

# Filling In The Gaps

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TRADE IN SERVICES IN SOUTH ASIA: OPPORTUNITIES AND RISKS OF LIBERALIZATION

Edited by Saman Kelegama

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This book of essays addresses an important issue of liberalization of service trade in South Asia. It examines seven individual country cases of India, Pakistan, Sri Lanka, Bangladesh, Nepal, Maldives and Bhutan. In addition, there are three other chapters, an Introduction by Saman Kelegama, a South Asian Perspective by Rashmi Banga and a final chapter on domestic regulation and General Agreement on Trade in Services (GATS) by Parashar Kulkarni. The discussion is somewhat limited by data availability and some ambiguity of South Asian Governments as to what they are seeking to achieve under the GATS framework and in opportunities for both multilateral and regional trade. Little is said about unilateral or (autonomous) liberalization given the focus of the volume on regional issues.

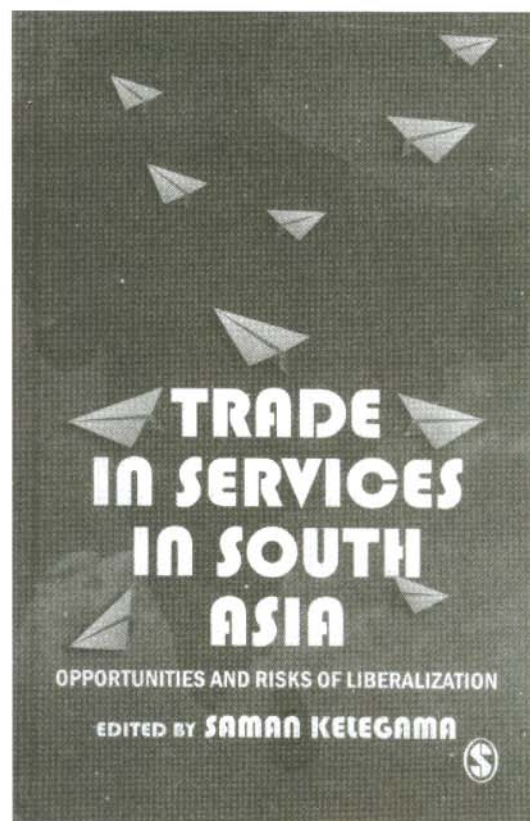
Services liberalization is a difficult topic since it is not confined to transactions at the border, typical of goods trade. Besides it is not possible to precisely identify the nature of the service that is offered, as to its content and value. Kelegama takes a more pragmatic approach to the issues under discussion and clarifies them in a lucid manner. Of course his task is made difficult due to the absence of a single framework of reference for the country authors and the disparate quality of the papers. Nevertheless, the introductory chapter does credit to a difficult discussion of the central issues of services liberalization. One small peeve that this reviewer has is that there is no symmetry in the presentation of the opportunities and risks. One gets the impression that risks are exaggerated and the opportunities are underplayed. That is not surprising given that South Asia has not been known to be particularly enthusiastic for trade liberalization. Besides, this position has received support from the United Nations Conference on Trade and Development (UNCTAD), which continues to champion import substitution in a more sophisticated way compared to its past positions. India was a bulwark against trade liberalization in the past and gave in only in 1991 in the throes of a macroeconomic crisis. Sri Lanka broke that mould when it liberalized trade in goods in 1977 but it has not followed it up with a more open agenda for trade liberalization. India reaped many benefits including raising the GDP growth rate to 6–8 per cent breaking away from the 'Hindu rate of growth' identified by the famous Indian economist, Raj Krishna in the 1960s.

Services are classified into four modes: services supplied across the border (or Mode 1) such as phone calls. Services consumed abroad (Mode 2) such as tourism, Services that require commercial presence (Mode 3) such as foreign banks and movement of natural persons (Mode 4) such as consulting services. Trade in services in all these modes is of interest to South Asian countries trying to break into the world market in areas where they have comparative advantage.

Three other chapters in the volume warrant special mention. Chapter two on India by Rupa Chanda does justice to a complex set of issues relating to services liberalization. India has made an impressive debut in the world markets with information technology (software), business services (due to out-sourcing by industrial countries) and communication services. Thus India is relatively more interested in Modes 1 and 4 as it has strong comparative advantage in these sectors. It is in this area that India takes an offensive strategy. It takes a defensive strategy in sectors such as retail, insurance and legal services. Major constraints exist in India with over-regulation, poor infrastructure and ambiguity with respect to opening its service sector faster, compared to all competitors, not only those from South Asia.

Chapter 4 on Sri Lanka by Deshal de Mel has a special interest for Sri Lankan policy makers, market participants and all interested parties in this area. The two large areas in services export are transport and tourism. Sri Lanka is interested in reducing barriers for its service export in Mode 1 and Mode 4 and is more open to foreign competition in mode 3. The author feels that Sri Lanka has to follow a defensive strategy given poor data sources, weak regulatory frameworks, and limited language capability in English and in IT capabilities. These are also areas common to other countries in the region.

Chapter 9 by Rashmi Banga on 'Liberalizing Trade in Services: A South Asian Perspective' provides an analytical approach to the issue. Both the volume and the composition of service trade have changed in the decade to 2003. Services exports from the region are led by computer and information services, thanks to India's dominance. Services imports have been led by computer and information services, construction and financial services and other business services. India leads the region with its revealed comparative advan-



tage (RCA) in computer and information services. Bangladesh leads in RCA in communication services while Maldives leads in travel services. Sri Lanka does not lead in any particular sector in the eight sector classification. However, since it is with respective comparative advantage what matters is the relative position of the compared to the country's comparative advantage and not which country leads in which area. Thus, for example, Sri Lanka has greater comparative advantage in construction services compared to other commercial services. In any case, RCA analysis is only indicative. It suffers from three limitations. First, the period is dated by six years in the past. Second, to be guided by even the RCA of last year is like driving your car by looking at the rear-view mirror and RCA's has limited value in revealing comparative underlying cost structures. Finally, since information technology is implicated in these services, a doubling of memory capacity takes place every two and a half years such that six years would have produced more than a quadrupling of memory capacity and hence affected relative prices.

Services liberalization is inherently difficult. But to add to that difficulty is the goal of liberalizing in the context of region, where the seven countries have to agree on what and when to liberalize services trade. There are the classic trade creation and trade diversion that Viner identified in the 1950s as the theoretical framework in which to examine economic integration. The seven countries have different agenda which makes it difficult to agree on a common front. India with its enormous size and its known historical aversion to trade and service liberalization is a clear leader in the South Asian context.

Bangladesh as a least developed country has easier access to developed country markets as does Nepal. Bhutan is not yet a member of the WTO and it has not made any commitments to liberalize trade in either goods or services. On the other hand, the new members such as Nepal made more commitments as a condition of entry into the WTO. Thus the task that the book set for itself is a difficult one. Nevertheless, these issues have to be addressed. Data have to be compiled and examined with respect to services, policy makers and the business community must be involved in a preparing a services liberalization strategy. The volume of essays makes a good contribution to this task but it is still only a beginning.

Beyond the RCA estimates, South Asian countries have a natural comparative advantage in tourism, retail trade, deployment of contract workers, port facilities among other sectors. Only a limited number of sectors have been committed to liberalization. As before, the fear (often misplaced) is that liberalization would lead to greater income inequality and increase levels of poverty. The empirical record is the opposite. South Asian anxieties have to confront what China has done in its Southern and Eastern (coastal areas). After liberalizing the economy at a rapid pace since 1989, China has raised 300 million out of poverty, a unique event in the annals of world economic history. It has one of the most liberal investment and regulatory regimes. It is the largest recipient of foreign direct investment in the world today. And, it has opened itself to competition on many fronts including services.

In the light of that experience the essays in the present volume are over-cautious and bashful about contemplating what would happen if the South Asian countries followed the China model or for that matter other models including Indonesia, Thailand and Malaysia, who have relatively open services sectors that have gained much from the four modes of service delivery.

Going beyond the present volume, the present reviewer finds four issues that could have substantial impact on service liberalization: first, countries considering services liberalization would do well to focus on unilateral or autonomous liberalization on the grounds that freer trade yields better results than restricted trade. This basic conclusion applies to services too. And, liberalizing trade by any means is better than not liberalizing trade in goods and services. A corollary is that unilateral liberalization may provide better opportunities than done in a regional context. Otherwise, Sri Lanka for example, would have had to move at the slower pace within a regional context.

Second, although under the GAT provisions, services liberalization is not required to follow the Most Favored Nation principle ( meaning no preferences are given to any

other country), it is not a bad strategy because primarily countries liberalize to increase their own welfare and not regional welfare. Regional integration could be a subsidiary project of MFN liberalization and in fact it could achieve greater integration than through negotiation within the region.

Third, it is also good to be reminded that services liberalization is a positive sum game and not a zero sum game. All parties can benefit, of course some will derive greater benefit given their advanced regulatory regimes, state of infrastructure, and role of private sector participation. There will be some losses in countries that do not have natural comparative advantage or have not acquired it in some areas. Overall, one can predict that exports will be intensive in labour content compared to being intensive in capital. This will support greater employment opportunities compared to restrictive policies that reward capital intensive project.

Fourth, the bifurcation of services liberalization strategy into offensive and defensive approaches is neither a good overall strategy, nor does it fit trade liberalization in general since all can benefit, including your rivals by exchange. This military metaphor is more consistent with arms limitation negotiations than to negotiations that apply to trade.

Finally, service liberalization will have a profound impact on goods liberalization. Consider the importance of financial services, transport, and communications technology for trade in goods. All these services are important determinants of comparative costs. Services liberalization by inducing competition will reduce the cost of these services and make the goods trade more competitive. As a corollary, a slower rate of service liberalization will have an adverse impact on goods trade.

To sum up, this volume of essays makes a very good contribution to the examination of services liberalization issues. It is highly informative, analytically well developed and it fills a much needed gap in our knowledge. It should be required reading for all policy makers engaged in this area, private sector participants and academics alike.

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#### Book News

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*Understanding Indian Society: Past and Present—Essays for A.M. Shah* edited by B.S. Baviskar brings together scholars across disciplines to write about the dynamic character of Indian society. The fifteen essays explore a wide range of issues, and the collection demonstrates the analytical richness of current scholarship. Orient Blackswan, 2010, pp. 378, price not stated.