

Non-partisan Papers for the Policymakers

On

"Towards a Coherent Policy for Trade in Services"

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أوراق غير حزبية للثورة

المصرية هو الإصدار الجديد
لشركاء التنمية للبحوث
والاستشارات والتدريب، والذي
يستهدف تقديم عدد من التوصيات
لصناع القرار السياسي في مصر في
كافة مجالات التنمية، وذلك مساهمة
منهم في طرح أساس علمي لسياسات
التنمية في مصر، ويأملون أن يكون
ذلك خطوة على طريق تفعيل نموذج
رشيد في صنع القرار.

وقد اشترك في كتابة تلك الأوراق
نخبة من أبرز الخبراء المصريين
المشهود لهم بالكفاءة والاستقلال.

1. Importance of Services from a Developmental Perspective: with focus on Egypt

With the increased level of economic development we consume more services and less goods. More jobs are being created in service sectors relative to industrial and agricultural sectors due to technological advancements which have substituted capital for labor. In other words, services will continue to constitute a major aspect of our economy whether in terms of jobs created, or products bought, or being integral components of goods we buy and consume (e.g. after sale service of a car). Services play also a paramount role in enhancing the competitiveness of the economies by acting as an important intermediate input in the production process. Moreover, efficient public and social services are crucial for ensuring better standard of living for different segments of the population.

In the case of Egypt, services have always been an important contributor to the economy in terms of share of GDP, trade, and employment. The importance of services in the Egyptian economy increased over time where the percentage of services to GDP increased from 54.7% in the early 1990s to more than 60% in the 2000s. Such increase in the relative importance of services in the GDP was matched by an increase of services' contribution to the balance of payments. Exports of services also played an important role in turning the current account deficit to a surplus. In addition, services' role in terms of enhancing employment increased tremendously accounting for 54% of the total employment early 1990s and almost reaching 60% in 2000s.

The structural breakdown of services changed over time where the share of production services as a percentage of total services increased relative to that of social services and public utilities as a percentage of GDP. Such characteristic of the structure of services implies that services have been contributing positively to enhancing the productivity in the Egyptian economy.

Services also play an important role in enhancing competitiveness of the Egyptian economy where inputs of services represent on average 33 percent of total local inputs in the manufacturing sector. Moreover, service inputs act as important inputs for other service sector. Examples of inefficient services that can hinder the Egyptian economy competitiveness include lack of storage capacity, poor stock management, unreliable transportation, expensive communications, poor product design, insufficient and costly financing, inadequate legal advice, or even outdated software products and processes. Improving the efficiency of such services is a key determinant of Egyptian firms' competitiveness. The price and quality of these services (features of efficiency) are crucial in determining the cost of the majority of products produced in the economy.

Efficient services are not only needed to enhance production of goods and services, but as well to upgrade living standards of Egyptian citizens. Public and social services

as education and health are in drastic need of reform in Egypt. The lack of reforms (and especially regulatory reforms) in such sectors has created several social and economic problems and have negatively affected the well being of Egyptian citizens.

The short review identified that service sectors have been playing a positive role in the Egyptian economy which has been progressing significantly over time. However, the diverse nature of service sectors, and the overlapping of policy changes with required regulatory reforms imply that there is a need to tackle services from a new and broader perspective. This new and broader perspective is the developmental perspective where services should be looked at as a developmental tool that is able to upgrade the standard of living of Egyptians and enhance the competitiveness of the Egyptian economy. In this regard, the perspective should account for a comprehensive services policy that takes into account several aspects as preserving the national sovereignty of the government of Egypt in dealing with services, as well as the liberalization of trade in services, and how this liberalization should be handled to ensure positive outcomes on the economic and social levels, which is the topic of this short policy brief. We focus mainly on why should we liberalize, if any, and how to ensure the best outcome of this liberalization.

2. What is trade in services? Case of Egypt:

Trade in services can take different forms, which trade economists have categorized into four. The *first* deals with the cross-border transfer of services. In this case trade in services is highly similar to trade in goods. Examples include students having an e-learning course via the Internet or a businessman conducting a video-conference with a firm in another country. In this case, both consumers and producers did not move but the service was transferred across the border (called Mode 1). The *second* form involves movement of the consumer towards an external producer to consume the service. This form is highly evident in tourism where consumers move to Egypt and hence they import tourism to their home country or Egypt exports tourism services to foreign visitors (Mode 2). Similarly is the case of a patient traveling to the United States or Europe to get a medical treatment. In this case the country of that patient is importing a health service. The *third* form, which is the most popular, involves the movement of producers to consumers to provide them with their service, called the right of establishment and in fact it represents foreign direct investment (Mode 3). For example, the mobile service is actually exported by a mobile operator which has moved to Egypt to provide this service to Egyptian consumers. The same applies to having an account in a foreign bank affiliate where in this case the bank has moved to Egyptian customers to export its services. The third form or mode is the widely most mode used to trade in services when compared to the other three modes. The *fourth* form deals with the temporary movement of natural persons to deliver services in a foreign country. It is important to emphasize that it only deals with specific categories of natural persons who deal with services' provision (Mode 4). In other words, this mode should not be mixed with migration.

The aforementioned four modes imply that trading in services is in fact an important policy issue that deserves a lot of attention from the different stakeholders with the aim of maximizing the benefit out its regulation and/or liberalization. In fact trade in services within this context implies having a vision on what is actually needed and expected from liberalization of trade in services, and the amount and extent of changes required in laws and regulations. Yet, it is important to emphasize that liberalization of trade in services within the General Agreements of Trade in Services (GATS) entails a high extent of flexibility where government can choose which service sectors or sub sectors to liberalize and which modes to be used. It does not imply deregulation, and it tackles most favored nation (MFN) and national treatment (NT), but it does not interfere with other regulatory requirements. There are several means and ways to include restrictions on liberalization which differ in shape (e.g. percentage of foreign capital, foreign workers, type of projects, etc). In other words, the government can always limit the Market Access by adding certain conditions as those aforementioned. Also governments can deviate from the National Treatment Principle (discriminating against foreign service providers) and to a lesser extent from the Most Favored Nation Principle (not treating trading partners the same). Moreover, the government can always preserve its sovereignty and control the liberalization process, not only through Market Access and National Treatment Limitations, but also through setting specific domestic regulations. Finally, the government has the right to chose which modes to liberalize, retaining the flexibility and exercising its sovereignty.

Liberalization of trade in services can also happen on the regional level within the different regional trade agreements a country has joined. In such agreements, normally the country goes further in its liberalization than what it has committed itself to on the GATS level either by including more sectors or subsectors or by going more liberal with its regional trading partners than what it has committed itself to under the GATS

It is worth mentioning that Egypt has undertaken liberalization commitments in five sectors (out of twelve sectors) or 44 sub-sectors (out of 160 sub-sectors) using the GATS terminology. The sectors included the financial, telecommunications, tourism, maritime, and construction and engineering. The commitments covered all modes and ranged from being highly liberal as in the case of capital market to limited in terms of liberalization as in the case of maritime. When compared to other developing countries at the same level of development Egypt is classified to have relatively limited multilateral commitments. The outcome of such liberalization initiatives ranged from being highly successful as in the case of telecommunications and capital market to being modestly successful as in the case of maritime. The institutional and regulatory framework that used to prevail played a determinal role in the outcome of liberalization. On the regional level, no regional commitments have been undertaken so far (embedded in regional trade agreements with Arab countries and the EU, but nothing has materialized so far). However, there is a huge and significant extent of

domestic liberalization in the majority of service sectors, yet not anchored by a regional or multilateral commitments.

3. Elements of Policy:

Liberalization of services should be thought of within a wider context of development and enhancing the competitiveness of the economy (as explained above), invoking competition (to enhance the welfare of consumers and ensure an efficient economy functioning), and achieving better social outcomes (through the provision of better quality less price social services). Hence, a main goal of policy making should be striking the balance between maximizing the benefit of liberalization of services, through enhancement of competition, with the minimization of costs associated with administration, and regulation, while attaining social and environmental considerations. The country should define its approach to service policy. First of all it should decide adopt a comprehensive trade in services policy that acts as an umbrella for the sectoral policies. There should be a clear mechanism for drawing the service policy (whether on comprehensive or sectoral basis) where all stakeholders involved are included. Liberalization should be thought of as a tool to enhance development, and not a goal by itself.

We believe that before embarking on liberalization, regulatory reform needs to be undertaken. Liberalization to succeed should ensure that competition prevails in the market (to avoid monopoly power), as well to attain social objectives. However, some views perceive that liberalization and regulatory reform can proceed in tandem and others view that it might be better even that liberalization precedes where it will act as an important pressure device to undertake regulatory reform. The sequence might differ by sector as well, however in general regulatory reform should precede liberalization, however it should be emphasized that regulatory reform is an ongoing process that continues even after liberalization. Regulatory reforms are diverse in nature and are spread over a long time span implying that correlating their impact at the macro level with the performance of the service sectors might not be the right approach to assess the development of the service sectors in Egypt. Moreover, the high inter-linkages between service sectors imply that the development in one sector can be highly attributed to changes in other sectors. For example, the positive developments experienced by service sectors as finance and commercial sectors can be a result of the positive regulatory developments in the telecommunications sector or other upstream service sectors, or can be a result of the increase in final demand due to a certain regulatory reform. Among the general principles of reform that need to be adopted when liberalizing trade in services are the following: transparency (which is an important principle in the GATS), credibility, fairness, predictability, enforceability, non-discrimination, equity, and effective competition. In other words, those should be the guiding principles of any move aiming at liberalizing trade in services.

Regulatory and institutional framework should focus on a number of elements to ensure being effective. Regulatory reform should focus on many aspects including content, design, scope, jurisdiction, and transparency. Institutions framework and reform should be clear and specific where mandate should be clearly stated, independence should be guaranteed for regulators, interface between relevant institutions must be effective, accountability should be an integral theme, and efficient human resources should be secured.

Another related question that we try to answer is what sectors should be slated first for liberalization? Are there any priorities that should be considered, and on what basis?. We argue that focus of liberalization attempts should be on services that either provide intermediate inputs to the rest of the economy (e.g. financial and telecommunications) or to specific sectors that the country wishes to promote (e.g. tourism, computer, and professional services), or sectors in which protection has resulted in a considerable inefficiency cost to the society (e.g. insurance and transport). Liberalization of trade in services entails as well identifying the choice of the modes of supply and the barriers that should be removed, which is a sector specific issue that needs to be considered carefully.

4. Best Practice:

There are different ways of approaching liberalization. In some cases liberalization is adopted domestically but not reflected in a country's regional or multilateral commitments. In other cases, liberalization is reflected in a country's regional and/or multilateral commitments the way liberalization is adopted domestically.

There is no blue print in this regard, where some countries opt to anchor their domestic liberalization in their regional and/or multilateral commitments, whereas others choose to leave a room between what has been liberalized on domestic level and what has been committed on regional and/or multilateral level. There are pros and cons for each approach.

If a country chooses to anchor what it has liberalized on domestic level on regional and/or multilateral levels it signals to the outside world that it is serious in the liberalization moves it has undertaken, with no backsliding. In other words, it adds to the credibility of reforms. However, it limits its ability to negotiate in the future and constraints the give and take process. If a country chooses not to anchor what is has liberalized it provides itself with the room for a more productive give and take process, but it loses the credibility aspect.

Another important aspect that should be considered when talking about building a comprehensive services policy and approaching liberalization in the right context is the presence of a coalition of service providers, as a non-governmental body that defends and oversees the rights of service providers, and lobbies for defending those

rights on collective basis. Such a coalition exists in a number of developed and developing countries, as the US, the EU, Brazil, Indonesia, and South Africa. Other countries believe that the coalition is difficult to adopt in practice due to the diversity of services providers, and the prevalence of small sized ones where it is difficult to have them in one body. The idea of establishing a coalition of service providers should be looked into seriously despite the challenges it might face due to the diversity of stakeholders, absence of an existing roster of service providers in each sector, prevalence of small and medium enterprises in several service sectors. The role of this coalition should mainly act as an advocacy group on services sector issues, i.e., a forum similar to a Coalition of Service Industries or a Federation of Service Industries, however with no government involvement, yet with full support of the government. The aim would be to formalize public-private sector coordination and dialogue through a private-sector led initiative which will help the government in drawing its policies right based on a well established institutional setup that reflects services' providers and users interests.

There is no clear approach to liberalization of trade in services that has been adopted in the case of Egypt, where it is difficult to identify a particular pattern that has been followed. What needs to be emphasized is that any liberalization initiative should focus on a number of objectives including accessibility, social concerns, better quality. Otherwise, liberalization can have negative repercussions. To avoid such negative repercussions we emphasize that liberalization should be complemented by other aspects, including regulatory reform. Experiences of countries that liberalized their service sectors have not been uniform in terms of the effect of liberalization on development, simply because other preconditions were not set. For example, in the case of Egypt the liberalization of telecommunications, where a strong regulatory framework was adopted and social concerns were taken into consideration, brought positive effects for the economy and the society and the flourishing of the outsourcing of ICT services. In other cases, liberalization was not as useful as expected where in Morocco, liberalization of the banking sector with the US did not help in bringing in FDI, whereas because of the lack of a strong regulatory framework for telecommunications in Zambia liberalization was not useful for the society. Egypt does not have a coalition of service providers, an aspect that needs to be carefully studied.

5. Recommendations (costing of different alternatives):

Have a national service policy where reform should precede liberalization or at least happen at the same time

Egypt is in drastic need for a comprehensive service policy that draws the main elements of national service policy and takes into consideration the different interactions between reform, liberalization, impacts on the different stakeholders

(consumers, service providers, producers in value chain, government) into consideration. In other words, the policy should be development oriented striking the balance between economic and social aspects. There is a need for sectoral studies to better understand the nature of service sectors, how they function, potential impact of liberalization, etc.

Regulatory reform is of paramount importance and is the core of any services policy. Regulatory reform should tackle rules as well as institutions. In this regard there is an urgent need to revisit the rules that govern the different services sectors and the relevant institutions and how they relate to each other in the area of services.

Regarding liberalization of trade in services to be effective it cannot proceed if there is no domestic reform. Any liberalization attempt is likely to be preempted if domestic reform was not undertaken before hand. Liberalization should mainly focus on enhancing competition as well as encouraging the role of foreigners in provision of services. The encouragement of the role of foreigners is mainly attributed to their role in bringing in new practices, technology, and differentiated quality of services. The sequence of undertaking domestic reform before embarking on any liberalization attempt is crucial in the services sector the government needs to build its own strategy of reform and liberalization of services (although as mentioned above this is not shared by all point of views). The diversity of service sectors and the large number of domestic reforms that need to be addressed imply that a priority list should be set. The priority list should focus on services that have a large impact on the economy or have a large number of linkages with other sectors in the economy or finally the government wishes to promote as a result of enjoying comparative advantage for example. Such list includes the infrastructure-related services (e.g. transport and public utilities) as well as network services (e.g. telecommunications and financial services), and tourism.

On the track of services liberalization: Egypt should enhance its regional moves. Multilateral negotiations are stumbling and there is a need to enhance exports of services, especially those that can flourish on regional level.

There are a number of service sectors that are more eligible for regional liberalization than multilateral liberalization. The specific nature of such sectors, in terms of setting their standards and the rules and regulations governing their markets, makes it more convenient to liberalize at the regional rather than the multilateral level. Among such sectors are infrastructure-type and network services (e.g. transport and energy) where regional liberalization is more suitable than multilateral liberalization for several reasons as identified below. Among the other sectors that are more eligible for regional liberalization are the construction/engineering and professional services where there exist no international standards (compared to the case of telecommunications and financial services), and most often such sectors are highly restricted and subject to strict national standards. Regional liberalization initiatives

should take also into consideration the regional partner and which type of services could be better liberalized with

Regional liberalization of services can help Egypt improve its infant service industries that have a potential to compete on the global level, but not yet ready to "learn by doing" by liberalizing at the regional level. Regional liberalization of trade in services requires some sort of regulatory convergence among trading partners. Regulatory convergence can take several forms including adoption of trading partner's rules or compliance with global standards . Moreover, regulatory convergence can be achieved through mutual recognition agreements (MRAs).

Establishment of services coalition: There is a need to have a body that can lobby on behalf of services providers.

ترقبوا صدور الأعداد التالية من أوراق غير حزبية:

1- إستراتيجية جديدة للأمن القومي المصري.

2- سياسة خارجية لمصر الديمقراطية.

3- السياسة المائية لمصر

4- مواجهة الفقر والنهوض بالعشوائيات.

5- السياسة الصناعية في مصر.

6- السياسة الصحية في مصر.