Services Liberalization in South Asia: Prospects and Challenges for Regional Integration

by

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Background

- 14th SAARC Summit Declaration declared the need to integrate services into SAFTA to realize its full potential

- August 2008 Colombo SAARC Summit Declaration stated that,
  - "Extending SAFTA to include services would considerably broaden its scope and impact and boost competitiveness in key emerging sectors such as banking, communications, and aviation."

- SAARC Agreement on Trade in Services (SATIS) signed at 16th SAARC Summit in 2010

- Preliminary outcomes under SATIS negotiations not encouraging

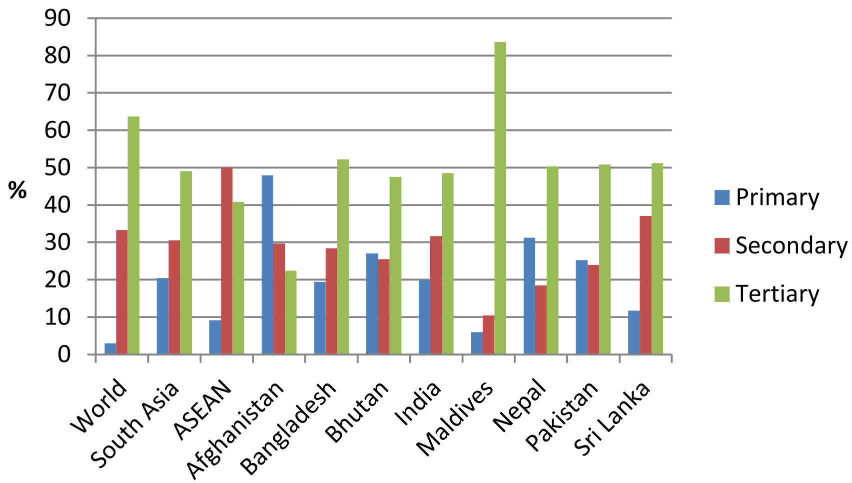
Services Performance in South Asia

- Service sector in South Asia on average grown more rapidly than in other regions, shown less volatility than other sectors

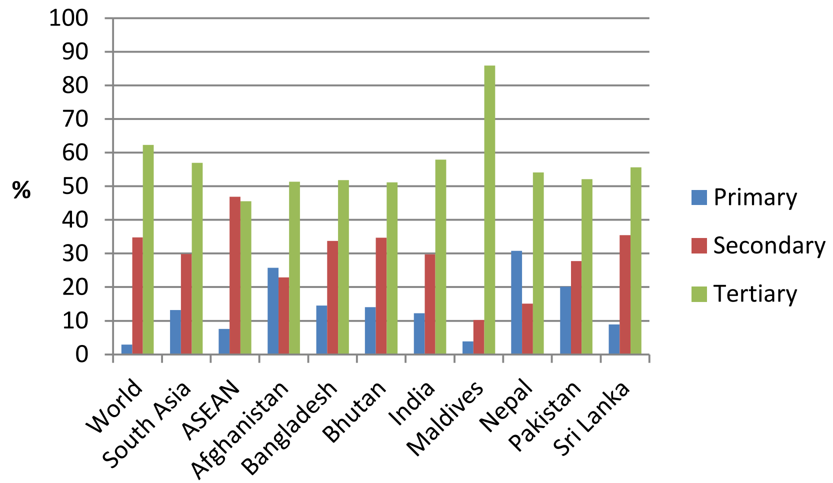
Output

- Services output registered an average annual growth of over 8% through the past decade, higher than in regions such as ASEAN, but variable across individual South Asian countries
- Services account for 50% or more of overall GDP in all the countries in South Asia, higher than in other developing regions such as ASEAN
- In some countries (Maldives) sector contributes to over 80% of GDP reflecting high reliance on certain (tourism) services
- Rising share of services in the region mainly at the expense of agricultural sector, as industrial sector's contribution increased only marginally or been stagnant
- Growth in employment not as high as in output, less than one third of total employment

Composition of GDP by sectors, 2000 (%)



Composition of GDP by sectors, 2012 (%)



Source: http://unstats.un.org/unsd/snaama/dnlList.asp (accessed December 19, 2013)

- Non-commercial (government or public administration related services) occupy a significant share of GDP in several countries in this region, part of growth non-tradable
- Communication services tend to exhibit highest growth, over 10% in most countries
- Driven by deregulation and policy reforms, role of rising incomes and domestic demand, lack of diversification in smaller economies- these factors will be important in shaping intraregional trade, investment, and collaboration in services within South Asia

Services Trade- export and import trends

- Services growth in South Asia has become more trade-oriented over time
  - Share of services trade in region's GDP increased from 3% in early 1990s to over 10% by 2010, primarily driven by India's export growth

- Both services exports and imports have experienced high growth
  - CAGR for services exports at over 20% for 2001-12 period, higher than that for world and for ASEAN
  - Performed better than goods exports at regional and country level
  - Services imports grown more rapidly than in other regions, though goods imports risen more rapidly

- Services grown in importance in the region's export basket
  - From 24% in 2000 to 33% in 2012, higher than for world and for ASEAN
  - Largest increases experienced by the Maldives, India and Nepal

- Trends in services trade performance indicate some of the countries are much more export-oriented in their service sector than the others

Role in global services market

- Significant share only for India
  - Increased from little over 1% in 2000 to 3.2% in 2012, much higher than its share of world goods exports
  - All other countries account for less than 0.2 percent of world services as well as goods exports, with stagnant shares
  - Although ASEAN shows higher penetration in global merchandise exports than in services, its global share in both services and goods exports greater than that for South Asia

- Trends suggest that South Asian economies may in general not be very competitive in global services exports

- Level of integration with world less for services imports than for exports

- Trade trends suggest that dynamics for services integration would need to be provided by India

- Likely to be subgroups within the region where progress in liberalizing services trade may be easier than for the region as a whole

Composition of services trade

- Trend towards “other services”, away from traditional services such as travel and transport
- Compared to other regions like ASEAN, services trade skewed more towards non-traditional services, share of travel services comparatively low or stagnant, except for Maldives and Nepal
- Non-commercial services (government services) constitute 20% or more of total services exports in Bangladesh, Nepal and Pakistan- lack of commercial orientation in services export basket for some larger member countries
- One common feature is growing importance of computer and information services in services exports-reflects low cost, skilled labour endowment and government policies
- Composition of services imports not changed much
- Transport services have 30% or more share in services import basket, account for nearly half of region’s services imports, greater than for the world and for ASEAN

Competitiveness in Services

- South Asia has consistently been more competitive in services than in goods, RCAs exceeding one and rising over the 2001-12 period

- RCA indices for South Asia and for individual countries higher for "other services", specifically for "other business services", very high for computer and information services, due to India's competitiveness in this subsector

- Smaller countries competitive in travel and tourism services

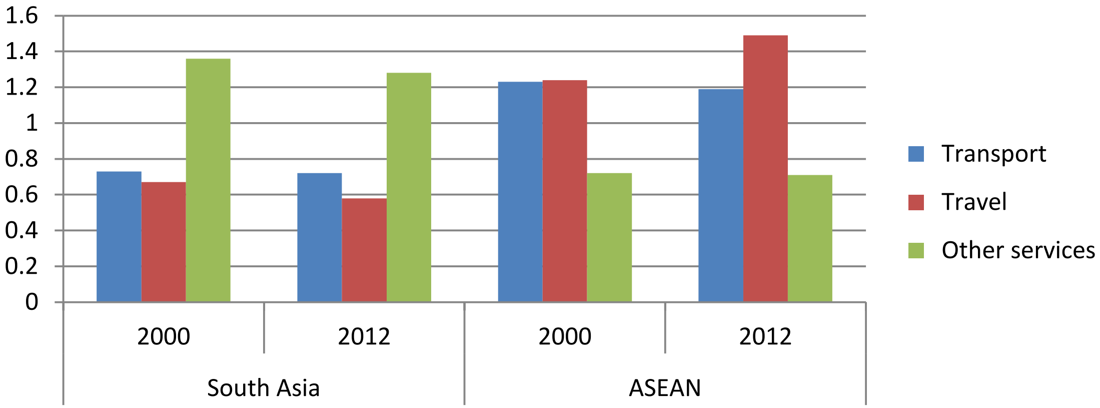
- Only Pakistan and Sri Lanka have RCAs exceeding one for transport services but for the region as a whole, both transport and travel services are not competitive

Trends in RCA indices for goods versus services, selected years

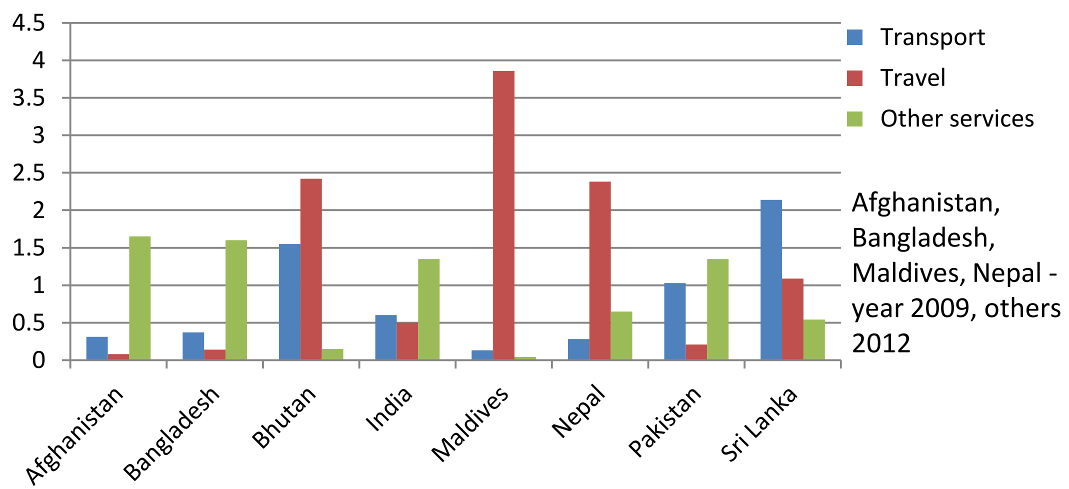
Area/Country	**2000**		**2005**		**2012**	
	goods	services	goods	services	goods	services
Afghanistan						
Bangladesh	1.10	0.59	1.10	0.60	1.15	0.38
Bhutan	1.04	0.85	1.07	0.72	1.06	0.74
India	0.89	1.48	0.81	1.76	0.84	1.67
Maldives	0.29	3.99	0.42	3.39	0.17	4.45
Nepal	0.76	2.02	0.86	1.56	0.62	2.60
Pakistan	1.07	0.69	1.01	0.95	0.98	1.09
Sri Lanka	1.05	0.77	1.00	0.99	0.88	1.48
South Asia	0.94	1.27	0.86	1.58	0.84	1.66
ASEAN	1.07	0.72	1.05	0.78	1.03	0.87

Source: http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx (accessed December 19, 2013, February 26, 2014 for ASEAN)

RCA indices for broad service subsectors in South Asia and ASEAN region, 2000 and 2012



Broad subsectoral RCA indices in services for the South Asian countries, 2012 or 2009



Source: http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx (accessed Dec 24, 2013)

- Overall trends in services exports and imports indicate sources of strength and weaknesses in services for South Asia, asymmetries in competitiveness
- Main sectors of competitiveness are “other services”, specifically, other business services and computer and information services
- Some of the smaller countries are specialized in tourism services and are competitive in niche segments
- Net import orientation in infrastructure services such as transport and logistics services
- Services trade pattern reflects resource endowment based drivers, exports dominated by labour-intensive services and imports largely consisting of capital-intensive services

Services FDI

- Considerable opening up and deregulation of the service sector in South Asia
- FDI has been allowed to varying degrees across many services, and several important services have been fully or partially liberalized.

Region/Economy	Light manufacturing	Telecom	Electricity	Banking	Insurance	Transport	Media	Construction, tourism & retail	Health care & waste management
South Asia	96.3	94.8	94.3	87.2	75.4	79.8	68	96.7	100
Afghanistan	100	100	100	100	100	100	100	100	100
Bangladesh	100	100	100	100	100	100	100	100	100
India	81.5	74	100	87	26	59.6	63	83.7	100
Pakistan	100	100	100	49	51	79.6	37	100	100
Sri Lanka	100	100	71.4	100	100	..	40	100	100

Source: http://iab.worldbank.org/Data/Explore%20Topics/Investing-across-sectors (accessed June 27, 2012)

Sectoral breakdown of FDI inflows by region, 2009 (% of total FDI)

Regions	Agriculture and Mining	Manufacturing	Services	Other
East Asia and the Pacific	3.50	45.21	50.81	0.47
Europe and Central Asia	11.43	9.14	77.17	2.25
Latin America and Caribbean	14.42	28.47	52.01	5.11
Middle East and North Africa	38.25	30.50	29.10	2.15
South Asia	3.95	22.28	72.04	1.73
Sub-Saharan Africa	57.17	15.78	24.40	2.59

Source: Reproduced from World Bank (June 2013), Table 3, p.14, based on International Trade Centre and World Bank staff calculations, based on 2009 statistics

- Services accounted for 72% of total FDI inflows in the region in 2009, but India accounted for over 80% of FDI inflows in services (and for 85% of total FDI inflows)
- Lot of asymmetry among the countries in terms of level and extent of integration with other markets through inward and outward services FDI
- Reflect differences in geography, market size, levels of development, availability of basic infrastructure, regulatory frameworks for FDI

Status of SATIS Negotiations

- SATIS signed at the 16th SAARC Summit in 2010

- SATIS resembles GATS in its architecture, provisions, carve-outs, scheduling modalities

- Progressive liberalization using a positive list approach, request-offer based negotiations

- So far, initial offers made by all member countries, excepting Afghanistan and initial request lists received by all the member countries, excepting Afghanistan

- Requests are quite extensive-cover a large number of services
  - Construction and engineering services, business services, financial, education, transport and tourism services common across request lists
  - India's requests most extensive, separate lists for LDC and non-LDC members of SAARC, computer and related services, professional services of most interest

- Carve outs with respect to measures affecting mode 4

- Offers minimal in nature, subject to many conditions

Status of SATIS offers by SAARC member countries

Sector		Bhutan	Bangladesh	India	Maldives	Nepal	Pakistan	Sri Lanka
Business Services	Professional	X		X	X	X	X	
	Computer and related	X		X	X	X	X	
	Other			X		X	X	
Communication			X	X		X	X	X
Construction and related engineering				X		X	X	
Distribution						X	X	
Education						X	X	
Environmental		X				X	X	
Financial						X	X	X
Health and related social						X	X	
Recreational, cultural, sporting						X		
Tourism and travel related		X	X	X		X		
Transport						X		
Remarks-conditions		Unbound subsidies, minimum investment requirement, FDI cap of 51%, intra-corporate transferees at management level, foreign exchange payments as per Central Bank guidelines	Network services only by government operators, foreign employees in management/specialized jobs	Differential taxation/subsidies, numerical ceiling on motion pictures, ICTs	No conditions	Maximum foreign equity of 80%, local incorporation require, no subsidies for foreign companies, ICT at managerial level, no transactions in real estate by foreigners	No subsidies for foreigners, ICT at managerial, ENT, residency requirements	Sub-sectoral carve out, FDI ceiling of 40%

- Meaningful market access not offered under SATIS
- Countries have generally offered less than 50% of possible services and within services offered, numerous sub-sectorial carve-outs, only specific segments offered
- India, has only offered 4 service subsectors, with restrictive conditions (FDI caps, necessity tests, and on mode 4)
- Important services which are critical for regional connectivity and development, or where scope for regional cooperation and commercial and social linkages, not scheduled
- Mode 3 subject to restrictions on degree of foreign versus local participation, regulation of these providers, and reservations for state operators in some infrastructure services
- Mode 4 sensitivities apparent as segments where market access could adversely affect domestic employment left out altogether or access is restricted for categories other than ICT
- An ambitious comprehensive approach to services integration seems to be subject to challenges in South Asia
- Incremental, gradual approach likely to work better in this region

- SATIS offers are GATS minus and more restrictive than unilateral policies

- SATIS commitments lower than under extra-regional agreements (India-Singapore CECA)

- Little or no progress in critical areas such as:
  - visa facilitation
  - financial services liberalization and financial integration
  - MRAs
  - infrastructure development (IT and transport connectivity)
  - investment promotion and protection and related tax and other regulations

- Only references to such issues or informal platforms where these have been discussed by industry or regulators in the region, no concrete progress

- No roadmap for services integration under SATIS

Inferences from SATIS liberalization

- General lack of willingness and preparedness to lock in existing levels of liberalization among SAARC countries
- Presence of sensitivities in several services, even in the largest and most competitive country in services within the region
- Lower levels of services commitments under SATIS than
  (a) under the GATS
  (b) comparable regional trading blocs such as ASEAN under their services agreements (AFAS);
  (c) under other bilateral agreements where services are included
- Rather defensive and closed orientation, including for India, does not bode well for regional services liberalization, which would need to provide momentum to the regional process
- Overall, South Asia lagging in commitments and in developing institutional and regulatory frameworks needed to underpin regional services liberalization

Prospects and challenges in selected services

Energy

- Huge potential given complementarities in energy resource endowments and energy consumption needs
  - Effective development of Nepal and Bhutan's huge hydropower potential could serve regional electricity needs
  - Interest from private sector companies in the region (mainly from India) to participate in generation, transmission, and distribution activities
- Estimated direct benefits from energy cooperation in the region are considerable
  - Investments in energy supply and demand technologies as well as environment related outcomes
  - Projected at $359 billion for the 2010-30 period, 0.98 percent of the region's GDP.
- Indirect benefits from such regional cooperation, due to the development of water markets, infrastructure development, and increased agricultural productivity due to better irrigation
- But constrained by lack of institutional arrangements for cooperation, absence of regional power trading networks, ownership and financing structures

Tourism

- Commonality of interest and affinity with respect to language, culture, history, religion and geography
  - sports and recreational tourism, adventure and eco-tourism, religious and cultural tourism, and medical tourism

- Huge potential intangible benefits in terms of goodwill and confidence building

- Several intergovernmental initiatives -Technical Committee on Tourism under SAARC, Working Group on Tourism

- Some bilateral agreements among SAARC governments to promote tourism

- Private sector interest in entering other markets in the region

- But constrained by poor transport connectivity, lack of infrastructure, low level of air services liberalization, uncertainty, political instability, visa issues (steep fees, lack of separate counters, onerous documentation requirements, lack of consular facilities)

Health services

- Cross-border investment in hospitals
  - Several leading Indian hospitals have entered other markets in the region, through joint ventures with a local partner, wholly owned subsidiaries, management contracts

- Medical tourism
  - Patients from Pakistan, Bangladesh, Nepal, and the Maldives in Indian hospitals
  - Driven by underdeveloped facilities and unavailability of specialized treatments in these markets, cost, quality, cultural, and geographic proximity advantages

- Telemedicine
  - Links between major hospitals in India and establishments in other South Asian countries, mainly for tele-consultation and tele-diagnostic services
  - Potential opportunities in remote monitoring of patients in other SAARC countries and tele-psychiatry

- But constrained by lack of infrastructure, resistance from local stakeholders, investment regimes, recognition and standards

Cross-Cutting Challenges

- Lack of visa facilitation
- Lack of harmonization of regulations
- Security concerns
- Lack of regional infrastructure
- Lack of institutional frameworks
- Problems with investment and business environment
- Political instability and uncertainties
- Protectionist policies in member countries

Factor Mobility- Intraregional FDI and Labour mobility

- Most of intraregional FDI is from India, much of this in services, but South Asia has a whole only 1.5% of India's outward FDI flows (1996-07)
- Intraregional FDI indicates absence of wider regional integration through investment flows, limited attractiveness of the region for India, presence of FDI restrictions between India and Pakistan
- Intraregional mobility mostly in semi and low skilled informal sector activities in agriculture, construction work, factories, transport, restaurant and security services
- Intraregional labour flows relating to formal service sector occupations such as business and professional services not significant, owing to:
  - restrictive and non-transparent visa and work permit regulations, lack of recognition of professional qualifications, nationality and residency requirements, investment linked conditions (such as requirement of local partnership), resistance from professional bodies and security related concerns

Intra-regional greenfield FDI inflows by recipient country and sector, 2003-11 (% of recipient country's total intraregional FDI)

	Bangladesh	Bhutan*	India	Maldives	Nepal	Pakistan	Sri Lanka
Manufacturing	40.4	1.1	16.7	1.4	23.9	77.4	19.3
Food and Tobacco	1.6	0.0	1.8	0.0	0.0	4.8	1.1
Mining and Extraction	0.0	0.0	0.0	0.0	22.5	0.0	0.0
Business, Financial, IT and Health Services	12.8	7.8	3.1	5.3	9.3	17.9	16.3
Hotels, Tourism and Entertainment	1.3	0.0	0.0	13.1	0.0	0.0	7.5
Construction and Real Estate	4.1	0.0	71.5	80.1	0.0	0.0	23.4
Communications	0.0	0.0	0.0	0.0	0.0	0.0	5.6
Transportation	0.0	0.0	0.4	0.0	12.0	0.0	6.1
Energy	39.8	91.1	0.5	0.0	31.7	0.0	20.7

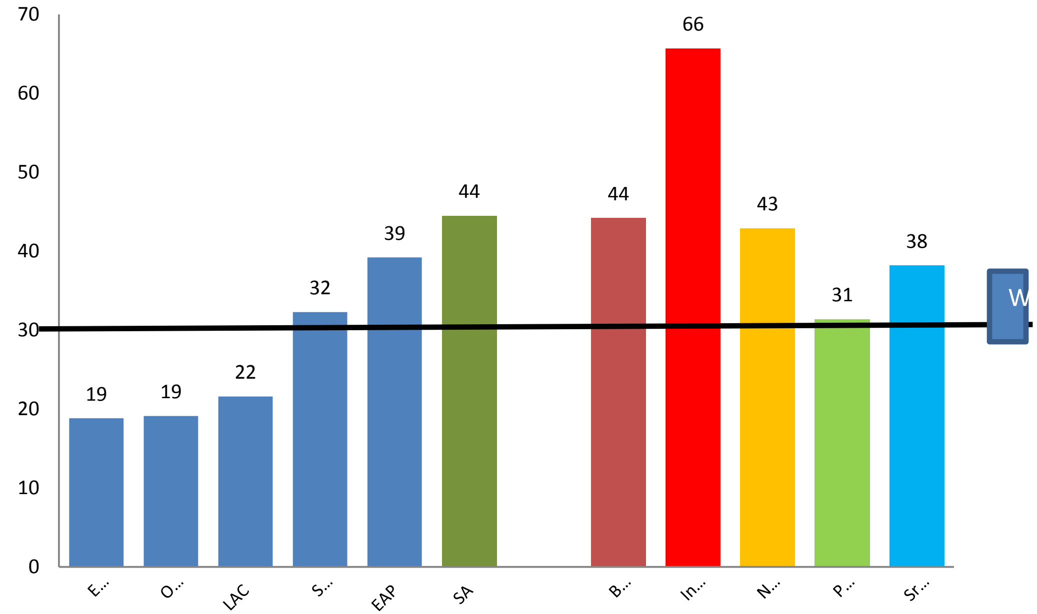
Source: Reproduced from World Bank (June 2013), Table 6, p.18

Restrictive regulatory environment

- South Asian countries perform quite poorly on various dimensions of their overall regulatory and business environment, which undermine their border liberalization

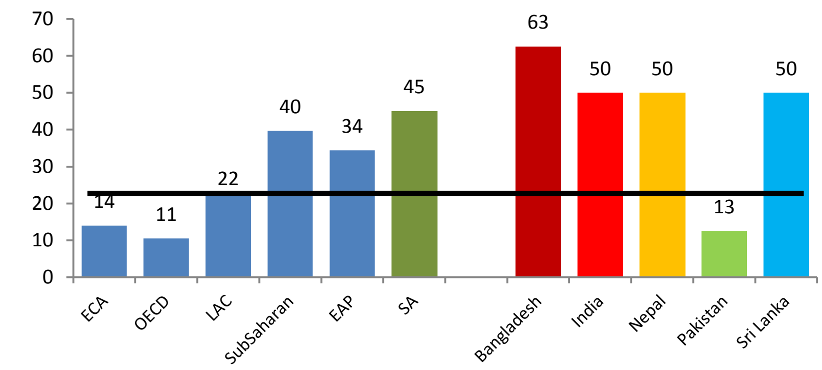
- In services, South Asia as a region and several SAARC countries much more restrictive than other regions, due to many "behind the border" domestic regulations- carve outs, anti-competitive practices, monopoly provision

- *Regional services liberalization can only take place in a meaningful way if supported at the national level by unilateral liberalization and "behind the border" reforms, improvements in the regulatory and business environment in individual member countries*

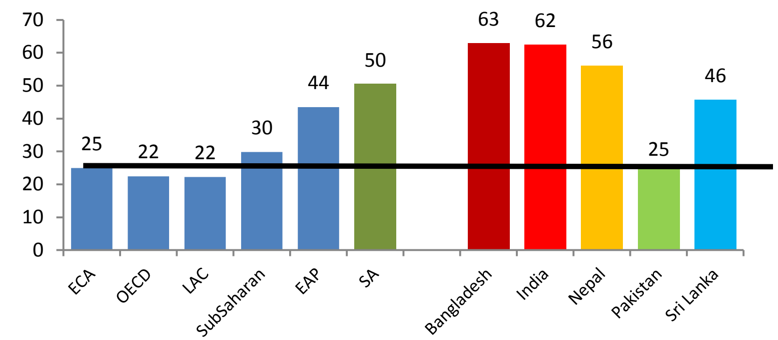


Source: Reproduced from World Bank (forthcoming 2014), based on Borchert, Ingo, Batshur Gootiiz and Aaditya Mattoo (2011)

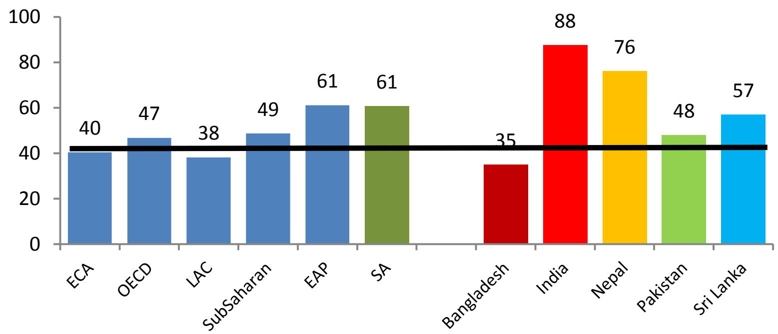
Telecommunications Services Restrictiveness



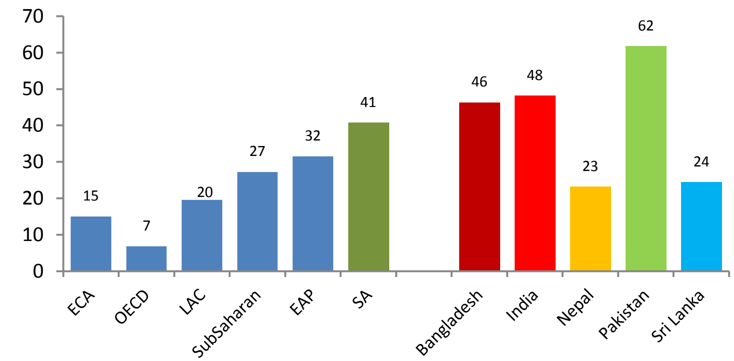
Transport Services Restrictiveness



Professional Services Restrictiveness



Financial Services Restrictiveness



Source: Reproduced from World Bank (forthcoming 2014), based on Borchert, Ingo, Batshur Gootiiz and Aaditya Mattoo (2011)

- High incidence of regulatory restrictions for these different services suggests presence of trade barriers affecting all modes of supply

- Mode-wise indices of regulatory restrictions for these services quite high

- High incidence of barriers to movement of labour and movement of capital in the South Asian countries relative to other regions

- Also restrictions in financial services which affect investment, people mobility, trade in goods and services:
  - Exchange controls, inability to list foreign companies in SAARC markets without forming locally incorporated subsidiaries, on raising of capital in local capital markets by foreign companies, on establishment of banks and other financial institutions in each other's markets, repatriation of foreign currency earnings and outward remittance flows
  - Divergence in the development of their capital markets and lack of harmonization of standards and regulatory frameworks in financial services

- Political economy constraints to liberalization
  - Resistance from from professional bodies on mode 4
  - Resistance from domestic stakeholders

Way Forward

- Potential gains from services integration in South Asia due to an interesting mix of asymmetries, complementarities, commonalities across countries in this region

- Asymmetries and complementarities in size, levels of development, technical and institutional capacity, private sector enterprise, and financial and human resources create scope for resource flows between the countries in this region

- Four mutually interdependent drivers of services integration in South Asia
  – Infrastructure gaps that exist in the region
  – Presence of a dynamic private sector
  – Social, cultural and historical ties
  – Institutional and human resource capacity requirements in the region.

- Key channels for making integration possible
  – *Mobility of production factors* in the form of financial and human resource flows
  – *Mobility of consumption factors* in the form of consumer flows

Some suggestions

Prioritize sectors for action

- Identify priority areas under SATIS-transport and logistics, ICT and telecom connectivity and energy where cooperation can yield huge benefits to member countries in the region

Prioritize issues for action

- Identify priority cross-cutting issues-free flow of services, investment, capital and skilled labour as core elements for creating a single market in services

- Formally recognize issues such as MRAs, visa facilitation, investment provisions and related areas like financial services under SATIS

Negotiating approaches: flexibility with accountability

- SATIS needs to set some timelines on deliverables
- Allow incremental approach to coverage and depth of commitments
- Allow for sub-regional negotiations in region

Negotiation approaches- Fast tracking and prioritization

- Incremental, phased and prioritized approach required on sectoral coverage
- First liberalize the least contentious services (tourism or IT)
- Pilot projects could be launched in these services, on a plurilateral and sub regional basis
- Already identified initiatives (Buddhist tourism circuit under the SASEC programme) could be taken up on a priority basis and related issues of mobility, transport connectivity, tourism infrastructure development, investments worked out
- Pilot based approach in selected services could provide confidence and practical experience to engage in larger and more complex regional projects
- Could expedite negotiations by introducing some degree of automaticity in the negotiating modalities
  - SATIS members could agree to liberalize cross border supply and consumption abroad for a majority of services as these are relatively less restricted modes of delivery
  - Would enable greater focus on issues such as investment and labour mobility, which are more sensitive modes of supply, thus economizing on negotiating effort

Negotiation approach- sub-regional platforms

- Incremental and phased approach could be taken with regard to country participation in services discussions

- Proceed on issues and sectors and sub-sectors where there is a minimum core group of 3 or more member countries interested in participating rather than an "all member" and "all services" based negotiating approach

- This group could be expanded over time as outcomes are realized among a smaller set of countries and there is learning by doing

- Attempt could be made to build on existing bilateral agreements and other plurilateral agreements and use an open regionalism approach as in ASEAN

Investment facilitation

- Focus on speedier clearances and approval procedures in general
- Fast track procedures for regional investors with prior collaboration or expertise, fast track clearances in identified services where fewer sensitivities
- Provision of regular and updated information on the regulatory framework governing investment in different services through government websites and reports
- Consider a regional investment treaty and double taxation treaties among the countries
- Harmonization of rules and procedures, mutual recognition of standards and technical specifications in services within the region
- Finalize bilateral investment treaty between India and Pakistan
- Adopt common standards and regulations in financial services, remove certain restrictions
- Introduce an investment chapter in SATIS

Facilitate intraregional mobiilty

- Streamline visa procedures and requirements for selected categories of persons within the region

- Mobility of people relating to investment flows could be given priority
  - business visitors, intra-corporate transferees, and professionals and academics against bonafide approved or prospective investment projects, institutional tie-ups, and exchange arrangements

- Introduce streamlined processes and speedier approvals for special categories of services consumers, such as medical tourists, students, leisure travelers, and transit travelers

- Indian government's endorsement for a liberalized regional visa regime and more than doubling of business visa exemption stickers from 200 to 500 at the 5th SAARC Business Leaders Conclave in January 2014 a welcome step

Improve connectivity

- Address transport connectivity
  - identifying selected bilateral and sub-regional projects to develop road and rail transport links and joint investments in these projects
  - sign open skies agreements between countries in the region
  - develop transit hubs in the region

Regulatory cooperation and harmonization

- Investment and labour mobility facilitation will require institutional and regulatory cooperation in specific services and generally

- Discussions required on establishment of standards and mutual recognition

- Discussions required among governments, regulatory bodies, professional associations, industry associations, research institutions, and civil society in the region to:
  - share information, exchange best practices, collect data, conduct joint feasibility and impact analysis studies, identify priority areas for a services agreement, develop soft skills, create regional templates for investment or immigration related initiatives

Final thoughts

- Only an incremental and progressive approach to services liberalization feasible under SATIS, given lack of preparedness in member countries and many challenges

- Working groups could be set up on issues and services of common interest, ambit of liberalization expanded gradually to cover more services

- Industry in the region will need to play a greater role by highlighting the benefits of cooperation and the costs of non-cooperation while political leaders at the highest level in the region have to show commitment and will

- India must provide momentum to regional negotiations-commit more extensively under SATIS, move discussions on investment, labour mobility, regulation, standards