Africa's Trade in Services and the Opportunities and Risks of Economic Partnership Agreements

Africa Trade Policy Notes

Note #6

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August, 2010

Introduction

Services matter for economic growth and development. In most non-oil producing sub-Saharan African countries, the services sector is now the largest part of the economy, and as countries develop, the importance of the services sector tends to rise further. The provision of clean water, effective sewerage, a stable supply of energy, and access to education and health services is critical to increasing welfare and alleviating poverty. Services, such as telecommunications, energy, transport, and business services are important inputs into the production of goods and other services and hence influence productivity and competitiveness. Increasing the availability, affordability and quality of these services is crucial for economic growth and poverty reduction in all developing countries.

In this context, international trade can play a key role in the development of services sectors in Africa. Opening up to services imports and foreign direct investment can be an effective mechanism to increase competition and efficiency in the provision of services in the domestic economy. In addition, services offer dynamic new opportunities for exports, but too often services are overlooked as a source of export diversification, with trade policies focusing solely on goods. Exports of services are of particular importance for land-locked countries for which opportunities to diversify into the export of manufactures are more limited by the high costs of transporting goods.[1]

However, trade opening may need to be coordinated with regulatory reforms to ensure efficient outcomes, while additional policies may be necessary to ensure that public policy objectives regarding equity are achieved. This emphasizes the importance of developing the capacity to define and implement sound regulatory policies for services sectors, capacity that is limited in many African countries.

[1] Indeed, over the past 10 years exports of services from non-oil exporting land-locked countries in Africa have increased at a rate more than 3 times faster than their exports of goods.

This policy note examines the role that international trade agreements, particularly the Economic Partnership Agreements (EPAs) that are currently being negotiated with the European Union (EU), can play in supporting coordinated trade and regulatory reforms. Such reforms will enable African countries to exploit the considerable opportunities for the expansion of trade in services both within Africa as well as with the global market. The note discusses the key issues that EPAs will have to address if they are to support the development of service sectors in Africa, while recognizing that EPAs might not necessarily be the most effective way to pursue service sector reform for all African countries. The note proceeds by first reviewing the role that trade liberalization can play in the reform of services sectors.

Trade Liberalization and Regulation of Services sectors

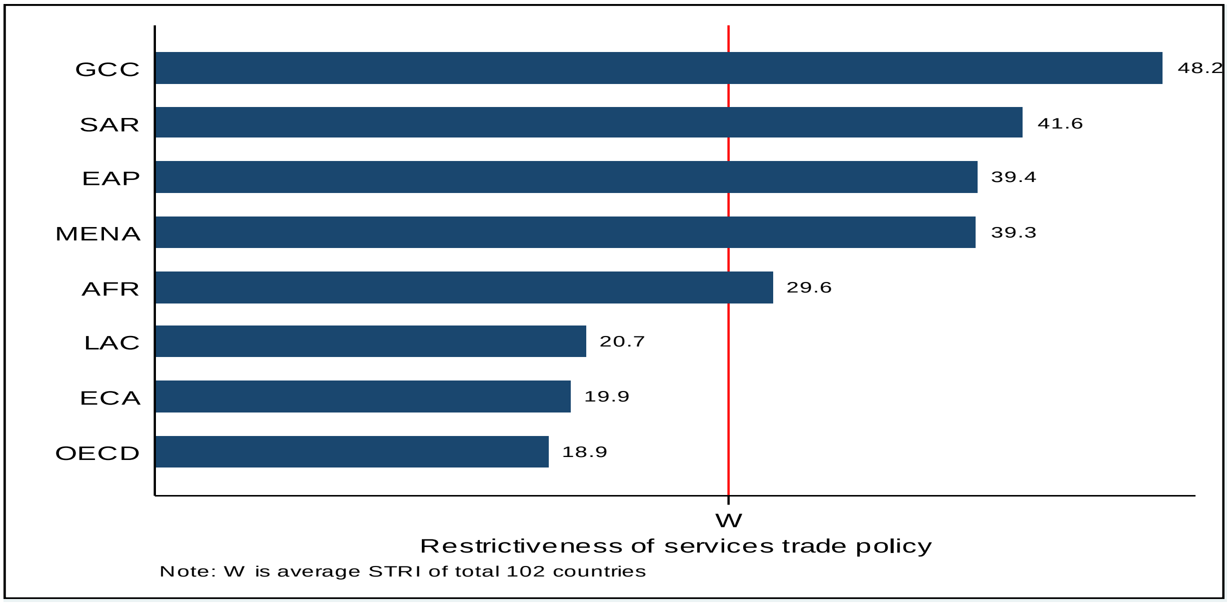
Trade policy plays an important role in determining the nature of competition in domestic services sectors. Countries that place restrictions on foreign service providers may limit access to the most efficient suppliers and the best technologies, and deny producers and consumers throughout the economy access to low-cost services. Empirical studies have shown that openness to trade in services is associated with greater efficiency and faster economic growth.[2] In addition, liberalization of services trade has positive impacts on trade in goods and allows developing countries to better exploit their comparative advantages in labor-intensive manufactures. The gains from services liberalization are likely to be larger than those from goods liberalization and the adjustment costs that arise from service sector reforms are likely to be lower than those arising from reducing protection of goods. This is because the dominant mode of cross-border supply in many services sectors is through commercial presence (mode 3), which means that services will likely continue to be produced locally, albeit following investment and the transfer of expertise and assistance by foreign firms.

However, liberalizing services trade can be more complex than the liberalization of goods trade and requires considerable technical capacity, which is often lacking in Africa. The complexity arises from the necessity for many services sectors to be regulated in order to ensure that they operate efficiently in the face of market failures. Opening up to services trade in the absence of appropriate regulations may not necessarily increase trade and generate greater efficiency in the provision of services and hence.

It may also be necessary to put in place mechanisms to ensure that social objectives regarding access to key services are not compromised by trade reform. The challenge is to achieve an appropriate balance between greater competition by improving market access for foreign providers and achieving public policy objectives. A particular concern is that increasing competition and liberalizing services will lead to a deterioration in the provision of services to the poorest or less populated areas because these are the least profitable to serve. This could arise if new competitors in formerly monopolized sectors compete away monopoly profits that were previously used to cross-subsidize unprofitable provision of services to poorer regions. In response, Governments can use a range of market-based mechanisms to

[2] Hoekman and Mattoo (2008) provide a full review of the empirical evidence regarding trade in services, trade liberalization and growth.

Figure 1: Restrictiveness of Applied Services Trade Policies by Region



Notes: Regional abbreviations: GCC – Gulf Cooperation Council, SAR – South Asia, EAP – East Asia and Pacific, MENA – Middle East and North Africa, AFR – Sub-Saharan Africa, LAC – Latin America and Caribbean, ECA – Europe and Central Asia, OECD – Organization for Economic Co-operation and Development.
Source: Gootiiz and Mattoo (2009).

ensure the provision of key services to poorer or under-populated areas in a competitive environment.

Coordinating services trade liberalization with regulatory reform is therefore important. Although there is no strict sequencing necessary such that regulatory reform should precede trade liberalization or vice versa, in general efforts should be made to ensure competition in the market. In some cases, trade liberalization can be a driver of regulatory reform, such as when regulatory agencies have been captured by incumbent producers and trade liberalization leads to greater participation of consumers and new suppliers of services in the regulatory process. In other cases, regulatory reform or an improvement in the business climate may be necessary to allow investment or cross-border trade to take place.

To be able to effectively plan trade liberalization and negotiate agreements on trade in services bilaterally, regionally or at the multilateral level it is essential for policy makers and negotiators to have extensive information on the nature of regulation and trade restrictions in all of the sectors that are subject to discussion. In many African countries as well as other developing countries, though, comprehensive data on services sectors are not available, and developing countries typically face difficulties in effectively participating in trade negotiations on services.

To address the shortage of data on applied policies governing trade in services in developing countries, the World Bank has recently carried out a survey to assess applied (actual) trade policies in five services sectors—financial services, telecommunications, retail distribution, maritime transport, and professional services—in 78 developing and transition countries and 24 developed countries in 2007 and 2008. Twenty-two African countries are considered in the analysis. The results show that, on average, African countries have relatively liberal services trade policies (Figure 1). For these African countries, the overall restrictiveness index of applied services polices is just above the world average and lower than the restrictiveness index in all other developing country regions except for Eastern Europe and Latin America. There is, however, considerable variation across countries in Africa. Madagascar and Mauritius have very open policies towards trade in services with a value of the restrictiveness considerably below the world average and also below the average for OECD countries. On the other hand, the value of the index for Ethiopia is the highest score of any country in the sample. Only 7 of the 22 African countries have an overall services restrictiveness index that exceeds the world average.

The Role of International Trade Agreements in Services Reform

International trade agreements can support governments that wish to implement services reforms but which are opposed by powerful vested interests. Such agreements can help break domestic deadlocks by improving market access for the country's exporters and mobilizing export groups to support the reform effort. Trade agreements can also provide a mechanism for overcoming domestic resistance to desirable reforms by locking in the commitment to reform and enhancing the credibility of the reform process. However, most African countries have been reluctant to make commitments on services at the WTO under the General Agreement on Trade in Services (GATS). Almost all of the liberalization of trade in services reflected in Figure 1 has been implemented unilaterally.

This caution reflects that negotiation of reciprocal commitments under the GATS has given insufficient attention and resources to enable developing countries to assess the impact of making market access concessions on domestic regulations and market outcomes. A lack of attention to concerns over regulation and the ability to regulate have constrained effective participation in negotiations. Regulators will respond to substantive arguments for reform, while GATS-style mercantilist bargaining over market access alone will be of little importance to them. This supports the need for careful analysis of the economic benefits as well as wider consequences of reform and the involvement of key stakeholders in discussions of regulatory reform.

There are several additional challenges to services trade liberalization negotiations. Developing countries often have concerns that negotiated global liberalization of services trade and negotiations over an EPA will be largely one sided, with developed country service providers likely to gain improved access to developing country service markets but with little improved access for developing-country service providers in developed country markets. The standard mercantilist bargaining over liberalization of trade in services may, therefore, not deliver improved outcomes in many of the poorest countries. In addition, many African countries face serious technical and administrative capacity constraints in designing, negotiating, and implementing liberalization of their trade in services and complementary regulatory reforms. The unwillingness of many African countries to bind existing services trade policies at the WTO/GATS level may also reflect their inability to prepare negotiating positions, and to participate meaningfully in the negotiations in a way that will positively affect the negotiation's outcome.

In general, the greatest gains from liberalizing trade in services will arise when access is provided to all suppliers on an MFN basis. By so doing a country gives its consumers and produces access to the best service-providers in the world. Sequencing preferential liberalization of trade in services before broader MFN liberalization can have adverse long-run consequences by handing a first-mover advantage to a less efficient supplier that a subsequent increase in openness cannot dislodge or force to become more efficient. Liberalization at the regional level first may be justified if there are important learning effects that local firms have not been able to exploit due to the small size of national markets or restrictive national regulatory regimes that have inhibited opportunities for growth. Preferential regional liberalization may then allow regional service providers to emerge in Africa that are then able to compete effectively when MFN liberalization is implemented.

Liberalizing first on a regional basis may allow regulators to gain experience before full opening is implemented. Regional agreements may also make it possible to reap scale economies in regulation and supervision, particularly where national regulatory agencies face skill constraints; they could also reduce scope for the capture of national regulation by private sector interests and reduce regulatory heterogeneity. However, regional policy makers also need to avoid creating protected regional service sectors that will be difficult to liberalize and giving first mover advantages to inefficient regional suppliers against which more efficient international suppliers will not subsequently be able to compete. For this reason, it is important to carefully assess the potential costs and benefits of proceeding with preferential regional liberalization. Countries should also look for ways to make binding commitments to ensure that there is subsequent MFN liberalization.

Reform of Services in Africa and Economic Partnership Agreements

The provisions on services in the CARIFORUM EPA between a group of Caribbean countries and the EU, suggest that a similar EPA with African countries could be a mechanism for locking in existing levels of openness, enhancing the credibility of reform and providing a signal to investors of the stability of the current policy stance on services. The CARIFORUM EPA also defines frameworks for the regulation of a number of services sectors, which could provide a basis for increasing the quality and credibility of regulations in Africa. In other sectors in which Africa has export interests, such as tourism and IT related services, commitments that go beyond the GATS could provide important precedents for future regional and multilateral trade agreements. Provisions in the CARIFORUM EPA for cooperation between competition authorities, especially the specific commitments in tourism, could be useful in disciplining anti-competitive behavior by EU firms in African markets and in allowing African firms to effectively compete in vertically integrated production chains. Regional regulatory cooperation and a regional preference clause could be useful for advancing regional integration in services in Africa. Putting in place structures for dialogue on mutual recognition at the EPA level may facilitate progress at the regional level.

However, an EPA is unlikely to offer much in terms of improved access for African countries to the EU market. Although the CARIFORUM EPA contains provisions for expanding the temporary employment of skilled professionals, it does not address the issue of temporary movement of unskilled workers. Greater temporary access to the EU for unskilled workers, for example, through carefully crafted and managed sub-contracting schemes would have a significant economic impact in Africa. Without significant opening to temporary movement of unskilled workers by the EU, services reform will have to be driven by African countries seeking to reform their domestic services sectors. Further, the current GATS-style negotiation of reciprocal commitments between the EU and African countries under the EPA has given insufficient attention and resources to improving regulatory policies and strengthening regulatory institutions.

A sector-by-sector approach to coordinated regulatory and trade reforms is likely to be the most effective approach for African countries than a broad but shallow approach to negotiating commitments in all sectors. For countries with limited capacity to negotiate and regulate services a focus on priority services sectors from a development perspective (in most countries these are likely to include transportation, telecommunications, electricity, finance, and business services) is likely to be more effective than a broad but shallow preferential trade agreement that involves negotiations across all sectors and modes of supply.

Recommendations

Regulatory and trade reforms in Africa will need to be supported with technical and financial assistance. Such assistance should be targeted at those factors with the greatest impact on performance in the market and not solely at market access and national treatment considerations and the preparation of GATS-type schedules of commitments. However, this assistance should not be directly linked to the signing of an EPA. Assistance should be available to all African countries that wish to reform their services sectors, whether they sign an EPA or not.

One way to organize and coordinate such support could be through a dedicated forum, independent of specific trade negotiations, that supports the application of economic and regulatory impact analysis, discussion of good practices and effective institutional structures. The forum, which would need to be organized around the priority sectors for Africa, would allow for meaningful dialogue between regulators and trade negotiators to address concerns about the impact of trade reform on the capacity to effectively regulate. Such a forum would have to encapsulate that for services reform one size does often not fit all and that reforms and appropriate regulatory structures will often tend to be country specific. A key issue would be where to host such a forum and how to ensure access to its resources for all countries in Africa.

For countries in Africa, drawing upon available sources of financial support and technical assistance:

- Define a strategy for trade in services that is integrated into the national development plan through the following activities (i) improving the collection and dissemination of more and better data on service sectors and trade in services; (ii) creating awareness and facilitating a dialogue among various stakeholders about the potential impact of services trade liberalization and reform; (iii) identification of priority sectors where greater competition, foreign investment and new technology can drive efficiency and growth (iv) establishing a committee for services trade and regulatory reform to champion open and transparent approaches to regulation and trade opening and oversee the use of regulatory impact analysis.

- In the priority domestic services sectors implement a trade and regulatory audit to identify the main constraints to competition and investment. Do they lie in insufficient openness to trade and investment, lack of credibility of existing openness, inappropriate regulations, insufficient capacity to implement a sound regulatory framework, a hostile investment climate?

- In priority export sectors assess the need for improvements in the regulatory regime to support competitiveness and mobilize an export supporting approach in relevant line ministries and institutions such as the export promotion agency.

- Identify if, and how, unilateral reforms and trade agreements at the regional, EPA and multilateral level can be used to alleviate the constraints that are identified for the priority sectors and support the process of trade and regulatory reform. Explore opportunities for cooperation with the EU outside of a formal broad services agreement, for example, with regard to cooperation between competition authorities.

- Pursue more actively opportunities for regional cooperation and deeper integration of services in priority sectors of mutual interest with regional partners.

With regard to the EPAs:

- The EU and African countries consider a more flexible approach to the EPAs that reflects the diversity of capacities and priorities across African countries. The EPAs become a process in which the focus is not on a bilateral deal between the EU and regional blocks in Africa for the preferential opening of services sectors based upon a GATS type schedule but rather a country based cooperative approach to remove the constraints to the development of the sectors identified as priorities by African countries. For example, if requested by an African country or group of countries, the EU could work with these countries to facilitate cooperation between competition authorities. This could be provided even in the absence of a formal comprehensive EPA agreement. Similarly the EU could look at opportunities for mutual recognition of qualifications that are not predicated on signing a formal EPA agreement.
- African countries and the EU adopt a sector-by-sector approach to coordinated trade and regulatory reform rather than a broad but shallow GATS type negotiation in which priority sectors for reform are defined by each country consistent with national development plans.
- The EU supports African countries in pursuing openness to trade in services primarily through MFN liberalization especially in infrastructure sectors where preferential opening may have long-term adverse implications.
- The EU works with other donors and international institutions to make adequate technical assistance available to all reforming countries in Africa from a fund that is independently managed and delink the provision of such funding from negotiations and agreement on an EPA. Such a fund could organize financial resources and expertise around key services sectors for Africa.

Suggestions would include telecommunications, tourism, transport, finance and business services.

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Reference

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