

5. Growing Trading in Services in APEC Economies

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5.1 Expanding Trade in Services & its Contribution to the Enhancement of Productivity in the APEC Economies

Keynote Speaker

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Context – Service Sector & Development

What is different about services production and why does the service sector become a larger part of output as development occurs?

Like other activities, services production involves the process of adding value but in the process, ownership does not change. In a services transaction, party A hands over to party B, something which is processed on party A's behalf. The situation is different in manufacturing, where something is bought, processed and resold.

As economies grow, the services sector becomes a bigger part of output. There exists a correlation between the share of the services sector and the stages of development of the economy (see Figure 5.1.1).

There has been a lot of discussion and analysis of why that takes place. One explanation is that as people become richer, they want to buy more services (demand side factor).

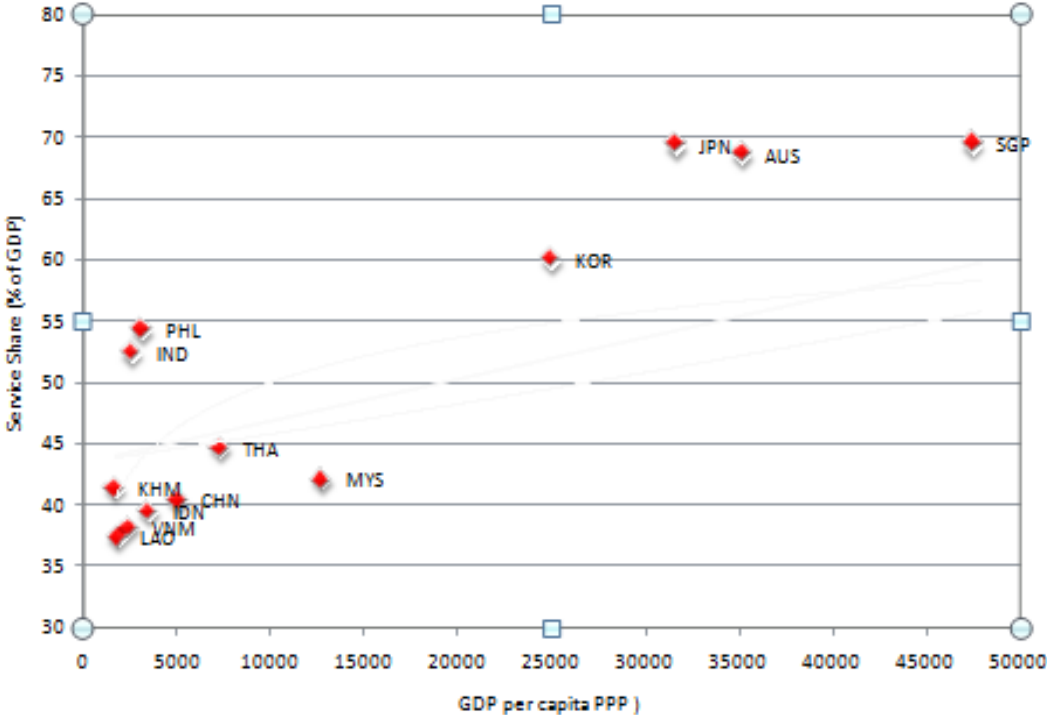
Another possible explanation comes from the supply side and concerns the organization of activity, both within the household and within the firm. The decision to buy things in (rather than make) drives the growth of the services sector.

Consider a manufacturing firm which manages some dimensions of its transportation requirements. It might have its own trucks and do assigned deliveries. At some point, it may question whether it should continue to do what it has been doing. After all, it is not a transport company; it is a manufacturing company. Instead of managing a transport system, it may be better to get others to buy into its enterprise. The advantage is that the manufacturing firm can be confident that it is purchasing transport services efficiently, since it can have its suppliers compete with each other to keep costs and prices down. Moreover, the manufacturing firm will be dealing with specialists who are going to be innovating in their area and coming up with ideas.

It is that process of moving to market transactions, a bunch of activities which were previously done in-house, which is the main driver of the growth of the services sector.

Underlying this result, however, is confidence. External transactions require confidence in the ability to use the market, to have institutions able to write the contracts, to be able to make the purchases. Confidence in contracting is ultimately the force which is driving the correlation observed in Figure 5.1.1.

Figure 5.1.1 Size of Service Sector & GDP per capital (PPP) – 2007



International Business in Services

One concern relating to the services sector was that as the services sector gets bigger, it will be extremely difficult to maintain high growth rates because it looks like the services sector is an area where it is really difficult to generate productivity growth.

That turns out not to be true. The Productivity Commission in Australia found that what was driving Australian productivity growth in the 1990s was very rapid change in the organization of the services sector. Significant gains in productivity, surprisingly, were in big sectors like retailing and wholesaling. Retailing and wholesaling are big parts of developed economies, and the application (not the production) of information technology in those sectors was an important driver for productivity growth.

More recently, the discussion is about the inevitability of the pathway that is illustrated in Figure 5.1.1. Does every economy have to follow the same track?

With regards to the linearity of the development process, there are some counterviews. According to The World Bank, it is possible for some economies to leap frog from agriculture into services without having to work their way through the manufacturing sector, partly as a result of the increasing tradability of the service sector. New models of doing business are being developed in services. Services sector firms are now thinking of breaking up their processes into stages, similar to what has been done for manufacturing. Services producers, especially those who have been exposed to competition, are thinking about how to construct their supply chains. For example, consider the construction of a swimming pool in Beijing. The organizer of the project will look all over the world to find who the best people are, who have the skills that they need for a particular project, and then they will put that team together.

Services trade is recorded as having a faster growth than goods trade in some years, while in other years the latter is recorded as having a faster growth. There is an issue with the data. In particular, services trade is inadequately measured. Many services transactions are delivered in another format, through foreign establishment. These transactions are difficult to measure.

The possibility of dividing the services process up into stages as well as the tradability of services creates the possibility of economies leap-frogging into services production. This creates interesting new opportunities. All economies might shift in the direction of a larger services sector, but the path will vary between economies depending on their history in their trajectory.

Contribution of Integration of Services Markets

Gains from integrating the services sector include:

- Specialization. There are labor intensive stages as well as capital intensive stages of production in services. All the standard gains from trade apply as economies specialize in these different stages.
- Competition. There are gains from competition in different services sector including infrastructure.
- Access to variety. Services have the capacity to be highly differentiated given the nature of their delivery, and services producers often have the capacity to design the service to suit a particular client. Tailor-making is a significant part of strategy in the service sector. In the international context, consumers have the opportunity through trade and exchange to have access to more variety.

Integration also reduces costs in trading systems. Included in the trade facilitation agenda is the services sector, which includes services reforms. Trade facilitation means making the air transport system, maritime system and ports work better. All those services are internationally tradable which can be opened up to competition.

Studies of participation in international trade now focus at the firm level, rather than at the aggregate sector data. Researchers are now examining the decisions of individual enterprises, in particular, which enterprises export and which do not? Not many businesses export; typically only between 10% and 20% of firms of a sector actually participate in trade. However, if a firm participates in trade, there are significant benefits for productivity. There is a very strong association between participation in trade and productivity in the firm.

The implication is that reducing the cost of entering the trading system, given this association with productivity, will contribute significant benefits. The extensive margin (or the participation in trade margin) may make a bigger contribution to productivity growth than the intensive margin, in which those already trading do so more.

Reform & Its Challenges

Reforms are difficult in the services sector. The barriers to entering markets are complex – barriers are not just at the border, but also behind the border. Usually, given the nature of the production process, the policy measures which apply in services are not simple. Taxes, rules, regulations and licenses affect the establishment and operation of services firms. Moreover, they apply to both domestic and international firms. In addition, many agencies are often involved. Market failures are common too in the services sector. Policymakers are genuinely concerned about issues in the services sector related to competition policy or information.

There are challenges in organizing a more competitive services market and taking advantage of the benefits of international integration. The bottom lines from the literature on policy and the process of reform are:

- There are a number of restrictions that remain on entry into the services markets, particularly in East Asia.
- The gains from reform are expected to be significant, since the restrictions are relative tight and the barriers relatively high.
- With respect to international entry into these markets, the assessment is both the General Agreement on Trade in Services (GATS) and the regional agreements have not made significant contributions.
- There has been significant policy change, but it has mostly been done unilaterally thus far.

Figure 5.1.2 Services Trade Restrictiveness Index (STRI) by Regions & Sectors

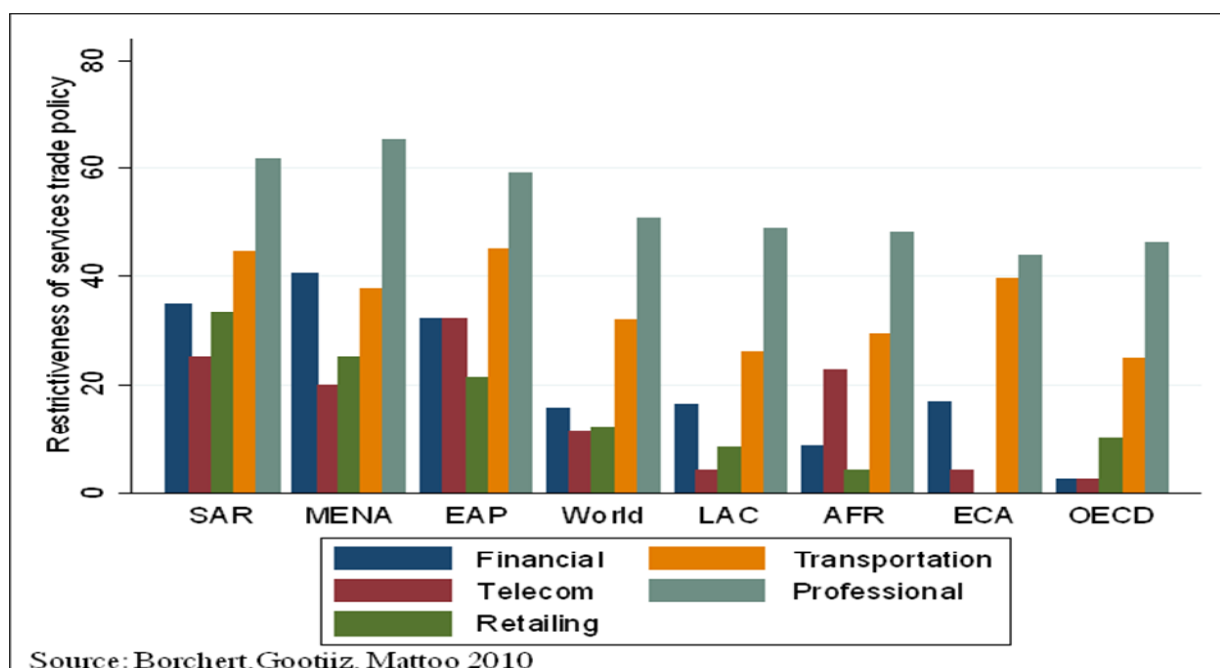


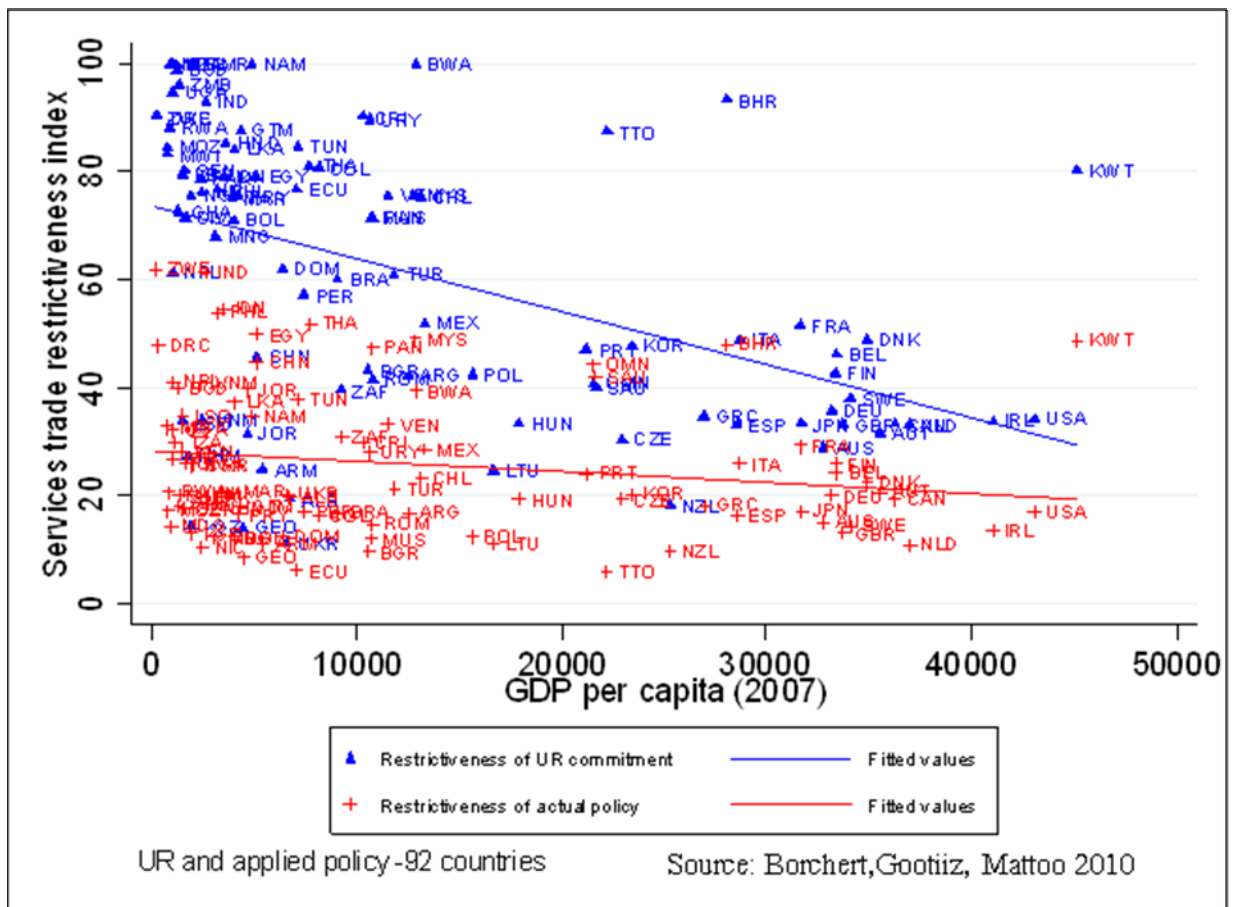
Figure 5.1.2 shows data on restrictiveness by regions and by sectors. The methodology employed here is akin to a frequency measure. The number of policy measures in place is counted, and an assessment of the extent to which there are impediments to entry is made. A higher score is more restrictive.

The APEC Policy Support Unit recently supported work to quantify the impact of policy measures. Some of the results of the study include:

- Conversion to full openness in air transport would lead to an average reduction in air freight margins for all APEC economies of 15%
- A movement from the current policy regime to full liberalization for all APEC economies would on average reduce maritime freight rates by about 20%
- In electricity, third party access, unbundling generation and a wholesale market would lower prices by 23%
- In gas, retail competition lowers prices by 15%

There is a big gap between what economies have committed to do in the WTO versus what has actually been done. In Figure 5.1.3, actual policies are represented by the red dots while the blue dots signify commitments made. Current commitments in the Uruguay Round are about 2.3 times more restrictive than current policies, while the commitments that are on the table in Doha are just under two times more restrictive. The Doha commitments are a little better but they are still twice as restrictive as the actual policies.

Figure 5.1.3 Uruguay Round Commitments & Actual Policy



With regard to regional agreements, Francois and Hoekman, in their 2010 paper in the Journal of Economic Literature, concluded that most regional agreements have not been effective mechanisms for liberalizing access to services markets. Instead, policy reforms have mostly been unilateral.

Why the Lack of Progress?

Hoekman and Mattoo provide some possible explanations for the lack of progress:

- Concern of governments. Governments are concerned that making commitments will reduce their freedom to regulate, create competition policy problems for them, as well as expose them to challenges of regulatory cooperation across countries.
- Lack of business interest. Businesses focus on actual policy. For many businesses, industrial economies' services markets are mostly open, except a few hardened pockets of protection (*eg* in transport and labor mobility) while developing economies are unilaterally liberalizing their markets.
- Pessimism in the business community. Past experience with services negotiations has created a sense of pessimism in the business community about whether they can deliver greater openness or even greater security of access in a way that is meaningful to their operations – in part because regulatory policies are not the focus of attention.

To move forward services reform and liberalization, two proposals are suggested by Hoekman and Mattoo. The first suggestion is to deal with domestic regulation. There are two elements to this, one domestic (economy-specific) and one international. The domestic element is to strengthen regulatory institutions and identify, design and implement policies that address market failures and ensure wider access to services. The international element is for international cooperation to address regulatory externalities. Hoekman and Mattoo's focus is on domestic regulation. They want to build a capacity in the region to deal with the market failure problems and international structures like ASEAN and APEC can contribute to this form of cooperation.

In the WTO itself, Hoekman and Mattoo seek commitments to remove uncertainty. Removing the uncertainty will encourage more firms to participate in trade. Even given the gap between commitment and actual policy that exists, a commitment to close the gap can be scheduled over time. Removing uncertainty and encouraging the participation in international transactions would be a key goal.

A third suggestion comes from a joint meeting between PECC and the ADBI. This referred to the WTO process itself, and a suggestion was made in that meeting which probably reflected business frustration with the failure of the WTO and regional agreements to deal with impediments. The suggestion of the majority was to have a separate negotiation on services. Possible items that might be on the agenda include:

- Cross-border transfer and storage of data
- Movement of services business people
- Sounder and clearer rules on the role of state-owned and linked enterprises creating competitive markets
- Improving the conditions for commercial presence for foreign companies
- Development of a set of principles providing best practice regulation

The theme here is the value of the focus on the extensive margin and the benefits of participating in international transactions. The goal is to have a competitive services market, and the participation of international providers is a very important part of that. Services producers have the opportunity to participate in the world market and increase their productivity growth. The policy question is how to lower the costs for participants entering international business.

5.2 Malaysian Experience

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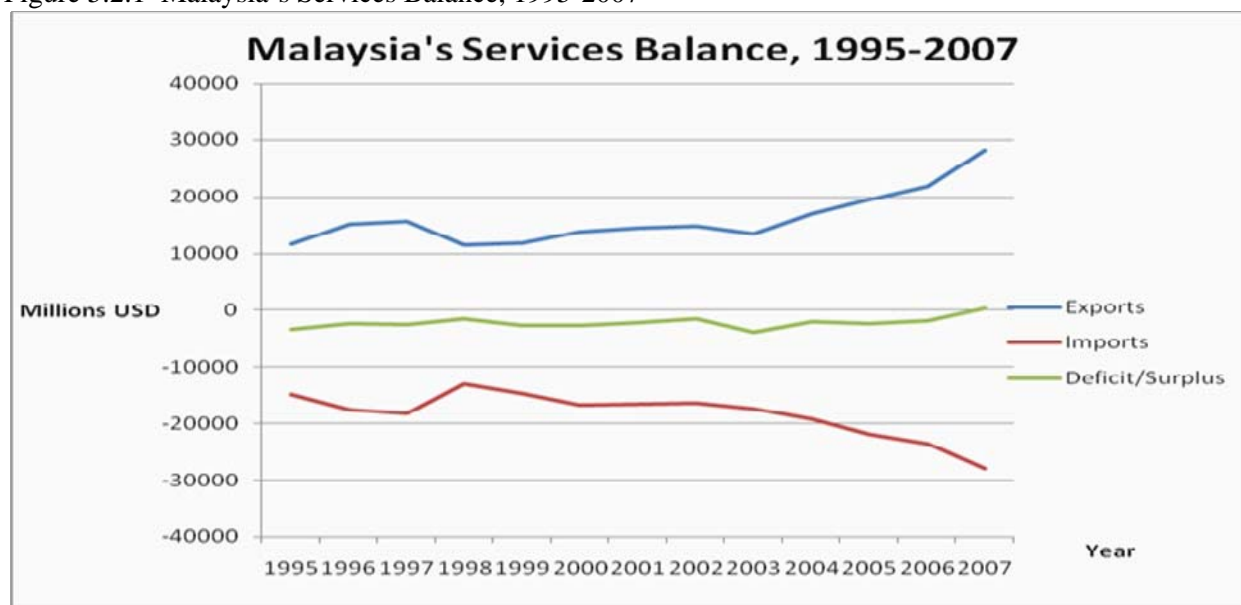
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Malaysia

Malaysia has some success in exporting services. The services sector in the Malaysian economy, as in most other economies, is the largest sector. However, that share has not grown very much over the years. Services have moved from supporting manufacturing, agriculture and mining sectors into producing its own final services and are now an important contributor to growth. However, in terms of employment, the services sector share has not grown very much.

Another interesting feature of the Malaysian services sector is that, over the years, the services trade account has been in deficit for a long time. This deficit was basically contributed by outflows of freight and insurance because of the large manufacturing exports in Malaysia. In recent years, there are signs that the services account is turning into surplus. This shift is contributed in part by the export growth in healthcare and air transport sub-sector.

Figure 5.2.1 Malaysia's Services Balance, 1995-2007



Source: IMF's Balance of Payment Statistics

Key Components of Services Export

From 1998 to 2008, the share of services in total exports has stagnated between 12-14%. Based on the IMF's balance of payments statistics, travel has now become quite an important component in Malaysia's export of services. Another important component is computer and information services, which is growing. This is partly linked to the effort by Malaysia in developing this sector, for example, through the development of the Multimedia Super Corridor. The major outflow continues to be freight and insurance.

Some of the services sector that has been promoted quite aggressively in Malaysia in the last few years are:

- Private higher education. The main reason why Malaysia is relatively successful is its relatively lower cost. Another reason is the availability of established foreign providers offering courses in Malaysia. In addition, the cultural environment of Malaysia makes it an attractive location particularly for students from Asia, Africa and the Middle East to study.
- Medical tourism. The Malaysian medical tourism sector is attractive due to the cost advantage and the availability of professional services or professionals that provide those services. The main market is the regional countries.
- Tourism. The emergence of low cost carriers has helped in promoting tourism. Malaysia is now becoming a transit point for regional low cost travelers to move between destinations, and also a point of attraction for foreign travelers to come into the region.

Domestic Regulation & Liberalization

One of the reasons for Malaysia's success in exporting services is because it had autonomously liberalized, adapted and strengthened the domestic regulations and preserved their flexibility before binding these liberalization measures multilaterally. In other words, the government first liberalized the domestic market, and then extended the commitments to foreign providers.

Examples include:

- Telecommunication. Liberalization of this sector was first introduced among domestic providers to promote capacity building and competition in the domestic market. The domestic market was then opened to foreign services providers.
- Banking. The first measure was aimed at increasing the scale of domestic banks through consolidation. Subsequent liberalization policies were introduced to improve competitiveness and to encourage domestic banks with sufficient capacity to be regional players. Contrary to what some suggest, the Malaysian banking is not restrictive to foreign participants as there are 14 financial institutions already operating in Malaysia.
- Medical services. A number of policies were introduced to build domestic capacity when the government allowed the provision of private health services.
- Education. Efforts made by the government include allowing foreign higher educational institutions to establish operation and offer courses in Malaysia and the promotion of private provision of education.

Malaysia made liberalization commitments through economic integration:

- Bilateral: For Malaysia, the best incentive for opening up the economy is through the bilateral FTAs, and the ASEAN Framework Agreement on Services (AFAS). Although bilateral FTAs require deeper commitments, this liberalization is possible because in turn Malaysia could get specific commitments with large potential benefits from its partners.
- Regional: ASEAN Framework Agreement on Services (AFAS). AFAS liberalization has encouraged Malaysia to open up its services sector. An example would be the latest commitments that Malaysia made via AFAS which opened up a number of the services subsectors.
- Multilateral: General Agreement on Trade in Services (GATS). Liberalization under the GATS has not progressed very much.

Barriers to Trade in Services

There are still barriers to the services trade in Malaysia. The degree of liberalization is very much dependent on the sectors, and is partly driven by the ministries or certain segments of the economy. One of the challenges of the services liberalization is that Malaysia does not have one single ministry to coordinate services, unlike for say, the manufacturing sector. In Malaysia, liberalization for the manufacturing sector is handled by the Ministry of International Trade and Industry. However, for services, there are many ministries involved, where the issues of responsibility or jurisdiction and co-ordination become quite important. There is currently no services liberalization master plan, and progress is highly dependent on which ministry has the interest and the commitment to see it through.

Liberalization is important in promoting services export or attracting foreign services provider into Malaysia. With regard to barriers in trade and investment, licensing requirements still exist in several services subsectors. Thus if one part of the services value chain is completely liberalized while the other are highly closed, this will not result in an effective opening up of the sector. The abolishment of the Foreign Investment Committee in 2009 has facilitated investment decisions in Malaysia.

There are also barriers to business and supply capacity, which are linked to the market structure. Monopolies, duopolies and oligopolies exist in several sub-sectors and often they form barriers to the opening up of the industry.

In terms of the movement of natural persons, the commitments made by Malaysia are also quite limited. Professional associations like lawyers, nurses, architects and doctors are highly adverse to the free flow of professionals from other ASEAN countries unless these professionals meet the national standards. Malaysia is moving to encourage skilled workers but there is still some way to go on this.

Policy Lessons from the Malaysian Experience

Four policy lessons derived from the Malaysian experience are:

- Services export capability starts with building competitiveness in the domestic market.
- Adopt a clear liberalization policy and a defined implementation timetable.
- Decide on the services subsectors to be promoted and put in effective measures to achieve this objective.
- Invest in infrastructure to increase the domestic services capacity, which will be the base for exports.

5.3 Services – Pillar of Growth for Hong Kong and Emerging Economies

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Hong Kong

This section shares the experience of Hong Kong's transformation into a highly services-oriented economy, and what HK is doing to promote trade in services.

Services: An Economic Driver for Hong Kong

Hong Kong is currently one of the most service-oriented economies, if not the most. Almost all of Hong Kong's major industries are service-oriented and over 90% of Hong Kong's GDP come from the services sector (see Table 5.3.1). 87% of Hong Kong's 3.6 million working population is employed by the services sector, and Hong Kong is the world's 14th largest trading entity in services.

Table 5.3.1 Industry Contribution to Hong Kong's GDP

Percentage Contribution to HK's GDP	1989	1999	2009
Primary industries	0.3	0.1	0.1
Manufacturing	19.3	5.7	1.8
Utilities & construction	7.4	8.9	5.5
Services industries	73.1	85.4	92.6

However, the Hong Kong economy has not always been this service-focused. Back in 1980, manufacturing comprised about 24% of the GDP. This share shrank to 19.3% by 1989 (see Table 5.3.1), and dropped significantly to 5.7% in 1999. Now, manufacturing contributes less than 2% to GDP.

The transformation of the Hong Kong economy was fast, drastic and accidental in a way. It was certainly not planned by the Hong Kong government. In fact, the rapid movement of Hong Kong's manufacturing activities across to mainland China was purely a private sector initiative. Hong Kong businesses recognized the opportunities offered by China in terms of lower cost of land and labor as well as other incentives across the boundary. As a result, the HK entrepreneurs were the first to invest in the mainland China, and Hong Kong remains the largest foreign investor in mainland China today.

As at the end of 2010, the cumulative value of realized FDI from Hong Kong into mainland China amounted to US\$456.2 billion, about 43% of the national total of China. In Guangdong province alone, a cumulative number of more than 110,000 Hong Kong invested enterprises have been approved since China opened up in 1979. Of these enterprises, 48,000 are still operating in Guangdong today. The Hong Kong entrepreneurs do not invest only in the southern part of China; Hong Kong is actually the largest investor in every province of the mainland.

The quick transition of the Hong Kong economy in the 1980s and 1990s had actually caught many factory workers by surprise. Factories were closing down by the thousands, and skilled workers saw their jobs vaporize in front of their eyes. The rapid shrinking of the manufacturing industry corresponded with the rapid expansion of the services sector. New jobs were created, but there was a major mismatch in skill sets, so the Hong Kong government set up the Employees Retraining Board in 1992 to help the workers learn new skills such as languages (*eg* English), the use of computers and other basic skills so that they could integrate into the services economy. At the same time, the higher education sector was expanded to meet the demand for a more highly educated workforce that is required of an increasingly service-oriented economy.

For a good proportion of the working population, the transformation was not without pain. However, the overall benefits for the economy are very apparent and significant. Back in 1980, the GDP per capita in 2009 prices was about US\$10,000. In 2009, it tripled to US\$32,000 in the same 2009 prices.

Four Traditional Pillar Services Industries

A closer look at the services sector shows the link between the development of the Hong Kong services industry and the manufacturing activities in mainland China. The 3 largest services sectors in Hong Kong (see Table 5.3.2) are

- Trading & logistics
- Financial services
- Professional services & other producer services

These sectors grew in support of the manufacturing activities that have moved across the boundary to mainland China. Apart from support functions, the services industry also built up their expertise, and expanded their scope and clientele over the years. Moreover, as Hong Kong is one of the freest economies in the world, foreign services enterprises are welcome. These foreign services enterprises bring with them the talents, knowledge, technology and innovative ideas, and help to contribute significantly to the development of the Hong Kong services sector.

The Hong Kong services sector is very good at both creating and seizing new opportunities. Take for example, the financial services sector. One hot topic is the internalization of the RMB. Back in 2004, banks in Hong Kong have already started to offer deposit taking and other banking services to personal customers in RMB. In 2007, RMB bonds were issued, and Hong Kong was the first outside of mainland China to do so. By the end of April 2011, there were 49 'Dim Sum Bonds' issued in Hong Kong with a total issuance of 92 billion RMB. The Chinese government, the World Bank, the Asian Development Bank and other multinational companies such as McDonalds are amongst the issuers of the 'Dim Sum Bonds'.

Table 5.3.2 Four Traditional Pillar Services Industries

	% to GDP		No of persons engaged		Value-added	
	2005	2009	2005	2009	2005	2009
Financial Services	12.7	15.2	178 800	212 000	172,100	235,600
Tourism	3.3	3.3	164 800	193 200	44,500	50,900
Trading & logistics	28.6	24.1	815 900	787 900	388,400	373,400
Professional services & other producer services	11.1	13.1	403 600	457 800	150,800	202,800

In July 2009, China launched the RMB trade settlement pilot scheme, and expanded that scheme in June 2010. Now, all of China's trading partners around the world are eligible to participate in this scheme. In the first quarter of 2011, about 7% of China's total trade was denominated in RMB, up from a mere 2.5% in 2010.

Of all RMB-settled trade, Hong Kong handles 86%. About 170 banks in Hong Kong are involved in this RMB trade settlement, and approximately 150 of them are foreign banks. The Hong Kong banking sector is much liberalized and foreign banks are welcome to operate in Hong Kong as long as they meet the licensing requirements. As such, the bulk of the banks involved in the RMB trade settlement in Hong Kong are foreign banks. Apart from RMB business, the banking sector also explores other opportunities in Islamic finance, in becoming a major capital raising platform and also in other asset management business.

New Growth Services Industries

While the 4 traditional pillar services industries are growing very strong, there remains a need to diversify the services economy as well. As such, Hong Kong aims to promote the growth of 6 other services industries:

- Medical
- Environmental
- Testing and certification
- Education
- Innovation & technology
- Cultural and creative

These service industries are not new industries in Hong Kong. They already contribute 7%-8% to GDP and employ about 350,000 workers (9.6% of our workforce) as at end-2010. As always, the principle of the Hong Kong government is to facilitate their growth and not to take any

central planning; rather, to let the market lead, but to provide support in terms of land, resources and other necessary support measures.

Mainland & Hong Kong Closer Economic Partnership Agreement (CEPA)

Hong Kong has a FTA with the mainland of China, which is a major contributor to the development of the Hong Kong services industry. The FTA: Mainland & Hong Kong CEPA was signed in June 2003. Under CEPA, China opened 44 services sectors to Hong Kong enterprises.

CEPA has proven to be very beneficial, not only to Hong Kong enterprises, but also to mainland China. In terms of employment creation, the 'Individual Visitor Scheme' and trade liberalization measures under CEPA helped provide 40,600 jobs in Hong Kong from 2004-2009, while creating 54,700 jobs on the mainland.

Hong Kong has always been a staunch advocate of free trade and the government will support further liberalization in services at all levels, be it multilateral, regional and bilateral.

5.4 Trading in Services: An ASEAN Perspective

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Thailand

Trading in services is a very important subject. However, liberalization of trade in services is a very sensitive subject. In fact, the military coup in Thailand in 2006 was brought about by this particular subject. The 2006 sale of the (then Thai Prime Minister Thaksin) Shinawatra family's share of Shin Corporation (a leading Thai telecommunications company) to Singapore's Temasek Holdings caused great controversy in Thailand. There were fears of Singaporeans eavesdropping on Thai military communications, and this controversy eventually culminated in Thaksin's government being overthrown in a military coup. In addition, negotiations between Thailand and the US on a potential FTA failed because of the service sector disagreements.

Trading in Services in the Context of Trade Policies

The basics about ASEAN's trade policies are:

- Manufacturing. Began with import substitution, and subsequently moved towards export-oriented particularly from 1980s. Manufacturing was the area that was liberalized first.
- Agriculture. Protection, with gradual liberalization according to the WTO and AFTA.
- Services. Protection in general, with exception in some services often on an ad hoc basis. During the 1997-1998 Asian financial crisis, Thailand liberalized the financial sector because it did not have the money to put the banks back into operation. The ASEAN Economic Community (AEC) 2015 will allow for gradual liberalization in services trade.

Most ASEAN economies follow protection in trade and services. Service trade policies are differentiated into four categories:

- Mode I: cross-border supply (*eg* call centres). If the domestic economy is able to supply this service, the policy is to promote (exports). If others wish to buy cross border service, the attitude is neutral (imports).
- Mode II: consumption abroad (*eg* tourism). If the local residents wish to spend their money across borders, the policy is not restricting (imports). As for tourists who wish to spend their money in the domestic economy, the policy is to strongly promote (exports).
- Mode III: commercial presence (*eg* foreign-owned banks). If domestic companies venture overseas and set up businesses and if they are welcome there, the policy is to encourage (exports). If however, foreign-owned companies wish to set up businesses locally, the policy is restricting (imports).
- Mode IV: presence of natural persons (*eg* engineers). If local experts wish to venture overseas to work, the policy is neutral (exports). However, if foreign talents wish to work, the policy is very restricting (imports).

In summary, service trade policies, exports of service are promoted in all categories, because that makes money for the domestic economy. Imports of services are restricted in the categories of foreign businesses (Mode III) and professionals (Mode IV). This is basically for fear of competition. Despite the benefits of free trade in services for Mode III and Mode IV, the attitude in some ASEAN economies, is to embrace it gradually.

AEC and AFAS, MRAs

Changes along the line of the plan for AEC are expected. ASEAN leaders signed the ASEAN Charter in 2008, which put in place the institutions and mechanism to build an ASEAN community. 2015 AEC agreements include:

- ATIGA (ASEAN Trade in Goods Agreement), formerly AFTA
- AFAS (ASEAN Framework Agreement on Services)
- ACIA (ASEAN Comprehensive Investment Agreement)
- MRAs (Mutual Recognition Arrangements for professionals)
- Agreement on Free Capital Flow

Table 5.4.1 AFAS Timeline





Sectors	2006	2008	2010	2013	2015
ICT, Health Care, Hospitality, Air Transportation	49%	51%	70%		
Logistics	-	49%	51%	70%	
Others	30%	49%	51%		70%

Table 5.4.1 shows the timetable for liberalization of commercial presence of foreign businesses (*ie* Mode III) in ASEAN. Foreigners could own more than the majority share-holding of 51% for selected sectors (ICT, Healthcare, Hospitality, Air Transportation) in 2010. By 2013, the logistics sector too, will allow foreigners to have up to 70% ownership. This maximum share-holding of 70% will be available for all sectors by 2015.

AEC will allow a more unencumbered flow of professionals, and MRAs will include 7 professional categories (*ie* Mode IV). The professionals that will be allowed to work in ASEAN economies are:

- Engineers
- Architects
- Medical doctors
- Dentists
- Nurses
- Accountants
- Surveyors

Prospects of Trading in Services In & With ASEAN

The policies and strategies, intentions and missions, of all the member countries of ASEAN are similar. ASEAN looks to Asia-Pacific for

- Energy, raw materials, machinery and equipments
- Products in the supply chain for automotives, machinery, electronics and electricals
- R&D, know-how, in agriculture and foods
- Professional services in industrial R&D, health and wellness care, legal and accounting, education and training, design and product development, etc.

The above are the things that ASEAN needs to have, and it will definitely benefit from the opening of trade in services. The next phase of ASEAN development will open opportunities for foreign services businesses and professionals from within and outside ASEAN. ASEAN will follow the AFAS and MRAs and by doing so, a gradual liberalization of trade in services among the ASEAN economies is expected.

5.5 Growing Trade in Services in the APEC Economies

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Russia

This section provides an analysis of the trends of trade in services in the APEC region, and provides some recommendations for economies to foster the services trade demand.

From the time of setting of the Bogor declaration, trade in services has become a vital component of the regional and international trade. Economies continued to foster liberalization of the services area, widen unilateral services markets and undertake reforms of national policies.

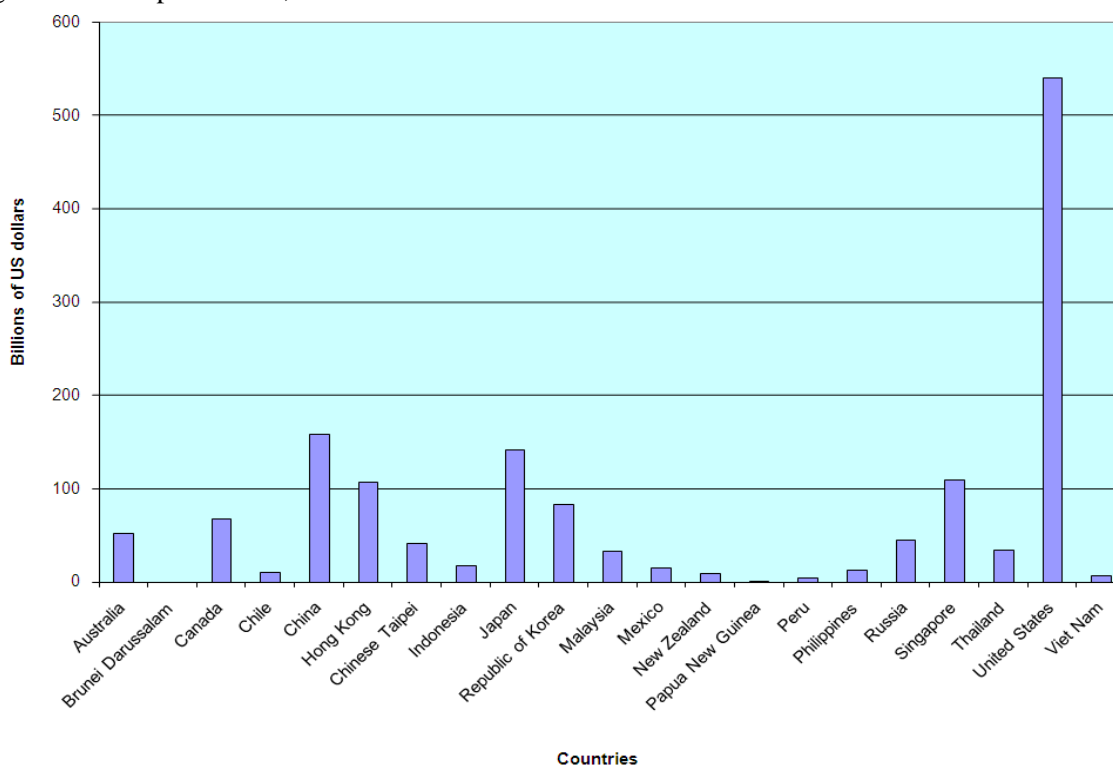
Overview of the Existing Statistics of Trade in Services in the APEC Region

Statistics of trade in services from the following official sources are analyzed:

- UNCTAD: United Nations Conference on Trade and Development
- TWB: The World Bank
- OECD: Organization for Economic Co-operation and Development (OECD)

According to UNCTAD, the common services exports in the APEC region in 2010 total US\$ 1.488 trillion, which has increased by 13.3% from 2009. Common services imports in 2010 are valued at US\$ 0.747 trillion, which exceeds 2009 data by 9.2%. Share of APEC economies in the world services trade is 39.7%.

Figure 5.5.1 Export Flows, 2010



source: UNCTAD

Figure 5.5.2 Import Flows, 2010

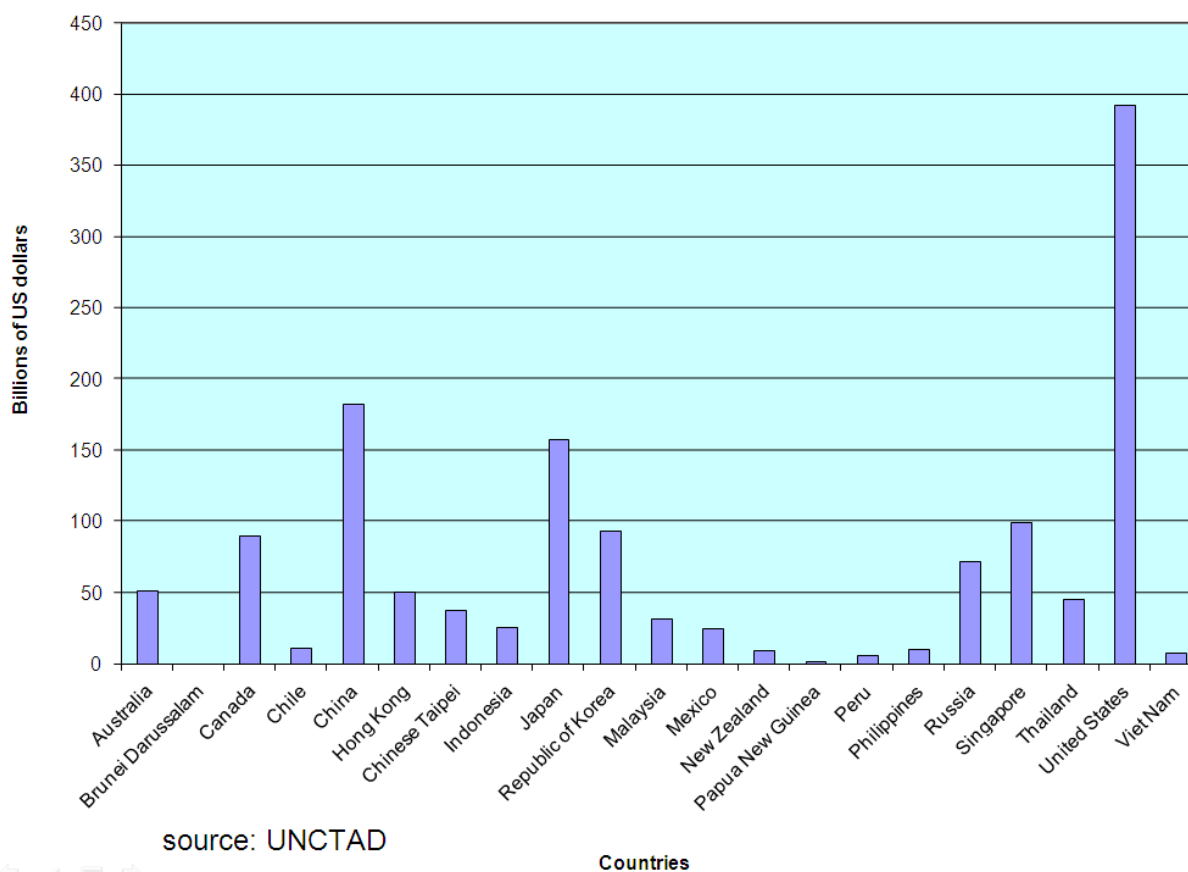


Figure 5.5.1 shows the export flows in 2010. From the figure, the US is the major services exporter among the APEC economies according to the UNCTAD. The US services export for the 2010 consisted of US\$540 billion. US is followed by China, Japan and Singapore where services export consisted US\$158 billion, US\$141 billion and US\$109 billion respectively.

Figure 5.5.2 shows the import flows in 2010. The major services importer is also the US. In 2010, US services imports amounted to US\$393 billion. US is followed by China, Japan and Singapore where services imports totaled US\$182 billion, US\$157 billion and US\$100 billion respectively.

Unfortunately, there is no data on Brunei Darussalam from UNCTAD.

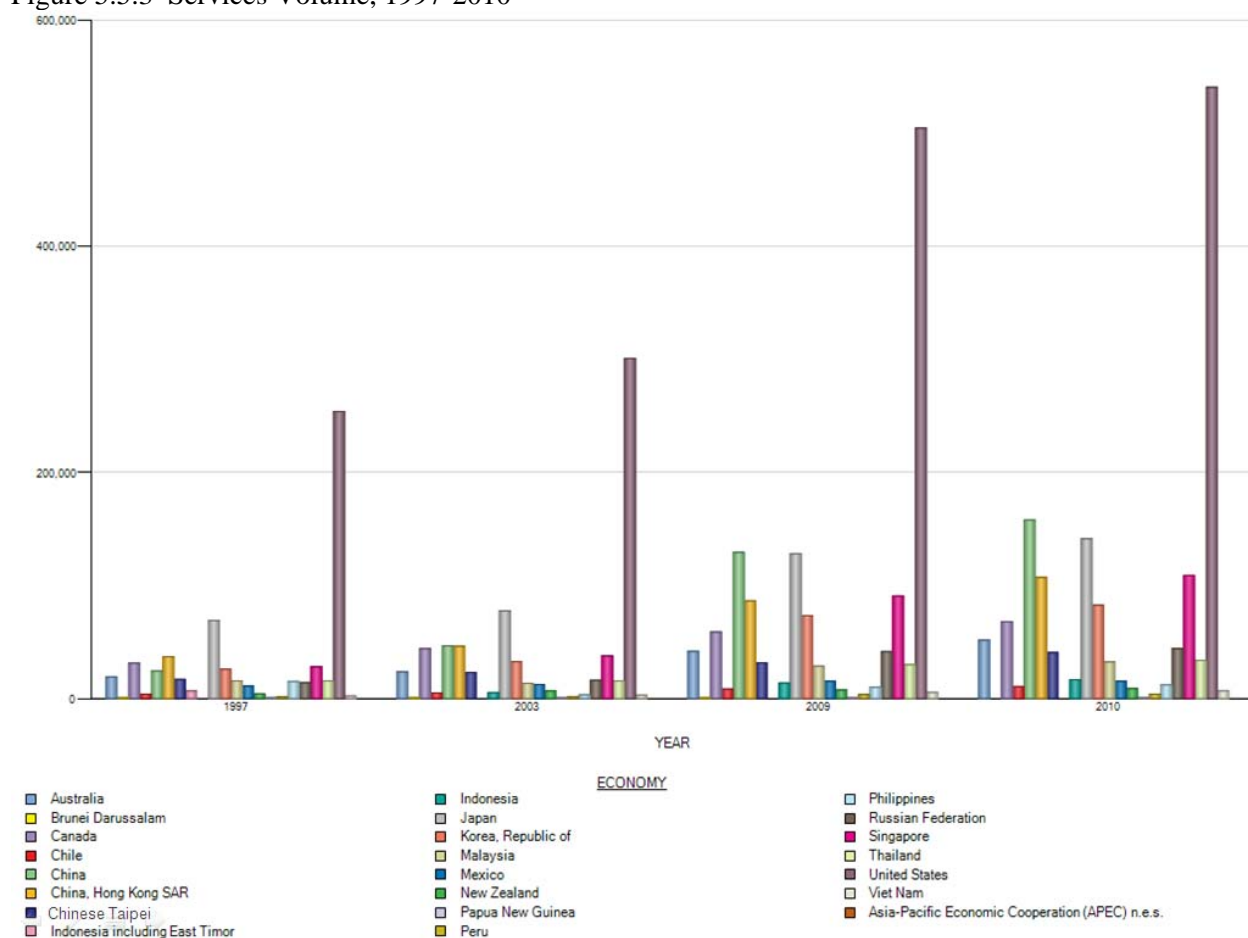
Figure 5.5.3 shows the services data of economies of APEC, from 1997 to 2010. Four years data are chosen to illustrate the increase of the services in the different economies of APEC.

To stimulate economic growth and activity, one should pay close attention to convergence and harmonization of statistics. In their 2008 statement, APEC leaders called for the accelerated implementation of APEC's regional economic integration agenda and instructed officials to undertake initiatives designed to promote greater convergence in key areas of APEC's trade and investment portfolio, including cross-border trade and services. That is why the APEC Services Action Plan was developed. The aim of the Services Action Plan is to provide common direction

and coherence to APEC's work on services trade, and establish a forward work program to foster the development of open and efficient services markets in the APEC region. Three broad categories will aid in the identification of future work priorities, including capacity building initiatives, to address gaps in APEC's overall services agenda:

- Policy issues: cross-cutting work relating to services trade, such as services principles, regulatory issues, economic impact on services trade
- Technical issues: work of a statistical or analytical nature, such as measuring services trade volumes and classifying services
- Sector specific work: work relating to trade in specific services sectors, such as professional services, energy services, education services, environmental services and tourism services

Figure 5.5.3 Services Volume, 1997-2010



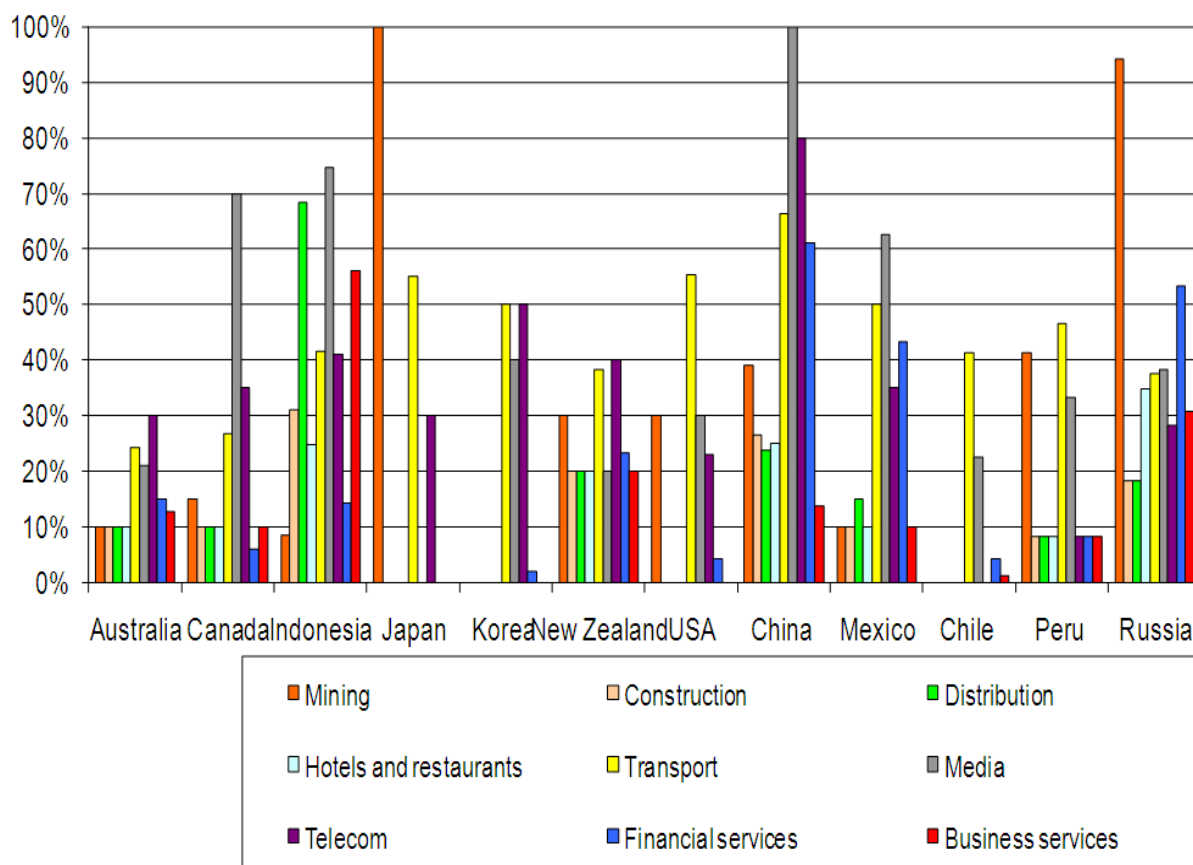
Existing Barriers to FDI in Services Sectors in the APEC Region

Figure 5.5.4 shows the barriers to FDI in the services sectors and the potential for improvement. There are only 12 economies of the APEC region in this figure. According to the OECD FDI restrictiveness of 2010, the most restrictive services sectors within APEC economies are transport, media and mining. The result of this cross-economy study indicates that APEC member economies vary in their level of restrictiveness for services sectors. Many of the economies that have experienced financial difficulties in recent years have medium to high

restrictiveness in these scores. These economies are also found to be the most discriminatory against foreign suppliers.

Restriction can be of any type of measure that limits a service being supplied to a consumer in the most efficient way. The restriction can be imposed on the service such as limits on the distribution of certain services, or on the service supplier such as a limit on the number of firms in the services market. The effect of restrictions can be partially or fully reflected in the price of the service. Restrictions can be of a regulatory or non-regulatory nature. Regulatory restrictions are imposed by governments while non-regulatory restrictions are usually private sector practices that may restrict the effective competition in the market.

Figure 5.5.4 Sample Sectors with Highest/Lowest FDI Restrictions



source: OECD, FDI restrictiveness 2010

Necessary improvements to foster services trade demand include:

- Creation of the stable macroeconomic policies
- Liberalization of trade in services
- Solid legislation basis
- Improve quality of life, attract human capital, stimulate innovation and modernization
- Foster competitiveness in the private sector, promote corporate governance
- Boost business climate
- Optimal level of government regulation
- Exchange of best practices among APEC economies

Figure 5.5.5 Trade in Services (% of GDP)

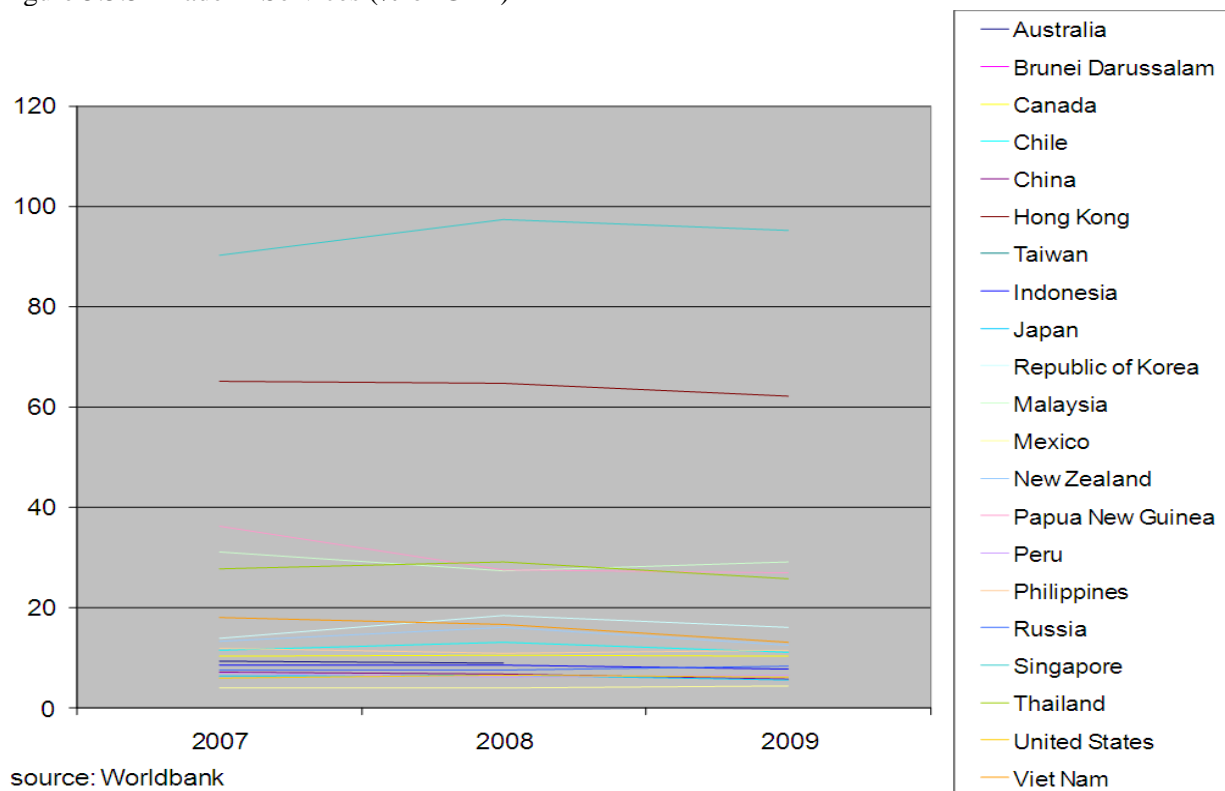


Figure 5.5.5 illustrates the share of trade in services (% of GDP) for selected economies. Trade in services is the sum of service exports and imports divided by the value of GDP, all in current USD. According to this figure which uses World Bank data, Singapore has the highest share of trade in services as a percentage of GDP, followed by Hong Kong.

Main Objectives

The main objectives to be achieved by the APEC community as a whole regarding trade in services are:

- Challenge and improve the views on practices in policy formulation by exchanging views and sharing information and experiences with experts from APEC economies
- Form best practices for policy in trade in services, benefiting from available research as well as accounts by participants of their experiences
- Increase awareness and build capacity in trade in services policy formulation that will in turn increase trade in services and investments in the region
- Deepen the coherent approach by policymakers and negotiators within the APEC region
- Implement the existing APEC Services Action Plan which aims to
 - Strengthen regional economic integration; strengthen the competitiveness and sustainability of economic growth of APEC member economies
 - Enhance compatibility of statistics; classification issues; sector-specific issues
 - Expand prosperity and employment opportunities in the APEC region
 - Make further progress toward achievement of the Bogor Goals

5.6 Comments & Discussion

Comments & Discussion: Professor Christopher Findlay's Presentation

A member of the audience questioned the ability of all economies to leap frog into services given that very high level of skills are required for some services. To this, Professor Christopher Findlay explained that it is not just about reducing barriers to entry; the progress depends on capacity building. It is about having the confidence to reduce the barriers to entry. People in the services sector think about themselves in the same supply chain fashion as manufacturers do. The services firms facilitate the split up of the supply chain in manufacturing, but they themselves are big users of services. A good way to develop the services sector is to ensure that the economy has a good services sector. As such, good infrastructure in the services sector is essential. Some modeling work done at the Australian National University (ANU) found that the biggest consumer of electricity in the economy is the services sector. Services sectors are big consumers of transport services itself: having efficiency in those infrastructure components is important for the economy's ability to compete.

On whether there is a need for domestic protection in small, developing economies given that their services industry are weak and immature, Professor Christopher Findlay's advice is to focus on ways of building the capacity and confidence in the services sector to allow the economy to compete internationally. The approach taken by Hong Kong (presented by Ms Subrina Chow) and the 'necessary improvements' (presented by Mrs Tatiana Palatova) are all the things that will come to make for an internationally competitive services sector. These are what should be explored rather than to protect the services sector.

In addition, Professor Christopher Findlay was asked the reason behind the big gap between what economies have committed to do in the WTO versus what has actually been done on the ground.

To this, Professor Christopher Findlay believes that there are a number of genuine concerns among policymakers about how these markets work, or what the consequences of transactions in these markets are. For instance, policymakers may worry about the impact of globalized financial markets on financial flows, and how consumers will deal with issues with foreign providers of services. Dealing with policy space involves giving confidence to policymakers that they can deal with a genuine market failure problem when it emerges. According to Professor Christopher Findlay, a really good agenda for dealing with policy space is the suggestions under 'main objectives' (presented by Mrs Tatiana Palatova).

On the policy space discussion, Dr Narongchai Akrasanee commented that the ASEAN framework would be the most effective way of liberalizing trade and investment in services. Although Modes III and IV are politically sensitive, politicians are not so averse to the liberalizing of the services sector via the ASEAN framework.

Following Dr Narongchai Akrasanee's remarks, Professor Christopher Findlay shares that, international businesses usually use all Modes I, II, III, IV at the same time as part of their strategies. As such, in order to make some international commitments that are going to resonate with the business sector, one has to talk about the package that matters to them. In order to make progress in this area, it is not only a matter of giving confidence to policymakers, but also

exciting the business community that there is something to offer. Approaching it in a way that fits in with their business model is important.

In addition, Professor Christopher Findlay raised a concern about the sequence in which things are done in ASEAN. Professor Christopher Findlay feels that the purpose of a regional arrangement is to become globally competitive, and that is an important point to remember when strategies are decided upon. There is a risk in the services sector given the nature of the production process: unlike in manufacturing, the first mover in services may have some very strong advantages that may be very difficult to dislodge.

Mr Ian Buchanan agreed with Professor Christopher Findlay. According to Mr Ian Buchanan, efficient services sectors are absolutely crucial enablers of competitiveness of the economy, and therefore the world, being the people. If one hampers the development – whether by labeling it Mode III or IV, transport, logistics, communications – one will reduce the ability of the integration of the domestic economy. It is not possible to regulate some aspects of the services without damaging the economy more broadly.