NON-TARIFF BARRIERS ON TRADE IN SERVICES

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Abstract

The increasing role of services in international trade increases restrictions on trade in this sector. Forms of barriers are more complex and less visible that tariffs. There are no significant differences between barriers on services and non-tariff barriers in goods. Based on experiences in developing countries, this paper tries to examine the barriers on trade in services. A brief explanation about types of service trade and the cost of protection on services are also presented. Studies of protections in services show liberalization in service increases productivity and overall outcomes of service sectors.

***Keywords**: Non-tariff barriers, trade in services, GATS.*

INTRODUCTION

In the last two decade, the role of service sector in international trade has increased significantly. This sector grew faster than trade in goods. Between 1980 and 1997, service exports grew 7.8 percent per year while export of goods only increased 6.7 percent per year (Urata and Kiyota, 2001). Almost 20% of global trade in 1995 and 50% of total Foreign Direct Investment (FDI) in the early 1990s were in service trade (Hoekman and Braga, 1997). It has become apparent that a stage of development shifts resources from agriculture and manufacturing into services. It will be a time where the contribution of services in per capita income outweighs manufacturing and industrial sectors.

Although the proportion of trade in services has increased significantly in international trade, this sector was not historically considered to be important. Most international economists ignored this sector because they regarded services as a “non-tradable” product (e.g. Hill, 1977). Economics textbooks considered services, such as telecommunication, electricity, and sewerage networks, as products that should be provided by the national monopoly and not regarded as tradable products (Ito and Krueger, 2001).

Along with technological improvement, the change of government policies, and the great reduction of production cost, some services become “tradable”. Transportation, communication, and travel become important economic activities. By the late 1990s, foreign services companies such as accountant firms, construction projects, and financial services had penetrated into domestic services (Hoekman and Braga, 1997).

To create freer trade and reduce barriers in services, the Uruguay Round established multilateral rules in the form of the GATS (General Agreement on Trade in Services).[1] This agreement became effective under the newly created WTO in 1995. Although it is still new, GATS has been providing a freer and more stable environment for conducting trade in services.

This paper examines non-tariff barriers in services trade based on the experiences in developing countries. In first part of this paper, several types of services in different categories are shown.

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[1] As trade in goods, economists believe that free competition increases welfare through lower prices. Protections cause deadweight loss and welfare transfer from consumers to producers. sasdas Through free trade, trading countries will be better off.

In the second part, non-tariff restrictions become the main focus. The third part shows some studies about cost of service protection and efforts to liberalization. Conclusions are given in the last part.

I. Types of Service Trades

Economists have grouped services using different methods. An idea of ranging or grouping services came from the Group of Canada[2] (Stern and Hoekman, 1988). Based on the relation with goods, they categorized services into three types: (1) services complementary to trade in goods (e.g. transportation, insurance, banking, and advertising), (2) services that substitute for trade in goods
(e.g. franchising, rental, repair, leasing), (3) services unrelated to goods (e.g. banking, life insurance, professional real estate, telecommunications, data processing and information, and travel).

Based on the method of delivery, GATS provided four types of service trade[3] (WTO, 1999). First is cross border supply, where services are produced by one country and delivered to another. For example, international telephone calls, air transportation that carries foreigners and banking services supplied to foreigners transmitted through telephone or mail. Second is consumption abroad, where consumers or firms make use of services in another country, for example, tourism, ship repair and aircraft maintenance abroad.

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[2] Following this category, there are a lot of groupings done by international economists, for example Bhagwati (1984) and Sampson and Snape (1985) who distinguished services based on a typology of the way services are provided. In this article, only the most famous category will be presented. For more detail discussion about type of services, see Stern and Hoekman (1988).

[3] This is a standard category used by all WTO members recently.

Third is the commercial presence, where a foreign company sets up subsidiaries or branches in another country (multinational companies). Foreign banks, hotel-chains, department stores and foreign subsidiaries of insurance companies are examples of this type of services. Fourth is the presence of natural persons, where individuals travel from their own countries to supply services in other countries. This last category includes professionals, such as accountants, doctors, fashion models, architects, consultants, programmers and teachers, who physically travel abroad to provide services.

The first two types of services provided by GATS are typically captured in the balance of payments statistics. However, the last two are usually not recorded. It is easy to record international telephone calls and international financial services but it is extremely difficult to search total income that is repatriated.

II. Non-tariff Barriers on Trade in Services

The growth of international service trade causes countries to protect their domestic service sectors from foreign competition. The objective of barriers in services is similar to that in trade in merchandise: to protect domestic providers[4]. The forms of the barriers are also similar. They can be “entry fee” (like a tariff in goods trade) or non-tariff barriers. This paper only focuses on non-tariff barriers, with consideration that tariff is difficult to impose and most protective barriers to services are non-tariff.

[4] On trade in goods, this objective encourages argument for infant industry protection. As a result, most developing countries adopt import substitution policies. In services sectors, the effect of this objective can be seen on restriction or even prohibition to foreign suppliers to enter domestic markets.

There are two groups of non-tariff barriers that have been examining by GATS (Article XVI and XVII): (1) Market Access Barriers, and (2) National Treatment Barriers. Market access barriers includes many types of restriction, such as quotas, local content, prohibition, price control and professional standards. National treatment barriers mostly focus on discrimination policies. In this part, those barriers[5] will be discussed briefly.

a. Quotas

Because of intangibility and non-storability of many services, quantitative restrictions (QRs) are usually imposed on the providers. According to Hoekman and Braga (1997), the famous example of quantitative restrictions is the bilateral air service agreements (ASAs). These agreements contain regulation of international trade in air transportation services, which regulate the route, the capacity, and the time period of international flights among countries. The agreement among countries are reciprocal (i.e. depend on consensus). For example, country X tend to offer landing rights in specific areas for country Y if and only if country Y offer reciprocal landing rights to country X.

In Chile, until the late 1970s the government imposed quantitative restrictions on shipping lines (Hoekman and Braga, 1997). Only certain countries were allowed provide ship transport and freight to and from Chile.

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[5] These types of barriers can also be found on trade in goods. The difference is barriers on services are imposed on providers while barriers on goods are applied directly on the goods. For example, quotas on services are related to the number of services that can be provided by certain countries whereas quotas on goods are imposed on specific goods without consider about which countries the goods come from.

The type of products that could be transported was also restricted to several products. Newly developed products such as fish and fresh food are prohibited.

b. Local Content

The common example of local content is cargo-sharing agreements administrated by the United Nations Conference on Trade and Development (UNCTAD) Liner Code. It consists of mutual conditions in freight and volume of traffic (Hoekman and Braga, 1997). In 1974, almost all Asia-Pacific countries adopted this agreement unilaterally. They included Japan, Korea, Thailand, Bangladesh, Turkey, Indonesia, the Philippines, and Malaysia.

Korea and Thailand signed the 40-40-20 agreement in late 1983. Indonesia and Singapore agreed to apply 50-50 cargo sharing for their trade. Indonesia also has had bilateral agreements with Japan, Taiwan, and Korea for logs shipping and with Taiwan for general cargo. The Philippines adopted an agreement on a 40-40-20 rule for all liner cargo and Malaysia has arranged bilateral agreement with Indonesia, Turkey, Bangladesh, Japan, Korea, Pakistan, and India (Brooks, 1985).

According to Miklius (1988), to support their cargo sharing arrangements, ASEAN countries have adopted a variety of financial assistance schemes. These schemes include reduction in income and other taxes, lower interest rates in loans to finance ship purchases, tax holidays, lower import duties, equity participation, government ownership, and government operation of shipping companies.

In ASEAN countries, local content policies are also applied on equity ownership of services. According to Mei Ling (1992), foreign ownership on business services has been prohibited in Indonesia since

1970. Based on 1981 policy, the Philippines' constitution allows only 30 percent foreign ownership. Meanwhile, the government of Thailand allows foreigners to own 49 percent equity except for firms established before the Alien Business and Occupation Laws in the early 1970s (such as Lintas, where 80 percent of equity is owned by United Kingdom Companies) and old United States firms under the United States Rule (100 percent are owned by United States companies). In Malaysia, although there is no restriction for foreign ownership, the government encourages Bumiputera (indigenous people) to own at least 30 percent of equity and prefers 51 percent Malaysian equity in government work. In contrast, Singapore does not restrict foreign ownership.

c. Prohibition to Enter Market

In many service markets, foreign access is still prohibited. Simple examples of prohibitions on service markets are transportation (by road, water and air) and utilities (electricity, telecommunications, and water and sewage). In Chile and Mexico, port services had been provided by the government until the late 1970s. In Argentina, before the early 1990s, the government had protected their telecommunications services for public companies (Hoekman and Braga, 1997). In Indonesia, national electricity, telecommunication, and water services are still provided by public companies although the government has introduced privatization on these sectors to cope with economic crises.

The maritime policies of the ASEAN countries (except Singapore) in the 1960s are also a good example of market prohibition. According to Brooks (1985), the ASEAN countries adopted a policy of "cabotage", that they reserved domestic shipping for national-flag ships and prohibited foreign-flag vessels to ship domestic goods.

ASEAN Countries also imposed prohibitions on advertising services. Malaysia and Indonesia disallowed totally foreign material in commercial advertisement as a mean to protect their infant industry whereas Thailand allowed up to 20 percent foreign content (Mei Ling, 1992).

There were also conditional prohibitions often imposed by certain countries for political reason. For example, suspending exports of technology and equipment for construction of the Trans-Siberian pipeline by the U. S. government against the USSR in 1982 (Hoekman and Braga, 1997).

d. Price Controls

To create barriers on service trade, governments can also imposed price controls. These include price setting, price monitoring, and sanctions for industries that break the set price. Price controls are usually used by government to ensure that prices are not set at either market clearing levels or at the monopoly level in cases where providers of specific services have substantial market power (Hoekman and Braga, 1997). Most countries impose price controls on telecommunication, air transportation, and financial services. In these sectors, government sets floor and ceiling price and imposes a price-setting formula to achieve uniform pricing.

e. Professional Standards and Licensing

For specific service suppliers, such as accountants, foreign law firms, education and medical services, licensing and professional standards are needed. The license requirements are often asked for by professional bodies or government to make sure that the services have a standard of quality. Tourism and travel often also need environmental standard to operate in certain countries (Hoekman and Braga, 1997). In ASEAN countries, barriers on professional suppliers are not only licensing and standard but also include academic qualification, age (Singapore), nationality (Thailand), residency (Singapore), and requirements for periodic renewal of professional practice licenses (Mei Ling, 1992)

f. Discrimination Policies

The most common discrimination policy in developing countries is flag discrimination. In the late 1960s, Latin America began to adopt a favorite flag policy. It later spread to other developing countries in other regions. In the 1970s ASEAN countries, except Singapore, adopted policies of flag discrimination. Only ships with the national flag could serve in sea transportation. The term “government cargo” was used to discriminate against foreign vessels (Miklius, 1988).

Another discrimination tool is government procurement. In this tool, the government designs policies that favor domestic service providers. For some countries, the discrimination procurement policies involve a large number of services with a large share of the market.

In specific services, such as transportation and telecommunication, policies to discriminate against foreign competition can be done through discriminatory access to distribution networks and cost of ancillary services (Hoekman and Braga, 1997). In the case of telecommunications, restrictions on the ability of new service providers to attach a specific type of equipment to the network will apparently reduce competition from abroad. In air transportation, restrictions on marketing channels can be an effective way to reduce competition from foreign companies.

III. Cost of Protection and Benefit of Liberalization

The increasing numbers of service barriers has encouraged countries to create new rounds of agreement for freer markets in services. In GATS, an adequate framework to deal with explicit protection has been introduced. Government binds current policies and commits themselves to implement liberalization in the future. However, most countries have only made limited commitments related to the agreement (Mattoo, 2000). In East Asian countries, for example, commitment was made in certain sectors, such as business and finance, but excluded distribution, education, environmental and health services (Mei Ling. 1992).

Studies about costs and benefits of protection on services shows that costs of protection outweigh the benefits and competition will increases overall outcomes of a service sector. Using a Computable General Equilibrium (CGE) model and the data from developed and developing countries, Dee et. al. (2001) measured the cost of barriers to trade in services. They show that barriers on trade in services have significant impact on price increases and trade liberalization expands service sectors in both developed and developing countries.

In the case of Taiwan's economy, Chou et. al. (2001) examine the cost of trade in services using tariff equivalent estimation and impacts of liberalization on service trade. They show that liberalization of service trade creates technological spillovers from advanced countries to developing countries.

Kim and Kim (2001) examine the impact of service liberalization on productivity and growth in Korea (see also Chung, 1988 for historical movements towards liberalization in Korea). This study shows that although there is a correspondence between liberalization and productivity growth in some service sectors, the full effects of liberalization has not been measured because liberalization in Korea took place only recently.

CONCLUSION

The forms of non-tariff barriers in service trade are similar to those in goods trade, such as quota, local content, prohibition to enter market and price discrimination. The objective is also similar: to protect domestic providers with argument that new services supplier in domestic market will not success in competition with high technology and skilled providers from abroad.

Some studies have been done to evaluate the impacts of protection on service trade. Most of them show that barriers increase cost of production and hence rise prices. They also argue that liberalization and reduction in protection expand service sectors.

However, when a country decides to adopt freer trade, the government should make sure that domestic provider can compete with foreign suppliers. Since most developing countries are new “players” in service sectors, immediate and dramatic liberalization can be detrimental to domestic suppliers. Lack of technology and skilled providers will be a reason why domestic suppliers failed in competition with foreign suppliers. In this case, dramatic liberalization is not a first best policy. Developing countries can choose to liberalize their service sectors gradually or continue the protections until “the right time” for dramatic liberalization. However, determining “the right time” for liberalization is not an easy task. The experience in industrial sectors shows that protected industries never grow up and always need protections. Therefore, supporting trade policies and temporary protection are needed to encourage more efficient productions and increase competitiveness of domestic suppliers.

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