

# Moving forward on regional integration in trade in services

*Michael Cornish, Indonesian Ministry of Trade, 21 February 2012*

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## **I: Introduction and overview**

Pak Syarifudin Yahya, Professor Lin Guijun, Professor Christopher Findlay, lainnya terhormat tamu, wanita dan pria;

Firstly I must thank you all for this wonderful opportunity to speak to you today – it is not every day that an Australian as young as myself gets the chance to deliver a speech at the Ministry of Trade of its most significant neighbour. I shall certainly endeavour to make the most of the opportunity.

The theme upon which I wish to concentrate today is the regional integration of trade in services. It is an interesting topic which is becoming of increasing relevance here in Asia as we see more and more economies continue to make the transition towards the high value-added, services-intensive end of the goods-services spectrum. This transition requires a constant and vigilant reform effort, the momentum for which is hard to instigate and harder still to maintain – the region still has its work well and truly cut out for it.

We know that the importance of services to economic development has historically been underestimated, often seen as merely symptomatic of economic progress rather than as a driving force for growth itself. We also know that services play a strong enabling role in an economy, with services in telecommunications, transport, and logistics playing a crucial complementary role to the success of manufacturing and the modern transformation of traditional industries such as fisheries, mining and agriculture.

Less constrained by physical distance, the development of services, especially those centred upon data transfer and data transformation, grant access to those components of international supply chains that were previously inaccessible, allowing activity to be parcelled out according to domestic competitiveness and comparative advantage. We have seen how this model has been particularly successful in driving growth in India. Whilst attempts at integration need not only be regionally based, it is the logical focus for creating the building blocks towards the global integration of trade in services.

Australia has a unique perspective on how regional integration has unfolded, founded upon an equally unique journey of economic reform at home. With Australia being on the few OECD economies still left standing in the wake of the Global Financial Crisis, policymakers have good reason to look towards my country for ideas.

However, Australia's reform journey has not been free of mistakes – far from it. It is in this historical experience of Australia with which I will begin, briefly drawing out some of our lessons so as to help inform us of what direction a common future for the Asia-Pacific region could or possibly should take.

## **II: The Australian reform journey and Australian unilateralism**

It is the early-1980s, and Australia languishes behind the walls of protectionism; it enjoys a world-class standard of living, but through the purview of its European history more than through self-design.

Australia is slipping in its relative prosperity, and the then-Treasurer Paul Keating warns of the risk that the country shall become a banana republic, complacently dependent on primary commodities for its ongoing economic success. An injection of economic dynamism is sorely required.

Australia decides to try to ride the stormy seas of the international economy, rather than ineffectually trying to keep building the walls of protectionism that have kept it at bay.

The Australian dollar is floated on international currency markets and domestic financial controls are relaxed; the dismantling of tariffs and non-tariff barriers begin to be dismantled in earnest; microeconomic reform, deregulation of the telecommunications and aviation industries, and a national competition policy all help to accelerate productivity growth; non-European immigration, especially Asian immigration, continues to gather pace, bringing with it some of the best international genius and talent; tax reform is tackled, slowly but surely.

By reducing the rigidities in its economic system and the barriers to free trade, Australia allows itself to become more flexible, and thus more adaptable to the ever-changing international economic climate.

Whilst we could look extensively at the individual detail of any of these economic initiatives of the Australian government, it is the overarching flavour of our reform program that I wish to highlight. In particular, I want to stress the multi-partisan commitment to unilateralism. It is worth noting that this commitment has not been drawn easily.

The latest iteration of the Australian Government's commitment to unilateralism can be found in their Trade Policy Statement from 2011, and the language on unilateralism that they use is sufficiently compelling for me to repeat it here:

Since competition provides strong incentives for innovation and price restraint, opening up an economy to competition will increase national prosperity over time. Pro-competitive economic reform should be pursued in its own right; it should not be conditional upon other countries reforming their economies. Adopting a bargaining-chip approach of refusing to liberalise at home unless other countries offer trade barrier reductions as a quid pro quo

only damages the home country's long-term prosperity. Using domestic reform as a bargaining chip in negotiations is akin to an athlete refusing to get fit for an event unless and until other competitors also agree to get fit.

In trade negotiations, Australia should make its offers, our trading partners should make theirs, and where appropriate we should encourage them to go further. If the final deal is in Australia's national interest it should be accepted and if it is not, it should be rejected. But the assessment of national interest should not include how much Australia had to give up, or 'pay', by way of domestic economic reform.<sup>1</sup>

These are powerful arguments. However, one cannot underestimate the significant barriers that are faced when a government seeks to pursue a policy of unilateral reform.

### **III: Barriers to unilateralism and regionalism**

The resistance of the domestic constituency is the biggest barrier facing unilateralism.

Trade liberalisation – whether it is of goods *or* services – faces the classic and recurrent political-economy problem attached to reform; the losers from liberalisation are to be found in concentrated groups – for example, those industries that huddle behind their tariff and non-tariff protection, often also enjoying the largesse of direct government financial support – whereas the winners – the consumers of their products, whether they are individuals, government or industry – have gains that are spread thinly between them. This project is designed to develop and add to the tools available for analysing those important gains from reform.

Added to this is the resistance generated by the uncertainty associated with reform efforts – will things truly be as good as the courageous academics and policymakers ordain? Rigorous debate over which reform path to chart – a sore and critical need to any reform effort – only serves to heighten this sense of uncertainty, creating yet more resistance. There is less research on the gains from liberalisation in the trade in services than there is on the gains from the liberalisation of trade in goods, and the case for services liberalisation has received less advocacy as a result, yet again reinforcing a tendency towards sluggish movement efforts towards services reform.

Unlike goods, the effect of the liberalisation of the trade in services affects multiple sectors and thus requires the involvement of multiple government departments and ministries – as recognised by the home agencies our Indonesian participants here today. Achieving effective domestic coordination is thus a practically complex exercise, beholden to public service politics and the relative strength of domestic political patronage.

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<sup>1</sup> p7, *Gillard Government Trade Policy Statement: Trading our way to more jobs and prosperity*, Department of Foreign Affairs; Government of Australia, April 2011

These barriers to unilateralism also complicate regional efforts towards the integration of the trade in services.

However, regional integration, or 'regionalism, also has some of its own unique complications. For example, many barriers to trade in services are 'behind the border', and so transparency becomes a key issue. Additionally, conventional trade negotiating strategies provide political cover for domestic interest groups opposed to reform by preaching the fallacy that 'foreigners want this so it must be good for them and bad for us'.<sup>2</sup>

Regionalism also lags *significantly* behind unilateral efforts, as evidenced by the research of Gootiiz and Mattoo, who have uncovered a significant gap between Doha Round offers and actual national policies.<sup>3</sup>

What reform that has occurred has been undertaken unilaterally, but significant barriers do remain. One cannot help but consider that if actual policy is ahead of WTO commitments, then why are WTO members not willing to offer more, and more readily?

Apart from the reasons already mentioned, it is my view that the gap is created by the request-offer dynamic of the GATS negotiations. This dynamic encourages a tit-for-tat negotiating strategy, with parties reluctant to relinquish their offer-policy gaps for fear of reducing their future leverage over negotiations.

Christopher Findlay and my recent work for the Economic Research Institute of ASEAN reinforces this view, with our work finding that an economy's commitments on services varies across agreements, in what may be a systematic manner depending on concerns about competition from the partner economy rather than a reflection of existing domestic policies.<sup>4</sup>

In a brief summary of all our findings, we also found that:

- significant barriers to trade and investment in services remain in WTO member economies;
- commitments to services reform in these agreements are relatively low compared to what might be possible, and while they provide some additional commitments to the GATS agreement, they are often circumscribed and continue to fail to deal with issues of domestic regulation;

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<sup>2</sup> As per Andrew McCredie, Australian Services Roundtable

<sup>3</sup> Batshur Gootiiz and Aaditya Mattoo, *Services in Doha What's on the Table?*, The World Bank, Policy Research Working Paper 4903, 2009

<sup>4</sup> Michael Cornish and Christopher Findlay, *Services Liberalisation in the 'ASEAN Plus' Free Trade Agreements*, Economic Research Institute of ASEAN, 2012 (*forthcoming*)

- Commitments to reform vary across economies within regional trade agreements, with generally greater commitments to cross-border trade, mixed commitments to investment, and fewer commitments to the movement of people;
- Whilst there are *some* similarities across these agreements, the correlations between them appear to be low

There also exists considerable concern from governments that multilateral commitments will deprive them of regulatory freedom, for example, in cross-border flows of financial and data services and cross-border gambling services.<sup>5</sup>

#### IV: A new regionalism

At the global level, the “nothing is agreed until everything is agreed” formulation of Doha has failed.<sup>6</sup> Within the realm of services, this is compounded by multiple factors. For example, GATS schedules are also so technically complex as to be almost unintelligible and completely disconnected from the reality of business<sup>7</sup>, and the absence of a widely adopted measure of restrictiveness of trade in services also makes the monitoring and evaluation of liberalisation progress exceptionally difficult. We have great hopes for the OECD Services Trade Restrictiveness Index.

I thus support the view now held by the Australian Government – amongst others – that the services component of the Doha Round should be broken off into a separate negotiation.

Quoting Australian Minister for Trade, Craig Emerson: “A pathway including plurilateral agreements under the auspices of the WTO is well-worth pursuing.” Whilst the architecture needs to be clarified, there are multiple possible approaches it can take. We have some precedent examples; the Information Technology Agreement, which extends commitments to all WTO members; or the more discriminatory modality used in the Government Procurement Agreement. So there are multiple paths to the desired end-point.

It is within this context that a window of opportunity now exists for a new approach to regionalism.

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<sup>5</sup> Bernard Hoekman and Aaditya Mattoo, Services trade liberalisation and regulatory reform: Re-invigorating international cooperation, 24 December 2010, <<http://www.voxeu.org/index.php?q=node/5969>>, accessed 19/2/12

<sup>6</sup> Geoff Kitney, ‘Australian trade push under fire’, *Australian Financial Review*, 30 January 2012, <<http://globalservicesnetwork.com/attachments/Australian%20Trade%20Push%20Under%20Fire.pdf>>, accessed 19/2/12

<sup>7</sup> p24, *Services Trade: Approaches for the 21<sup>st</sup> Century*, Asian Development Bank Institute and the Pacific Economic Cooperation Council, 2011

The role of regionalism here should be used to consolidate regional positions and thus reduce the complexity in reaching a plurilateral agreement. Given that value chains in services criss-cross more intensely at the regional level, regionalism is also the most appropriate platform from which to undertake technical cooperation, to work together to understand the nature and benefits of reform.

However, a reliance on regionalism to drive plurilateral agreement on the trade in services is not without its own dangers, as what can be labelled regionalism can take many different forms.

For example, it can be interpreted as being supportive of regional trade agreements. Over the past decade we have seen a marked proliferation of such agreements, especially here in East Asia, creating the insidious 'noodle bowl effect' upon domestic rules of origin.

Focus on regional trade agreements also diverts attention and talent away from the real game of plurilateralism.

Another danger of regionalism is that it will not only consolidate negotiating positions within regions, but also harden them into blocs, limiting the flexibility of manoeuvre in negotiations and thus reducing the chance than any agreement can be reached.

APEC is the best-placed institution for leading regional efforts in liberalisation and integration of trade in services in the Asia-Pacific. I have real hope that this forum can create the critical mass and impetus required for successful plurilateral action.<sup>8</sup>

### **V: Is it worth the effort?**

I think it is worth pausing here for a moment to consider what is at stake with all of this. With such a monumental and seemingly never-ending soul-draining task ahead, is all this trade liberalisation and regional integration really worth the effort?

My answer is unequivocal: absolutely it is.

Freer trade, whether in goods *or* services, provides manifest economic benefits to the people of the world, especially in its contribution towards poverty reduction. Access to higher quality services – particularly in education, health care, communication and transport – offers significant improvements to the global human experience, alleviating human suffering.

As a personal reflection, the other compelling reason for pursuing reform and liberalisation in services is to promote international security.

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<sup>8</sup> p32, Ibid.

During the Cold War, the economies of the Soviet Union and the United States were, in any meaningful sense, completely detached from one another. The possibility of global war was real, and it came close more often than anyone might like to admit.

There exists now a level of economic integration between all the globally significant military powers that precludes war as a rational option, at least on economic grounds. By increasing economic integration, both regionally and globally, we directly reduce the chance of a conflagration that could destroy our planet.

It is here that I see a danger with the Trans-Pacific Partnership. Whilst it would be hard to argue that the United States has designed the TPP with the sole purpose of excluding China it has been made in the spirit of economic containment and risks splitting the region into two blocs. My own government has made the mistake of deliberately ignoring this fact, and I urge the Indonesian Government, as an important regional leader, not to do the same.

As individuals, even though we merely contribute to a greater whole, should not be underestimated. The work is slow and incremental, but for all that, no less important. As researchers, you inform the policymakers so that they might make better decisions, and as policymakers, you take the knowledge granted to you by researchers and put it into action. Please keep working together!

Observers – like myself – merely look on in wonder.

Terima kasih semua.

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