Services Globalization in an Age of Insecurity: Rethinking Trade Cooperation

Aaditya Mattoo
April 25, 2018
Services are different from goods but also from each other

- Services transactions often require face-to-face contact.
- There is a risk of market failure, especially because consumers are not well-informed about suppliers.
Either producers must to move to consumers or vice versa...

...and regulation is often needed to protect consumers
Of course, services markets are changing

- DIGITAL COMMUNICATION
- Mobile Banking
- RIDE SHARING
- TELEMEDICINE

• Technology is reducing, but not eliminating, the need for face-to-face service delivery
• “Over-regulation” is leading to the emergence of new services
Services “trade” has a wide scope and potential impact

1. Cross-border Trade
   - Outsourced IT and back-office services
   - International transport
   - International communication

2. Consumption Abroad
   - Tourism
   - Education abroad
   - Health care abroad

3. Commercial Presence
   - Banking
   - Retail distribution
   - Telecommunication
   - Education

4. Movement of Natural Persons
   - Construction workers
   - Doctors and nurses
   - Performers
I. Digitization and aging are driving services trade but “divergent globalization”

II. Much unilateral liberalization, but still big barriers and big unrealized gains

III. Better regulation the basis for success in both reform and exporting

IV. Greater tax and regulatory cooperation the key to sustaining openness and successful trade negotiations
Goods trade stumbles, but services trade does not fall

Services trade declined less during the crisis and has grown faster after the crisis

China’s rebalancing and demographics are already shifting demand towards services

Who is participating in services trade?

Comparative advantage in services is determined by the interplay between:

- Endowments, especially of skills
- Infrastructure, especially telecommunications
- Institutions, especially regulatory
New value added trade data reveals evolution of comparative advantage and structural change

Direct and indirect value added exports of financial services, share of GDP, 1995-2009

Direct and indirect value added exports of business services, share of GDP, 1995-2009


Note: Does not include Ireland and Luxembourg
Binding constraint on job-creation is not high skill intensity of services production but low availability of skills

The surprisingly high unskilled labor value added in services exports

Labor value added (LVA) in $1000 of exports

Source: Joint work with Alen Mulabdic based on Cali et al (2016), "The Labor Content of Exports Database."
II. What are the barriers to trade and how big are the gains from reform?
The Services Trade Restrictions Database

World Bank Services Trade Restrictions Database covers 103 countries (of which 79 are developing)

The persistence of protection

STRI by sector and region

India’s services reform boosted performance of downstream manufacturing industries

**Gains in Annual TFP Growth After Services Reform**

- Industries with limited dependence on banking
- Industries with high dependence on banking
- Industries with limited dependence on telecoms
- Industries with high dependence on telecoms


**FINANCIAL TIMES**

Modi to refresh ‘Make in India’ manufacturing drive
February 14, 2016
More open bilateral air service agreements could lead to more traffic on existing routes and more cities being served.

Source: Cristea, Hillberry and Mattoo (2015), 2015 Open Skies over the Middle East, forthcoming in the World Economy.
Potentially big gains from the international fragmentation of education

• Need for education to be fragmented between:
  – Standardized components which poor would have a comparative advantage in providing and
  – Specialized components which would continue to be provided in rich world

• Cost-saving from even 2 years of education abroad could be $90,000 or 40% of the cost of a 4-year US medical education

• Quality is probably not a serious problem. Why?
  – About one-quarter of doctors, medical faculty, and nurses are already foreign trained

• Mobility is already rising:
  – Post-secondary US students studying abroad jumped from 65,000 in 1987-88 academic year to 260,000 in 2008-09.
  – US students studying in developing countries increased from around 2,500 students in 1987-88 to 57,000 in the 2008-09 academic year.

• But again lack of portability of qualifications and scholarships is a problem

Source: Mattoo and Subramanian (2013)
### Access to markets (mode 4)
The regulatory tax on foreign professionals in the US

<table>
<thead>
<tr>
<th>Profession</th>
<th>Number of Indian professionals coming to the US annually (average for the 1995-2000 period)</th>
<th>Visa, examination and licensing fees paid per professional</th>
<th>Average income foregone per professional due to differential requirements</th>
<th>Total Income/ fees paid or lost by Indian professionals due to regulations (US$ in million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Physicians and Surgeons</td>
<td>1092</td>
<td>$4,640</td>
<td>$100,000</td>
<td>114</td>
</tr>
<tr>
<td>Civil and Mechanical Engineers</td>
<td>683</td>
<td>$2,270</td>
<td>$60,000</td>
<td>43</td>
</tr>
<tr>
<td>Accountants</td>
<td>518</td>
<td>$5,600</td>
<td>$30,000</td>
<td>18</td>
</tr>
<tr>
<td>Architects</td>
<td>350</td>
<td>$3,030</td>
<td>$25,000</td>
<td>10</td>
</tr>
<tr>
<td>Total for all professionals</td>
<td>10234</td>
<td>$60,000-$75,000</td>
<td>$60,000-$75,000</td>
<td>614-768</td>
</tr>
</tbody>
</table>

Access to markets (mode 1)
Privacy regulation - a European Damocles sword

NASSCOM-DSCI Survey of the Impact of EU Privacy Regulation on India’s Services Exporters

Non-fructification of deals because of data protection related concerns

<table>
<thead>
<tr>
<th></th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Response</td>
<td>67%</td>
<td>33%</td>
</tr>
</tbody>
</table>

Estimation of Opportunity Loss (in USD)

<table>
<thead>
<tr>
<th>Range</th>
<th>Opportunity Loss</th>
</tr>
</thead>
<tbody>
<tr>
<td>500 million - 1 billion</td>
<td>6%</td>
</tr>
<tr>
<td>100 million - 500 million</td>
<td>11%</td>
</tr>
<tr>
<td>10 million - 100 million</td>
<td>22%</td>
</tr>
<tr>
<td>1 million - 10 million</td>
<td>33%</td>
</tr>
<tr>
<td>Below 1 million</td>
<td>11%</td>
</tr>
</tbody>
</table>

Source: NASSCOM-DSCI Survey (2013)
The US could save over $1.4 billion annually even if only one in ten US patients chooses to undergo treatment abroad.

<table>
<thead>
<tr>
<th>Procedure</th>
<th>US inpatient price ($)</th>
<th>US inpatient volume</th>
<th>US outpatient price ($)</th>
<th>Estimated US outpatient volume</th>
<th>Foreign price including travel cost ($)</th>
<th>Savings if 10% of US patients undergo surgery abroad instead of in the US ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Knee surgery</td>
<td>10,335</td>
<td>399,139</td>
<td>4,142</td>
<td>60,000</td>
<td>1,236</td>
<td>380,604,366</td>
</tr>
<tr>
<td>Shoulder Arthroplasty</td>
<td>5,940</td>
<td>23,300</td>
<td>7,931</td>
<td>N/a</td>
<td>2,204</td>
<td>8,704,809</td>
</tr>
<tr>
<td>TURP</td>
<td>4,127</td>
<td>111,936</td>
<td>3,303</td>
<td>88,064</td>
<td>2,385</td>
<td>27,581,317</td>
</tr>
<tr>
<td>Tubal Ligation</td>
<td>5,663</td>
<td>78,771</td>
<td>3,442</td>
<td>621,229</td>
<td>1,248</td>
<td>171,065,574</td>
</tr>
<tr>
<td>Hernia Repair</td>
<td>4,753</td>
<td>40,553</td>
<td>3,450</td>
<td>759,447</td>
<td>1,608</td>
<td>152,655,706</td>
</tr>
<tr>
<td>Skin lesion excision</td>
<td>6,240</td>
<td>21,257</td>
<td>1,696</td>
<td>1,588,884</td>
<td>812</td>
<td>151,952,860</td>
</tr>
<tr>
<td>Adult Tonsillectomy</td>
<td>3,398</td>
<td>17,251</td>
<td>1,931</td>
<td>102,749</td>
<td>1,010</td>
<td>13,588,218</td>
</tr>
<tr>
<td>Hysterectomy</td>
<td>5,783</td>
<td>640,565</td>
<td>5,420</td>
<td>N/a</td>
<td>1,869</td>
<td>250,704,845</td>
</tr>
<tr>
<td>Haemorrhoidectomy</td>
<td>4,945</td>
<td>12,787</td>
<td>2,081</td>
<td>137,213</td>
<td>781</td>
<td>23,160,663</td>
</tr>
<tr>
<td>Rhinoplasty</td>
<td>5,050</td>
<td>7,265</td>
<td>3,417</td>
<td>N/a</td>
<td>1,906</td>
<td>2,284,315</td>
</tr>
<tr>
<td>Bunionectomy</td>
<td>6,046</td>
<td>3,139</td>
<td>2,392</td>
<td>41,507</td>
<td>1,487</td>
<td>5,186,290</td>
</tr>
<tr>
<td>Cataract extraction</td>
<td>3,595</td>
<td>2,215</td>
<td>2,325</td>
<td>1,430,785</td>
<td>1,133</td>
<td>171,078,116</td>
</tr>
<tr>
<td>Varicose vein surgery</td>
<td>7,065</td>
<td>1,957</td>
<td>2,373</td>
<td>148,043</td>
<td>1,393</td>
<td>15,618,521</td>
</tr>
<tr>
<td>Glaucoma procedures</td>
<td>3,882</td>
<td>-</td>
<td>2,292</td>
<td>75,838</td>
<td>1,017</td>
<td>9,670,440</td>
</tr>
<tr>
<td>Tympanoplasty</td>
<td>4,993</td>
<td>754</td>
<td>3,347</td>
<td>149,246</td>
<td>1,261</td>
<td>31,408,685</td>
</tr>
</tbody>
</table>

Total savings: 1,415,264,725


And addressing inequality requires more not less globalization of essential services.
III. How is reform best implemented?
Elements of services trade policy reform

3 goals
• efficiency
• stability/reliability
• access

3 instruments
liberalization – ownership, competition
regulation
policies to improve access

3 issues
• Sequential epiphany on importance
• Tension between goals
• Sequence of implementation
Services trade matters for the least developed countries: Zambia

And produced some clear benefits

• Mobile telephony: dramatic growth since competition and foreign entry in 1995

• Tourism: investments by Sun International have created jobs

• Insurance: improved access since liberalization in 1992
But despite openness, access to services in Zambia was limited and unequal.

Foreign banks dominated but credit to the private sector only 8 per cent of GDP - lower than in 1990.

National air carrier liquidated and sector opened; but domestic traffic declined 5 per cent per annum.

Only 5,000 people held 90 percent of loans.

Even by poor country standards, access to telecommunications is low.

80 percent of fixed lines in Lusaka and the Copperbelt, where only 30 percent of the population is

Where Zambia could have liberalized unconditionally, it did not

Zamtel’s de facto monopoly in the international telecommunications gateway deprived households of access to telephones.

“When fee was reduced from $12m to $350,000, international and local call charges fell by more than 50%.” -Darlington Mwape, Zambia’s Ambassador to the WTO:

Denial of Fifth Freedom rights by Zambia and South Africa undermined competition and hurt horticulture and tourism.

February 12, 2016 “After a bilateral open-skies deal, fares between South Africa and Zambia fell by almost 40 % and passenger numbers rose nearly as much.”

Burdensome licensing in tourism (74 licenses and a year’s wait) cost Zambia nearly 300,000 more tourists every year. And Zambia’s tax system discriminated against services, the small firm and the poor regions

Why? Understanding the political economy of liberalization
Where other reform’s were first needed, liberalization was rushed


Agricultural output markets liberalized before the development of markets for services inputs. Durable effect on agricultural development.

Zambian Govt Caused Meridien Bank Closure, Reveals Sardanis Lusaka — …former chairman of Meridien BIAO International Andrew Sardanis has denied ever siphoning US $90 million to the Bahamas.
Regulatory inadequacy persists and undermines the benefits of openness

**Weakness:**
The Communication Authority of Zambia  
The Pensions and Insurance Authority  
The Civil Aviation Authority  
The Competition Authority of Zambia

**Inappropriateness:**
In banking, burdensome “Know Your Customer” rules,  
In accounting, demanding International Financial Reporting Standards (IFRS)

**Absence:**
After independence, clumsy instruments to widen access;  
after liberalization, none

Why? Understanding the political economy of regulation
If we cannot implement efficient instruments to widen access to services

FROM COLONIALISM

FROM CONDITIONALITY

TO KAUNDA’S SOCIALISM

TO STATE CAPITALISM?

The PF government will renationalise ZAMTEL-Opposition leader Michael Sata

Government will soon revive the national airline-Commerce Minister Mwanakatwe

THE ZAMBIAN ECONOMIST

Should we reinstate NAMBOARD?

Yes - according to National Farmers Union president Jarvis Zimba:
Elements of successful services trade policy reform

• Emphasis on competition
• Effective but appropriate regulation
• Efficient instruments to widen access to services

In appropriate combination and sequence
IV. Why have services trade negotiations disappointed, and can we do better?
What does international cooperation on services trade offer?

- Deeper liberalization at home and abroad through reciprocity-based market access negotiations
- Enhanced credibility of
  - current trade regime
  - commitment to future reforms
- Regulatory cooperation

Key policy question - where can and should these gains be realized: in a regional or multilateral context?
Multilateral negotiations have struggled to eliminate protection

 Uruguay Round Commitments, Doha Offers and Actual Policy

STRI for 61 countries, excluding Qatar and 31 countries that did not submit offers

The TPP too has delivered credibility but not much liberalization

Example: 1. “The US reserves the right to adopt or maintain any measure…”

• Transport: “…relating to the provision of maritime transportation services …”

• Cross-Border Trade: “…that is not inconsistent with the US’ obligations under the GATS….”

• MFN: “…that accords differential treatment to countries under any bilateral or multilateral international agreement in force or signed prior to the date of entry into force of this Agreement.”

Mode 4: “the United States is not undertaking any commitments in this area.”

2. Malaysia: licenses based on “prudential considerations and “the best interest of Malaysia.”
Security is a growing concern in an insecure world

- Automation, job insecurity and shrinking state support
- Digital trade and privacy violations
- Financial internationalization and financial instability
- Labor mobility and illegal migration
- Monopoly power and consumer exploitation

- Tax and regulatory externalities – action or inaction in one state can impose costs on workers and consumers in another state.
- Key nation states are now more responsive to internationally immobile labor and consumer interests than to “firms and citizens of the world.”
Impact of globalization on tax structures makes it harder to tax the winders and compensate the losers

In 1994-2007, middle-income workers experienced a globalization-induced rise in their personal income tax rate of around 1.5, whereas the top 1% of workers faced a reduction of approximately 1.5 percentage points.

Is the current US tax proposal driven by ideology, influence or the imperative of globalization?
In parallel, the growth of “intangibles” - footloose and hard to measure

Intangible assets have soared in the US ...
Investment as a share of sector gross value added - US

... and in the UK
Investment as a share of sector value added - UK

Source: 'Capitalism Without Capital - the Rise of the Intangible Economy'
Haskel & Westlake (Princeton University Press, 2017)
© FT
Routes to international tax cooperation

• OECD initiatives to deal with base-erosion and profit shifting
• But strong resistance to the idea of fiscal harmonization
• Destination-based taxation? Not just US Congress but increasingly favored by the EU and India to deal with new services.
The problem of international market failure

*Conventional approach*: negotiations about exchange of **market** access commitments by importers
Does not work for services

For services to be global, regulation cannot be national

Inability to protect consumers leads to:
- Protection as precaution (esp on modes 1 and 2) or
- burdensome requirements (esp on modes 3 and 4).

*Needed*: a mechanism to protect consumers from international market failure
Towards a solution to the problem

Proposed: regulatory commitments by exporters to protect foreign consumer interests in return for market access commitments by importers
How exporting country regulatory commitments work: data flows

The problem

Exporting country commitments to adhere to importer standards of privacy in return for free data flows

The necessary bargain

Examples

• EU-US Safe Harbor Agreement; renegotiated as EU-US privacy shield;
• TPP provisions on data flows matched by provisions on protecting privacy and preventing fraud
Enshrining regulatory cooperation in a trade agreement – the TPP innovation

• Article 14.11: Cross-Border Transfer of Information by Electronic Means
  • 2. Each Party shall allow the cross-border transfer of information by electronic means, including personal information, when this activity is for the conduct of the business of a covered person.

IN RETURN FOR

• Article 14.7: Online Consumer Protection
  • 2. Each Party shall adopt or maintain consumer protection laws to proscribe fraudulent and deceptive commercial activities that cause harm or potential harm to consumers engaged in online commercial activities.

• Article 14.8: Personal Information Protection
  • 2. To this end, each Party shall adopt or maintain a legal framework that provides for the protection of the personal information of the users of electronic commerce.
  • 3. Each Party shall endeavour to adopt non-discriminatory practices in protecting users of electronic commerce from personal information protection violations occurring within its jurisdiction.
How exporting country regulatory commitments work: labor flows

The problem

The necessary bargain
Source country commitments to certify character and qualifications, facilitate repatriation, combat illegal migration in return for freer labor mobility

Examples

• Bilateral labor agreements between Spain-Ecuador; Korea-Philippines;
• APEC Business Travel Card
How exporting country regulatory commitments work: financial services

The problem

Dodd-Frank ends capital exemptions for European banks

Financial crisis: Banks reduce credit supply in emerging Europe

The necessary bargain

Exporting country commitments to protect interests of foreign consumers, financial stability, and avoid “financial nationalism”, etc. in return for market opening

Examples

• EU efforts to preserve the internal financial market EU-US markets

• EU-US discussions under the TTIP, UK-EU negotiations on Brexit

• Vienna Initiative, for macroeconomic stability in emerging Europe
How exporting country regulatory commitments work: competition policy

The problem

European Commission - Press release
Competition: EU and US celebrate 20 years of cooperation; agree to advance cooperation further

The necessary bargain

Exporting countries to enforce competition rules to protect interests of foreign consumers in return for market opening

Examples

- EU-US cooperation on price rigging by financial institutions,
- EU-US action on collusive arrangements in air and maritime transport;
- APEC initiatives on competition policy;

Rigging of Foreign Exchange Market Makes Felons of Top Banks

EU, US tensions on treatment of digital giants

EU, US exemptions from competition policy for export cartels

Airlines Come Under EU-US Cargo Cartel Probe
Watching out for the risk of excluding developing countries
Risk of trade based on mutual trust rather than comparative advantage

Recognition without restrictive rules of origin promises the greatest benefits to third countries

The importance of GATS Article VII on recognition agreements

Impact on trade volumes with non-members

<table>
<thead>
<tr>
<th></th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Harmonization</td>
<td>-0.1</td>
</tr>
<tr>
<td>Mutual recognition with restrictive ROO</td>
<td>-0.1</td>
</tr>
<tr>
<td>Mutual recognition without restrictive ROO</td>
<td>0.5</td>
</tr>
</tbody>
</table>

Source: Chen, Maggie Xiaoyang, and Aaditya Mattoo (2008), Regionalism in Standards: Good or Bad for Trade, *Canadian Journal of Economics*, vol. 41, 838-863
Notes: ROO = Rules of origin.
Resisting the tyranny of harmonization to avoid exclusion within countries

In Mexico, the introduction of simplified bank accounts with less burdensome information requirements is associated with an increase in the number of deposit accounts.

Source: Xavier Faz (2013), Mexico’s Tiered KYC: An Update on Market Response, CGAP
Three concluding suggestions

• **Strengthening national regulation**
  • Identify sectors where regulation matters for trade liberalization
  • Diagnose and remedy regulatory inadequacies
  • Country- and sector-specific advice and assistance on sequence of regulatory reform and liberalization

• **Advancing International regulatory cooperation**
  • Identify sectors where absence of regulatory cooperation matters for trade liberalization
  • Facilitate cooperation and ensure coherence with trade negotiations; developing country participation.
  • Country- and sector-specific advice on sequence of regulatory cooperation and liberalization.

• **Addressing the risk of exclusion**
  • Reaffirm relevant WTO MFN-related provisions (GATS Article VII).
  • Restrain use of exclusionary rules of origin
  • Support development of appropriate standards in developing countries.
Options for incorporating regulatory commitments into agreements

1. Importer unilaterally specifies conditions (e.g. as *Additional Commitments under GATS Art. XVIII*) and unilaterally determines conformity

2. Importer unilaterally specifies conditions but recognizes exporter’s conformity assessment procedures (*Recognition under GATS Art. VIII*) – e.g. authorized operator (*WTO TFA Art. 7:7.1*), *safe harbor/privacy shield*

3. Importer conditions are also internationally standardized (*WTO TFA Art 7:7.4*; “*Authorized Operator Reference Paper*” or *WCO standards*

4. Conditions are bilaterally/multilaterally agreed and legally binding on the exporter – *TPP data provisions*
Drivers of services trade 1: Demographic Change
Young and old have different patterns of demand, e.g. USA

Housing includes interest on mortgage and property tax

Source: Work in progress with Erhan Artuc, Zovanga Louis Kone, Maggie Liu and Caglar Ozden
Therefore, demographic change is influencing services trade by affecting the demand and supply of services.
Drivers of services trade 2: Digitization

The international fragmentation of goods production includes both goods parts and services tasks.

Driven by, and boosting demand for, information, communication and transport services.
In parallel, the international fragmentation of services production is creating new opportunities for trade.

Call Centre for customer service, etc.

Medical transcription services

Web hosting and webmaster services

Outsourced consultations and diagnostics