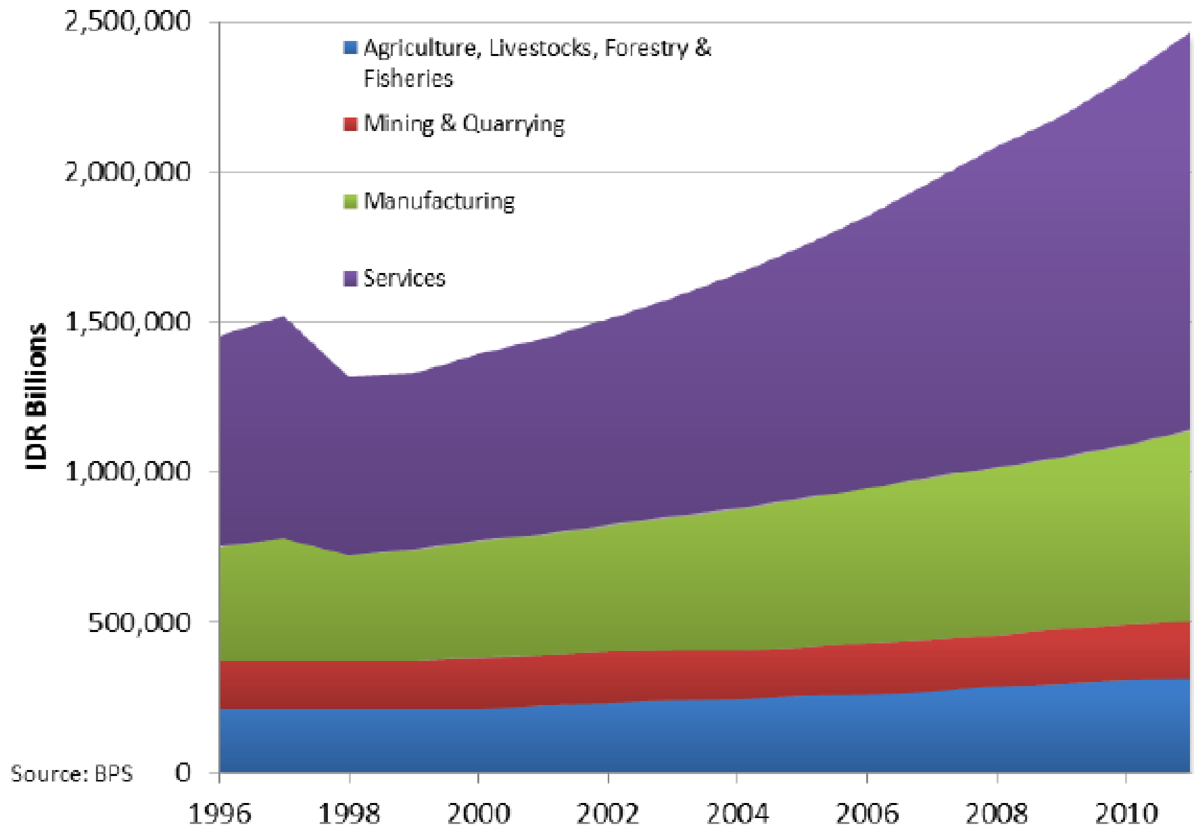


Sources: UN Comtrade Database and WTO estimates

- Other Commercial Services (i.e. business support services) are the fastest growing component of world trade – much faster than Goods

Indonesia: SERVICES MOST IMPORTANT SECTOR

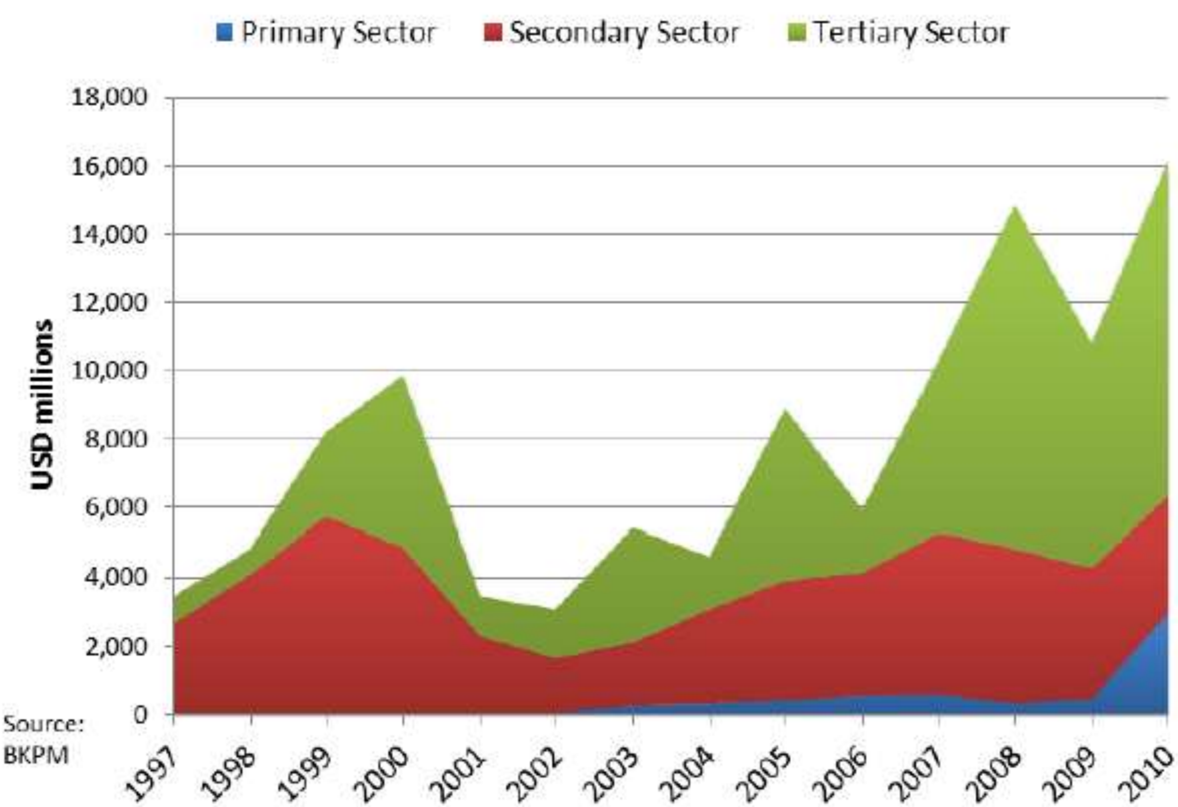
Figure 1: Indonesian GDP at constant 2000 prices.



Source: Duggan, Rahardja, Varela. “Service Sector Reform and Manufacturing Productivity. Evidence from Indonesia” (WB, 2013)

Indonesia: MOST FDI NOW IN SERVICES

Figure 6: Inward FDI by sector.



Source: BKPM

Source: Duggan, Rahardja, Varela. “Service Sector Reform and Manufacturing Productivity. Evidence from Indonesia” (WB, 2013)

2. SERVICES ARE NEARLY HALF OF WORLD TRADE

NEW OECD-WTO DATA BASE ON TRADE IN VALUE ADDED

- **SERVICES represent not 20% of world trade, as formerly reported, but 46% of total trade → measured by value-added**
- **Why? Because services are used as inputs into manufacturing and agricultural products**
    - Note: This is only cross-border trade (modes 1 and 2), not the trade that comes from FDI (sales by foreign affiliates of firms abroad- mode 3)

Source: Joint OECD-WTO Trade in Value-Added Initiative with data on trade in value-added for 58 economies (95% world output) *http://www.oecd.org/industry/industryandglobalisation/measuringtradeinvalue-addedanoecd-wtojointinitiative.htm*

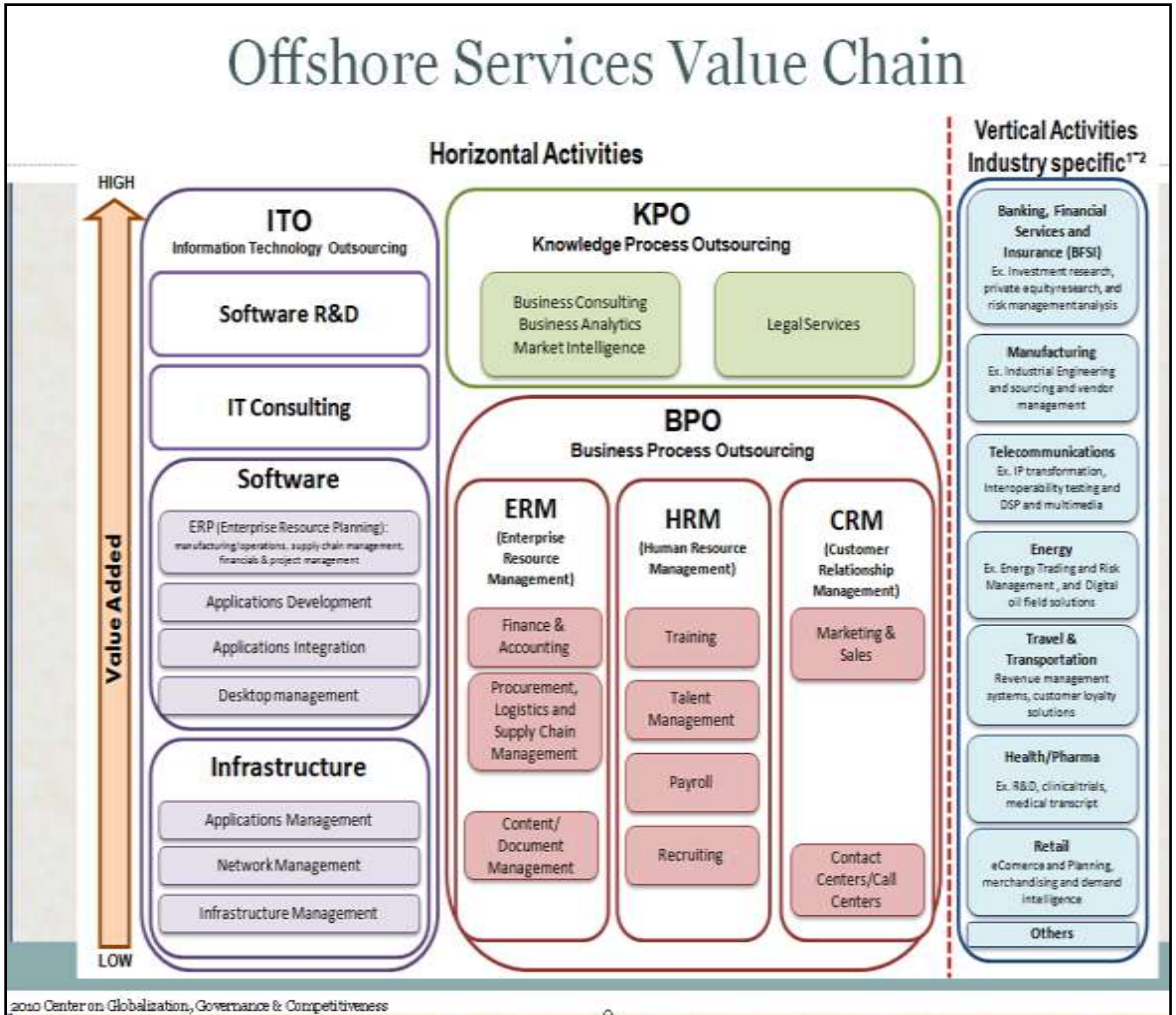
INDONESIA and Value-Added Trade?

- On a value-added basis, Indonesia exports to a broader set of countries than realized. It **produces inputs that are further processed in Japan and Korea and subsequently exported to third countries.**
- **BUT … the services content of Indonesian gross exports is rather low (22%). Manufacturing industries use less services inputs than in other countries in the database.   WHY?**

3. GOODS AND SERVICES "MADE IN THE WORLD"

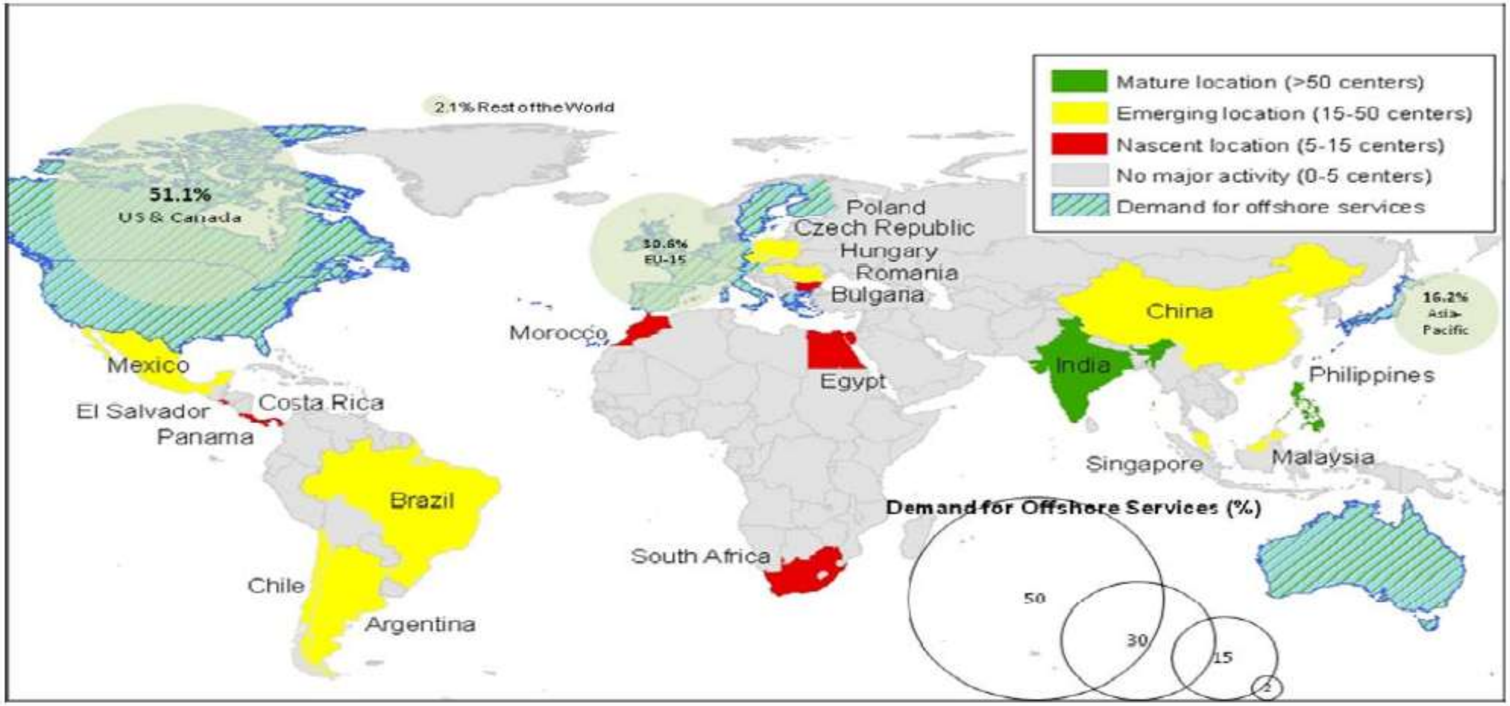
- Growth of trade in intermediate goods has resulted in Global Value Chains → main vehicle for trade now in many regions, especially **East Asia**
- **"MADE IN THE WORLD"** (WTO): Not one country but many countries involved in producing a single good
- **Services have a DOUBLE ROLE in Global Value Chains**
  - **Inputs into supply chains of manufactured goods**
  - **Constitute value chains on their own (exp: tourism)**

Offshore Services going into Value Chains



Source: Gary Gereffi (2010). “The Offshore Services Global Value Chains”.

Global Supply and Demand Centers for Offshore Services



Source: CGGC, Duke University based on data from Everest and Datamonitor.

<u>Source:</u> Gereffi, G; Fernandez-Stark, K. “The Offshore Services Value Chain: Developing Countries and the Crisis”. Center of Globalization, Governance & Competitiveness. Duke University. The World Bank Development Research Group, Trade and Integration Team. 2010.

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Indonesia among the Top Five Attractive Offshoring Locations for Services (2011)

Rank	Country	Financial attractiveness	People skills and availability	Business environment	Total score
1	India	3.11	2.76	1.14	7.01
2	China	2.62	2.55	1.31	6.49
3	Malaysia	2.78	1.38	1.83	5.99
4	Egypt	3.10	1.36	1.35	5.81
5	Indonesia	3.24	1.53	1.01	5.78
6	Mexico	2.68	1.60	1.44	5.72
7	Thailand	3.05	1.38	1.29	5.72
8	Vietnam	3.27	1.19	1.24	5.69
9	Philippines	3.18	1.31	1.16	5.65
10	Chile	2.44	1.27	1.82	5.52
11	Estonia	2.31	0.95	2.24	5.51
12	Brazil	2.02	2.07	1.38	5.48
13	Latvia	2.56	0.93	1.96	5.46
14	Lithuania	2.48	0.93	2.02	5.43
15	United Arab Emirates	2.41	0.94	2.05	5.41
16	United Kingdom	0.91	2.26	2.23	5.41
17	Bulgaria	2.82	0.88	1.67	5.37
18	United States	0.45	2.88	2.01	5.35
19	Costa Rica	2.84	0.94	1.56	5.34
20	Russia	2.48	1.79	1.07	5.34
21	Sri Lanka	3.20	0.95	1.11	5.26
22	Jordan	2.97	0.77	1.49	5.23
23	Tunisia	3.05	0.81	1.37	5.23
24	Poland	2.14	1.27	1.81	5.23
25	Romania	2.54	1.03	1.65	5.21
26	Germany	0.76	2.17	2.27	5.20
27	Ghana	3.21	0.69	1.28	5.18
28	Pakistan	3.23	1.16	0.76	5.15
29	Senegal	3.23	0.78	1.11	5.12
30	Argentina	2.45	1.58	1.09	5.12

Source: The AT Kearney Global Services Location Index 2011

Services Offshoring Activities in 10 Economies

Figure: Industry activity in the top 10 countries

Country	BPO	Voice	ITO
India	●	●	●
China	◑	○	◕
Malaysia	◔	◔	◑
Egypt	◑	◔	◑
Indonesia	◔	○	◔
Mexico	◕	◕	◑
Thailand	○	○	◔
Vietnam	◑	◔	◑
Philippines	◕	●	◑
Chile	◔	◔	◔

Note: BPO is business process outsourcing; ITO is information technology outsourcing

Source: A.T. Kearney Global Services Location Index™, 2011

● *High industry activity* ○ *Limited industry activity*

Indonesia attractive in the world rankings but…

- **Has not captured much offshoring activity in services**
- **Limited services offshoring to date : in BPO and ITO**
- **What is holding Indonesia back?**

Source: The AT Kearney Global Services Location Index 2011

POLICIES TO ATTRACT FDI OFFSHORING

- IT Training at universities; institutes
- Information on potential investment partners
- Improved quality and use of English
- Improved business environment: faster time for preparing documents and concluding contracts
- Focused government incentives
  - Technology Park
  - Tax credits

4. IMPROVING LOGISTICS IS KEY FOR TRADE

- **Logistics barriers (border administration, transport and telecommunications infrastructure and services) are most important today to trade flows – strongly affect operation of Supply Chains**
- **Biggest benefits from improving this area**

Reducing these logistics barriers could increase world GDP over 6 times more than removing all tariffs

Source: "Enabling Trade: Valuing Growth Opportunities". WEF-WB Report 2013

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Supply Chain Barriers to Trade

Figure 2: Supply chain barriers to trade

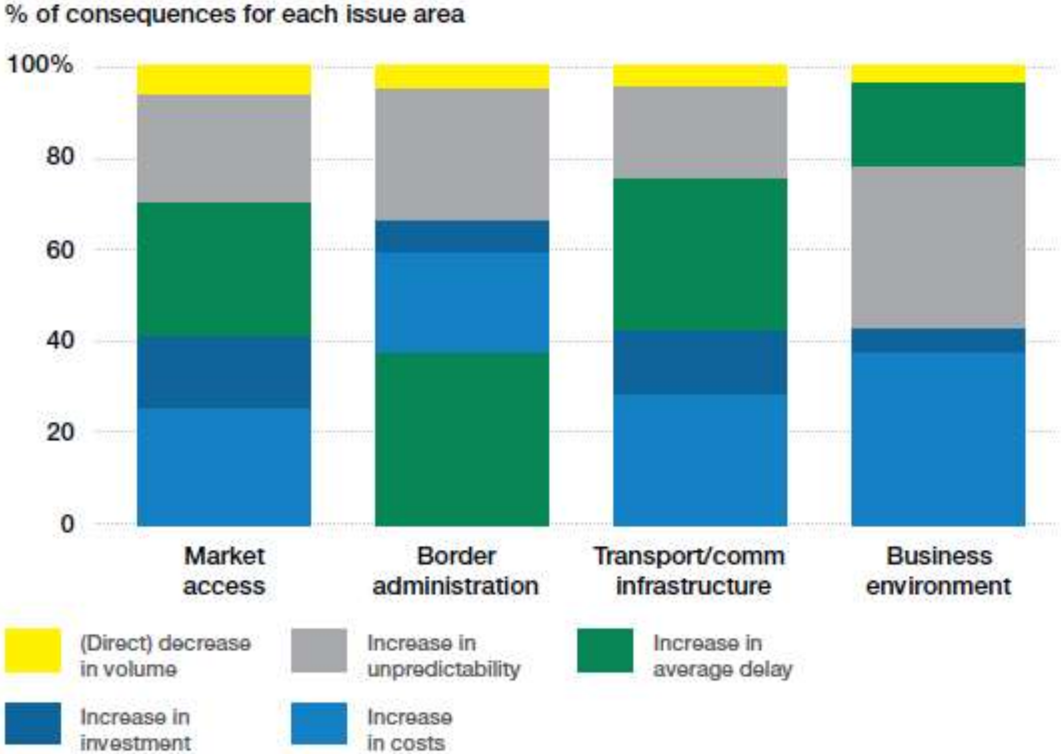
Definition: The lack of infrastructure, institutions, policies and services facilitating the free flow of goods over borders

Market access	Border administration	Telecom and transport infrastructure	Business environment
1. Domestic and foreign market access - Quotas - Import fees – not tariffs (e.g. tax schemes) - Local content requirements - Rules of origin - Technical, sanitary and phytosanitary measures or other requirements - Import/export licenses	2. Efficiency of customs administration 3. Efficiency of import-export procedures (e.g. coordination between border agencies; administration burden of complying with standards) 4. Transparency of border administration (e.g facilitation payments)	5. Availability and quality of transport infrastructure 6. Availability and quality of transport services 7. Availability and use of information and communication technologies (e.g. tracking, electronic-tolls, communication)	8. Regulatory environment - Investment policy - Hiring foreign workers - Other regulatory environment issues (including trade finance) 9. Physical security

Note: The Global Enabling Trade Report identifies 9 pillars, this is an extended list including several sub-pillars as tested in a separate survey for this study.

Consequences of each kind of Barrier to Trade

Figure 4: Each trade barrier can disrupt a company's supply chain and lead to higher costs



Note: Includes manufacturing, retail and logistics, N=108

Source: World Economic Forum survey.

WHY IS LOWERING SUPPLY CHAIN BARRIERS SO EFFECTIVE?

- Because it eliminates resource waste, whereas abolishing tariffs mainly reallocates resources.

- Moreover, the gains from reducing barriers are more evenly distributed among nations than the gains from eliminating tariffs, reducing inequality worldwide.

Source: "Enabling Trade: Valuing Growth Opportunities". WEF Report, 2013

5. TRADE AGREEMENTS CAN HELP– HOW?

TRADE AGREEMENTS CAN IMPROVE SERVICES EFFICIENCY

- MARKET ACCESS OPENING (CROSS-BORDER TRADE: FDI
- BETTER REGULATORY EFFICIENCY : REGULATORY COHERENCE
  - WITHIN A COUNTRY
  - BETWEEN COUNTRIES

BUT,……. THIS DEPENDS ON THE QUALITY OF THE SERVICES AGREEMENT……….

5. SERVICES NEGOTIATING INITIATIVES

- SERVICES NEGOTIATIONS MADE NO PROGRESS IN THE DOHA ROUND SO FAR UNDER WTO
- RESULT: BIG GAP AT PRESENT BETWEEN RULES AND COMMITMENTS (MARKET OPENING) UNDER THE WTO SERVICES AGREEMENT AND THE REAL WORLD
- GAP IS GETTING WIDER ………

- SEVERAL NEGOTIATING INITIATIVES
  - High quality services agreements being negotiated- EXAMPLES:
    - UPDATES OF NAFTA
    - TPP – modern template (Japan may join?)
    - US-Korea RTA; EU-Korea EPA
    - US-EU

WHAT IS NEEDED FOR A 21st CENTURY SERVICES AGREEMENT?

- **MUST TAKE ACCOUNT OF NEW DEVELOPMENTS IN WORLD TRADE**
  - **TRADE IN INTERMEDIATES; MADE IN THE WORLD**
- **SHOULD FOSTER GLOBAL VALUE CHAINS**
- **RECOGNIZE CENTRAL VALUE OF SERVICES**
- **INCLUDE REGULATORY CONSIDERATIONS**
  - **FOCUS ON BARRIERS THAT WILL ALLOW FOR MORE LIBERALIZED AND EFFICIENT SERVICES TRADE**
- **SHOULD ADDRESS THOSE BARRIERS THAT COUNT THE MOST: LOGISTICS and REGULATION**

➢SERVICES – EXPANDED AFAS

- **ASEAN MEMBERS HAVE AGREED TO IMPROVE ASEAN FRAMEWORK AGREEMENT ON SERVICES IN CONTEXT OF ASEAN ECONOMIC COMMUNITY (AEC) by 2015**
  - **More market access for services providers**
  - **Commitments on 70% Foreign Equity Limits already in place for 8 service sectors; 2 more to be incorporated at end 2013 (Logistics and Transportation)**
- But…….
- ASEAN Services Text is out of date
- Focus in ASEAN has been on market access
- Little work on regulations
- Also question: Where will new investment come from? Do other ASEAN members have this capacity to invest?

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➢SERVICES IN RCEP

- REGIONAL COMPREHENSIVE ECONOMIC PARTNERSHIP
  - RCEP agreed by ASEAN LEADERS November 2012
  - (10 ASEAN members plus Australia, New Zealand, China, Korea, Japan, India)
  - Negotiations starting this week
  - Services integral component -Goal : 2015 (same as AEC)
- High level of ambition mandated
  - Must go beyond ASEAN + 1 RTAs
  - Each ASEAN member must have a single list of services commitments for all sectors included vis-à-vis all other RCEP partners
  - The highest quality RTA is ASEAN-Australia/ New Zealand: must be more ambitious
  - ➢ BUT….. Will regulatory issues be included?

➢SERVICES IN THE ISA - GENEVA

- **International Services Agreement (ISA) initiative –** discussion for a services agreement by self-selected WTO members who will agree to deepen the WTO GATS through new rules and market access commitments

- The ISA will be negotiated initially as an RTA agreement meeting **GATS Article V** standards…- the provision on Economic Integration Agreements
  - Will be a Services-only agreement **covering "substantially all services trade"** (sectors, volume of trade and modes of supply)
  - It must **eliminate "substantially all discrimination" in services trade.**

What is the ISA initiative?

- Response to business community to revitalize services negotiations
- “Real Good Friends” of Services - 47 WTO Members:
  - Australia, Canada, Colombia, Costa Rica, European Union (27 countries), Hong Kong, Israel, Japan, Mexico, New Zealand, Chile, Norway, Peru, South Korea, Switzerland, Taiwan, Turkey, the United States, Pakistan, Peru and Iceland

  Represent 2/3 of global trade in services

    - **Note: No ASEAN Member at present in discussions but 4 of the ASEAN + 1 RCEP Partners are present (Australia/ New Zealand/ Japan/ Korea)**

Possible Elements to include in the ISA

- **Liberalized Temporary Movement (Mode 4)**
  - Emphasis on skilled persons:
  - Expand coverage of categories: ISS, CSS, trainees

- **Key regulatory provisions being considered for ISA**
  - Domestic Regulation / Regulatory Coherence
  - Government Procurement opportunities in Services
  - Competition Policy / Monopolies
  - Mutual Recognition to help Professional Service Providers
  - Transparency in Regulations
  - Fostering trade of Small and Medium-sized Enterprises
    - **<u>NOTE:</u> Many of these may be similar to what could be proposed for the RCEP Negotiations –**

Indonesia's interests and ISA

- Negotiations starting formally on March 2013…
- WTO GATS modality and rules will be used as basis for ISA
- Resulting agreement would be open-ended, with an accession clause
- Ultimate aim: to incorporate ISA into the WTO
- **No agreed text right now;** members are in process of circulating their draft text proposals; big opportunity to influence the outcome of the agreement (Exp: inclusion of a development chapter with technical assistance)

Indonesia's interests and ISA

- ISA discussions could provide space for learning about new issues being incorporated into trade agreements for services
- Possibility to take some of these discussions into RCEP or Expanded AFAS so as to be coherent as between the regional and plurilateral / multilateral context
- ISA could bridge the gap between ASEAN members and RCEP partner expectations
- ISA might help Indonesia to lead in the regional context and be better placed to chair the WTO Ministerial Meeting
- For business, ISA should result in a modern, up-to-date services agreement with the world's largest trading economies

What Indonesia needs to negotiate Services

- Coordinated national approach on services to define priorities, together with stakeholders: private sector plus government
- Indonesian Services Dialogue critical
- Inventory of regulations affecting trade in services
- Understanding of modern services issues

> **➢ Mainstreaming a "TRADE IN SERVICES" Policy into the national agenda & new 5- Year Plan**

THANK YOU

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