

## **International Conference on “Broadening Economic Integration in South Asia: Incorporating Services Liberalization at a Time of Global Economic Crisis”**

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### **Outcomes and Way Forward**

In the wake of the global downturn, global trade in services has been severely affected, mainly in terms of decline in imports of services of developed countries. Scope of increasing trade within the region and inter-region, possibly ASEAN, has become a timely need. According to available data, South Asia’s exports of commercial services, which were growing by 19 per cent in the first nine months of 2008, have dropped to an 11 per cent decline in the last quarter with travel, transportation and commercial services recording a maximum decline. Despite the initiatives, the proportion of intra regional trade and investments in South Asia is still quite modest. In 2001, the intra-regional trade was only 4.9 per cent of the total trade (with members and non-members) of the SAARC countries while intra-regional trade in ASEAN and Mercosur was around 22.4 per cent and 20.8 per cent respectively and in 2006, intra-regional trade constituted less than 2 per cent of GDP against 20 per cent in East Asia.

The composition of trade in services in South Asia depicts the fact that imports of services were higher than exports of services for the SAARC region, since 2007 total exports have become higher than the total imports of services in the region-mainly due to India. Almost all South Asian countries are net exporters of communication services. Travel services are found to be an important service in terms of exports for almost all South Asian countries (apart from Bangladesh and Pakistan). All the South Asian countries are net importers of transport services, with India being the biggest importer followed by Pakistan. India and Pakistan are also net importers of insurance, financial and other business services. Comparative advantages in different services sectors in South Asian countries have economic rationale for boosting inter-regional trade in services in SAFTA. Discussions suggest the fact that sectors like tourism, IT, telecommunications, transport, energy, health, education and professional services should be included in SAFTA negotiations, for instance, in transport services, Pakistan and Sri Lanka have competitive advantage, India has a competitive advantage in construction services, computer and information services and other commercial services, Maldives and Nepal are found to be more competitive in travel services, and Bangladesh has a higher competitive edge in financial services.

South Asia is one of the most important exporters of services through the movement of natural persons (or temporary migration of workers) - both high skilled and low skilled (Mode 4 under GATS). In 2005, South Asia received US \$ 32 billion as remittances and across all the countries, remittances constitute between 2 per cent to 12 per cent of GDP with Nepal receiving 12.1 per cent, Sri Lanka 8.1 per cent and Bangladesh 5.5 per cent of the GDP. It was identified that the most common way to achieve recognition is through bilateral agreements. Once bilateral agreements are achieved, this can lead to other bilateral agreements and eventually to regional agreements. India and Sri Lanka are already working on the aforementioned, and other likely candidates could be invited to join. Moreover, cultural and historical relations pave the way for a smooth functioning in bilateral negotiations.

Provision of many services like transports and infrastructure has been under State monopolies for a long time in South Asian countries and only in the last decade or so privatization of these services has taken place. This offers provision of services by foreign service providers an extremely sensitive issue as it entails the risk of eroding not so competitive domestic

investments in these services. Yet the hindrance is not being able to regulate the quality and prices of the services provided.

South Asian countries monopolized many service sectors until the early 1990s, particularly the infrastructure sectors including transport, telecommunications and electricity. Weak financial situation of most infrastructure sectors and inadequate access to services showed that governments were not able to fulfill the demand for these services. But in many countries domestic private investors either do not have the capacity or capability to meet the growing excess demand in services, for example in telecommunication services. In the face of the excess demand the quality provided by the foreign investors may suffer and the prices demanded may be too high and unaffordable. Consequently, many governments have agreed to the establishment of independent regulatory commissions in key infrastructure services sectors. In many services sectors domestic regulations are still not in place. There is a perception that services sectors in South Asia continue to be over-regulated and as a result, South Asia is not fully realizing its growth potential.

Existence of barriers to FDI is also one of the reasons for low share of the region in global and regional FDI in services in spite of the liberalizing policies adopted by the countries. Restrictions may apply at the point of entry, stretching from mere notification requirements to outright prohibition of FDI, ownership and control. Also, the restrictions may vary with the nature of services, For example, in distribution services, restrictions may include performance requirements, zoning regulations and advertisement restrictions. In professional services, restrictions used are generally of the nature of nationality, residency requirements and lack of recognition of foreign qualifications. Thus, even if equity restrictions are removed there may be other restrictions that may not allow inflow in FDI into services sectors. Sri Lanka has opened many of its services to foreign investments. Foreign commercial banks are allowed to open branch offices in Sri Lanka, subject to an economic needs test and approval by the Central Bank and foreign investors are allowed to hold 100 per cent equity in local banks, subject to limits on individual share ownership. Countries restrict FDI to avoid the risk of foreign investors out-competing domestic investors. Countries without the necessary regulatory framework may lose by rushing into liberalization, particularly when a reversal of the liberalization is hard to achieve or when liberalization has “systemic implications”, as in the case of the financial industry. Over-regulations need to be avoided in sectors where FDI is required and when domestic service-providers do not have the capability and capacity to fulfill excess demand

Through liberalizing the services sector, foreign firms can reap economies of scale, if they are able to set up base in one country and provide services to other countries in the region, for example, in higher education services, intra-regional cooperation in movement of students and professionals can attract renowned universities and professional colleges to open campuses in any one country in South Asia. Through opening up to the region in a limited way initially, may assist countries to adjust their domestic regulations in a way that assures better quality of services provided at competent prices. Given the similar levels of structural development, geographical proximity and cultural ties, it will be easier for South Asian countries to negotiate Mutual Recognition Agreements (MRAs) in services. Regional cooperation in services can encourage countries to specialize in different stages of value-chain and in the process, exports of all concerned countries rise along with the specialization of the region. Such a value chain can be formed in information and technology enabled services (ITES) and outsource with countries like Bangladesh, Sri Lanka, Pakistan and India specializing in different ends of the value-chain.

Domestic regulations may lead to higher prices of services that were earlier available at a subsidized rate under public-private ownership. These rises in prices may translate into higher inflationary pressures reducing the overall welfare of the economies. To circumvent such spirals

it is important for the region to have appropriate domestic regulations in place, which will assure better quality of services at affordable prices. Clear domestic regulations will also increase the transparency in the system and encourage foreign direct investments.

The requirement of a good understanding of domestic service sectors at national level and the interest at regional level was highlighted throughout the Conference giving special consideration to the following issues: the need to understand trade prospects in sub-sectors, activities, modes of supply, internal constraints, competitive advantage areas and sources, extent and nature of liberalization undertaken and resulting impacts, nature of regulations and regulatory framework, extent of regulatory preparedness and inadequacies. It is important to get a multi-stakeholder consultation in making the initial assessment at national and regional levels: involvement of private sector, industrial associations, professionals, civil society groups, academics and researchers. The discussions should identify opportunities and constraints, initiatives on the ground and their progress, practical issues of implementation, possible solutions, priority areas, and sensitive areas. Additionally, business surveys are required to recognize the nature and incidence of regulations, relative importance and ranking in terms of priority areas. SAFTA services negotiations must receive early inputs from industry delegations and lawyers at drafting legal texts and frameworks and in ensuring coherence in provisions.

Detailed case studies on selected sectors in each country quantifying incidence of regulatory barriers, creating indices or other measures of restrictions in services to understand sectors and related issues will facilitate an effective liberalization in the services sector. Case studies require addressing data issues through national and regional efforts identifying the kind of information needed (bilateral, sub-sectoral, modal) and approaching relevant institutions. There is also the need to examine services and benchmark sectors where cases for trade and investment complementarities, common interests, and synergies exist

Consensus appears to be that a GATS positive list approach may be most appropriate in liberalizing the services sector in South Asia with gradual phasing out of commitments and with additional sectors and sub-sectors being scheduled as countries gain confidence and willingness to expand scope and depth of commitments. It is evident that there is a vital need to ensure key infrastructure services where clear gains and synergies and commonality of interests exist, for instance transport and logistics, energy services. Several services may need an innovative approach to scheduling and if required need to deviate from GATS classification to ensure relevant activities included in regional negotiations (air transport, logistics and energy). Some services' initial focus can be limited to cooperation alone expanding gradually to commitments depending on the nature of the domestic environment. It was identified that Inter-sectoral and Inter-modal linkages need to be delivered into negotiations, for instance, air connectivity and tourism, telecommunication and IT-ITES, visa facilitation and professional services, and professional services and investments.

Existing asymmetries in levels of development, degree of maturity and preparedness across countries in different services require a flexible approach that permits special and differential treatment of the LDCS/less prepared countries, provisions for withdrawal or modification of commitments made, periodic reviews and impact assessment and less than full reciprocity. Plurilateral approach within the region, with bigger countries making first move in some sectors and modes could address imbalances. Finally it was deliberated that the possibility of MRAs with ASEAN needs to be explored by South Asian countries as India has already set a stepping stone in exploring possibilities of Indo-ASEAN MRAs.