ASEAN SERVICES INTEGRATION REPORT

A Joint Report by the ASEAN Secretariat and the World Bank

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The ASEAN Secretariat
Office of the Chief Economist, East Asia and Pacific Region, the World Bank

The Association of Southeast Asian Nations (ASEAN) was established on August 8, 1967. The Member States of the Association are Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam. The ASEAN Secretariat is based in Jakarta, Indonesia.

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Abbreviations

AANZFTA	ASEAN-Australia-New Zealand Free Trade Agreement
ABIF	ASEAN Banking Integration Framework
ACIA	ASEAN Comprehensive Investment Agreement
ACMF	ASEAN Capital Markets Forum
ACPE	ASEAN Chartered Professional Engineer
ACPER	ASEAN Chartered Professional Engineers Register
AEC	ASEAN Economic Community
AEM	ASEAN Economic Ministers
AFAS	ASEAN Framework Agreement on Services
AGCM	ASEAN Central Bank Governors' Meeting
AMNP	Agreement on the Movement of Natural Persons
AMS	ASEAN Member States
APEC	Asia-Pacific Economic Cooperation
ASEAN	Association of Southeast Asian Nations
ATM	ASEAN Transport Ministers Meeting
ATM	automated teller machines
BIMP-EAGA	Brunei Darussalam, Indonesia, Malaysia, and the Philippines East ASEAN Growth Area
BPO	business processing outsourcing
CAFTA	Central America Free Trade Agreement
CCS	Coordinating Committee on Services
CLMV	Cambodia, Lao PDR, Myanmar, and Vietnam
EDSM	Enhanced Dispute Settlement Mechanism
EIA	economic integration agreement
EU	European Union
FDI	foreign direct investment
FTA	free trade agreement
GATS	General Agreement on Trade in Services
GCC	Gulf Cooperation Council
GDP	gross domestic product
GMS	Greater Mekong Subregion
GTAP	Global Trade Analysis Project
GVC	global value chain
ICT	information and communication technology
IMS-GT	Indonesia, Malaysia, Singapore Growth Triangle
IMS-GT	Indonesia, Malaysia, Thailand Growth Triangle
INACA	Indonesian National Air Carriers Association
IOSCO	International Organization of Securities Commissions
ISO	International Organization for Standardization
IT	information technology
LMT	labor market test
M-ATM	ASEAN Tourism Ministers Meeting
MAAS	Multilateral Agreement on Air Services
MAFLPAS	Multilateral Agreement for Full Liberalization of Passenger Air Services
MALIAT	Multilateral Agreement on the Liberalization of International Air Transportation
MAS	Monetary Authority of Singapore
MFN	most-favored nation
MRAs	Mutual Recognition Agreements or Arrangements
NAFTA	North American Free Trade Agreement
OECD	Organisation for Economic Co-operation and Development
PRA	Professional Regulatory Authority
QABs	Qualified ASEAN Banks
QFB	Qualifying Full Bank
RIATS	Roadmap for Integration of Air Travel Sector
SAR	special administrative region
SSE	service supplying employees
STRI	Services Trade Restrictiveness Index
TELMIN	Telecommunications and IT Ministers Meeting
TII	Trade Intensity Index
WC-FSL	Working Committee on ASEAN Financial Services Liberalisation
WTO	World Trade Organization

Countries

CHN	China
IDN	Indonesia
KHM	Cambodia
LAO	Lao People's Democratic Republic
MMR	Myanmar
MNG	Mongolia
MYS	Malaysia
PHL	Philippines
PNG	Papua New Guinea
SGP	Singapore
THA	Thailand
VNM	Vietnam

Regions

AFR	Sub-Saharan Africa
BRN	Brunei Darussalam
ECA	Europe and Central Asia
LAC	Latin America and Caribbean
MENA	Middle East and Northern Africa
SAR	South Asia Region

Foreword

With the services sector's increasingly significant contributions to the regional economy, supporting about half of its combined GDP and 60 percent of its total foreign direct investment inflows in recent years, ASEAN fully recognizes the opportunities for further growth and employment that the services sector creates. The liberalization of the services sector in the region has traditionally focused on two areas, specifically, the promotion of trade in services as well as the promotion of flows of skilled labor through the establishment of Mutual Recognition Arrangements (MRAs) for professional services. Under the ASEAN Framework Agreement on Services (AFAS), ASEAN has made concerted efforts to enhance cooperation among Member States, setting specific targets for the process of liberalizing and integrating the services sector in the region to enable the free flow of services envisioned in the ASEAN Economic Community (AEC).

This Report provides an in-depth assessment of the role of services trade in ASEAN's economic integration, analyzing the framework of ASEAN's services policies and the impact of services integration in the region. Aside from identifying prevailing challenges and potential opportunities, the Report provides a useful reference on ASEAN's progress and puts forward key recommendations to enhance regional trade in services.

The formal launch of the ASEAN Community and the endorsement by the Leaders of ASEAN of the forward-looking and ambitious ASEAN Community Vision 2025 this year will create greater impetus to further broaden and deepen ASEAN's services integration process with its benefits ultimately redounding to the people-oriented, people-centred ASEAN Community.

LE LUONG MINH
Secretary-General of ASEAN

Foreword

The Association of Southeast Asian Nations (ASEAN) brings together ten countries with over 620 million people and a combined gross domestic product of more than USD 2.5 trillion. These countries are well integrated into the global economy and have benefited from this integration. And, as evidenced by their adoption of the ambitious goal of forming an ASEAN Economic Community (AEC) by 2015, they are committed to even deeper regional integration.

An earlier report – the *ASEAN Integration Monitoring Report* (2013), which was jointly prepared by the ASEAN Secretariat (ASEC) and the World Bank, showed that ASEAN's regional integration agenda has provided important benefits to the Member States. In particular, ASEAN integration has helped boost regional trade flows without trade diversion, improve trade logistics, lower aggregate trade costs and increase regional investment flows.

This joint ASEC--World Bank report, which focuses on services integration within ASEAN, is timely for two reasons. First, as ASEAN prepares to launch the AEC at the end of this year, addressing services integration is clearly high on the agenda of policymakers. Second, Member States are now discussing a new services integration agreement to replace the previous ASEAN Framework Agreement on Services.

This report takes stock of ASEAN's achievements in services integration, delineates the potential gains from further integration and highlights the challenges that remain. Recognizing the role of services in spurring economic growth and job creation, including in manufacturing and agriculture, regional policymakers have committed to an ambitious plan for integrating their services sectors as a core element of the AEC. As the report highlights, there are successes in some sectors – such as in health in Thailand, education in Malaysia and finance in Singapore – on which future actions can build. Nevertheless, intra-ASEAN trade in services remains low relative to the economic size, complementarity and geographical proximity of ASEAN member states. As the report notes, there are still a range of policies in ASEAN economies that impede services integration. Overall, the data and analysis show that while there has been good progress in making commitments to integrate services trade, more needs to be done to fully realize the goals laid out in the AEC Blueprint.

The report reviews approaches to negotiations and institutional processes underlying services integration. It provides a range of specific recommendations on implementing commitments, enhancing transparency, and strengthening the institutional framework and negotiating modalities. Finally, it highlights priorities for regional regulatory reform and cooperation as a means of deepening services integration.

On behalf of the World Bank, my thanks to the ASEAN Secretariat for a productive partnership over the last three years in implementing the ASEAN Economic Community Monitoring and Evaluation program, of which this report is one output. Our thanks also to the Government of Australia for financing most of this work through their technical assistance program for ASEAN. I hope this report will contribute to the ongoing debate on services integration within ASEAN and will help inform policymaking aimed at enhancing regional cooperation.

Axel van Trotsenburg
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This report was written by a team of World Bank (WB) staff and consultants led by Ahmad Ahsan of the World Bank. Other team members were Aaditya Mattoo, Batshur Gootiiz, Sebastian Saez, Martin Molineuvo, and Peter Walkenhorst of the World Bank. The report benefited from extensive inputs and comments from Julia Tijaja, Tan Tai Hiong and Wai Mun Hong of the ASEAN Secretariat. Alan Khee-Jin Tan (National University of Singapore) and Saurabh Mishra (Consultant) contributed background papers for the study. Guillermo Arenas and Christina Busch contributed to the analysis of Chapter 1, 4 and 5 and Claire Hollweg contributed with gravity model analysis of Chapter 1.The team gratefully acknowledges comments by peer reviewers Siow Yue Chia (Senior Research Fellow, Singapore Institute of International Affairs), Ndiame Diop (Lead Economist, Macroeconomic and Fiscal Management), and Bernard Hoekman (Professor and Program Director, Global Economics, Robert Schuman Center for Advanced Studies, European University Institute) and other participants at the review meeting of the World Bank. Yan Sun (EAPCE) provided research assistance. Cecile Wodon (EAPCE) processed the report and Diane Stamm edited it. Okti Z. Maaruf of the ASEAN Secretariat helped to design the cover.

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Notes and Data Sources

The analysis on ASEAN's commitments under ASEAN Framework Agreement on Services (AFAS) contained in this Report is limited to the eighth AFAS package in a wide range of service sectors under the purview of ASEAN Economic Ministers. The policy analysis of financial services covers Banking and Insurance sectors and the fifth package in financial services under the purview of ASEAN Finance Ministers. There is a brief reference to the scope of the recently concluded sixth package in the financial sector. The quantitative analysis of the transport sector policies compares multilateral and regional commitments and actual policies in 2012 in maritime transport (mode1 and 3), rail (mode 3), and road freight services (mode 3). The discussion of commitments in air transport services under the Purview of the ASEAN Transport Ministers is based on the Multilateral Agreement on Air Services (MAAS) and the Multilateral Agreement for Full Liberalization of Passenger Air Services (MAFLPAS), adopted in 2009 and 2010 respectively.

ASEAN continues to improve its commitments under AFAS. The Protocol to Implement the Sixth Package of Financial Services Commitments was signed in March 2015 by the ASEAN Finance Ministers. The Sixth Protocol of Financial Services Commitments contains the enabling provision for the implementation of the ASEAN Banking Integration Framework (ABIF). The Objective of ABIF is to achieve a more integrated banking market, by allowing any two ASEAN economies to enter into reciprocal agreements to provide Qualified ASEAN Banks (QABs) with greater market access, and operational flexibilities consistent with those of domestic banks in the respective host countries.

The signing of the Protocol to Implement the Eight Package of Commitments on Air Transport Services was completed in November 2014. The signing for the Protocol to Implement the Ninth Package of Commitment under AFAS to-date is also close to completion. In addition, further liberalization in each of these AFAS processes continues to be undertaken. The services commitments made in these subsequent packages include new subsectors, higher foreign equity participation, and fewer restrictions to trade in various modes of supply. It is therefore expected that incorporation of these more recent commitments would have yielded a lower (less restrictive) index of AFAS commitments than that presented in this Report.

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Executive Summary

1. **This report, prepared by the World Bank with support from the ASEAN Secretariat, takes stock of ASEAN's achievements in the integration of services markets and identifies the challenges ahead.** A previous joint report, the *ASEAN Integration Monitoring Report* (ASEAN Secretariat and the World Bank, 2013), looked at the overall progress of regional integration in trade in goods, trade facilitation, investment flows, and services. Both the earlier report and other work (ERIA 2012) have identified services integration as one of the most important challenges facing ASEAN. This is true in terms of both the slow progress in achieving the ASEAN Economic Community (AEC) goals regarding services integration, and the broader potential gains that can be obtained from achieving those goals. This report addresses four questions: (a) How have ASEAN countries performed in services and services trade and why are services trade and integration important for ASEAN countries? (b) How open are services markets within ASEAN and to what extent has ASEAN achieved the goal of services integration? (c) What lessons can be derived from past experiences of services sector reforms in ASEAN countries? (d) What constrains services integration and how can the integration process be enhanced?

2. **ASEAN economies are aware of the key role that the services sector and services trade can play in their development, and have made services central in their integration agenda.** Governments in the region have realized the fundamental role of services for economic growth and job creation, and have embarked on an ambitious regional integration program that is intended to culminate in the free flow of services by 2015. The services integration agenda in the region was first launched through the ASEAN Framework Agreement on Services (AFAS), signed in 1995, three years after the signing of its goods counterpart, the ASEAN Free Trade Area (AFTA). The AEC Blueprint adopted in 2007 provided a bold and more ambitious vision of deep integration, where goods, services, investment, and skilled labor would move freely across the borders of ASEAN countries by 2015. Detailed targets were set for achieving the integration of services markets. The AFAS and the AEC Blueprint provide a valuable framework to foster services trade within the region.

Why are services and services trade important for ASEAN countries and how do they perform?

3. **The growing importance of services in the world economy is being driven by strong demand from consumers and producers, and by international trade.** As incomes increase, consumers seek a widening range of personal and recreational services or consume more services-intensive products, while producers search for more specialized and sophisticated inputs and professional advice. Parts of these demands are satisfied through international trade, since services have also become exports and tradables in their own right. Increasing fragmentation of production processes in global value chains, along with advances in information and telecommunication technology, including digitization of content, has made it possible for many services activities that used to be thought of as being nontradable to be supplied internationally. Furthermore, backbone services, such as transportation, logistics, telecommunications, and financial services are integral to the working of global value chains, serving as the glue that makes it possible for production activities to be undertaken across multiple countries. International experience suggests that an expansion of services trade is associated with increased per capita incomes and higher productivity.

4. **ASEAN economies are no exception to these trends.** While their rapid growth over the last four decades was largely fueled by strong manufacturing exports, the services sector and services trade have become increasingly important. On average, services contributed more than 40 percent of total value added

in ASEAN Member States in 2010 and accounted for more than 50 percent of total employment.[1] Trade in services has also risen sharply. When trade is measured in terms of value added, the share of services in total exports increases in all ASEAN countries except Indonesia.

5. **An analysis of forward linkages of the services sector in this report also shows that services have a key role in ASEAN countries.** Services are important inputs to other economic sectors and exports. Indeed, many services, such as finance, transportation, and communication, are "backbone services" that feed into other production processes, so that services trade can help foster competition through access to vital production inputs at lower costs. Forward linkages are the contributions to value added of a particular sector to other sectors in the economy. In ASEAN countries, the four services sectors (electricity, gas, and water; construction; trade and transport services; other private services) contributed between 25 percent (Lao People's Democratic Republic) and 56 percent (Singapore) of total domestic value added and between 17 percent (Indonesia) and 56 percent (Singapore) of total export value added in 2007. For the more developed ASEAN Member States, Indonesia, Malaysia, the Philippines, Singapore, and Thailand, manufacturing uses services relatively intensely, with services providing about one-third of the value-added contributions of manufacturing. The exception is Indonesia, with a contribution closer to 23 percent. For lower-income ASEAN Member States, that is, Cambodia, Lao PDR, and Vietnam, the share in services in the value added of agriculture as well as energy extraction and minerals is above one-third, reaching almost 47 percent in the case of Lao PDR.

6. **The regional economic integration of the AEC, constituting a potential market of more than 620 million people and US$2.5 trillion of gross domestic product, offers opportunities for using services and services trade to generate growth in productivity and income.** Services contribute between 40 and 70 percent of the gross national income of ASEAN economies. In terms of trade in services, ASEAN's trade in services represents 5 percent of world trade in commercial services, or US$343 billion in 2009. In addition, foreign direct investment (FDI) in the services sector has accounted for about 60 percent of total ASEAN FDI) in the past two years. This clearly underscores the importance of services to ASEAN.

7. **Despite these opportunities, ASEAN countries have not yet realized their full potential in services, particularly in view of their levels of income and development.** This assessment is based on a variety of indicators, including straightforward comparisons with similar countries, analysis using cross-country estimates, and other modeling tools. Some ASEAN countries have established themselves as services exporters in particular sectors. Overall, however, sophisticated, skill-based services exports remain largely niche activities in ASEAN economies. While the contribution of services growth has picked up in the last decade, the share of services in GDP remains relatively low for ASEAN economies (accounting, on average, for less than half of the GDP the last five years) compared to countries in other regions (more than 60 percent in Latin America, Eastern Europe, and the Middle East).

8. **Further, ASEAN Member States are mainly exporting "traditional services" such as transportation, and travel and tourism services.** They have been less successful in tapping into the new services opportunities such as information technology (IT) and business-related services. The Philippines and Singapore are the main exceptions in the region. In the case of the Philippines, in recent years its business processing outsourcing and IT-enabled services exports became a success story. Singapore's exports of modern services, such as professional and other business services have developed significantly since the mid-1990s.

[1] Following ASEAN's official convention, ASEAN countries are referred to as ASEAN Member States in this report.

9. **Regional trade in services for most ASEAN countries has yet to meet its full potential.** This is seen in two ways: first, actual services trade among most ASEAN countries is less than the potential trade volumes predicted by trade determinants. All ASEAN countries are shown to under-export to Malaysia and Singapore (and Malaysia and Singapore to each other). There also appears to be untapped potential for countries such as Brunei Darussalam, Cambodia, Malaysia, and Singapore to increase services exports with select countries in the region. Second, the intensity of regional services trade is low; that is, services trade among ASEAN countries is generally less than services trade between ASEAN countries and non-ASEAN countries.

How open are services markets within ASEAN?

10. **ASEAN countries have, on average, more restrictive services policies than any other region in the world, except the Gulf States, although the restrictiveness of applied policies varies widely across ASEAN countries.** The average Services Trade Restrictions Index (STRI) for the region is 60 percent higher than the global average. But restrictiveness of applied policies varies widely across countries and income levels. Cambodia and Singapore have the most open policies in the sectors covered. Myanmar and Vietnam are also relatively open with a few restrictions, and the rest (Indonesia, Thailand, the Philippines, and Malaysia) have significant restrictions. Note that in some case, the presence of only a few restrictions may be more reflective of the regulatory readiness in these countries than the openness of their services market policies.

11. **The AFAS has contributed to greater regional policy certainty, but has not resulted in significant additional liberalization on the ground.** On the one hand, commitments to liberalize service sectors scheduled under AFAS now surpass those made under the General Agreement on Trade in Services (GATS) during the World Trade Organization (WTO's) Uruguay Round or even offered under the Doha negotiations. While AFAS commitments have unquestionably created greater regional policy certainty, their commitments have not produced significant additional liberalization, because they did not go far enough beyond the current applied regime.

12. **Further, despite having AFAS in place, ASEAN countries have not undertaken significant liberalization in the last four years.** While there are some instances of market opening, there are also instances of reversal of liberalization. For the six ASEAN Member States for which the same surveys were conducted in 2008, there is little change in the overall policy regime from 2008 to 2012 (regional average STRI fell only about 16 percent from its high level). As a consequence, even though actual openness is greater than that promised by current AFAS commitments, it is still not close to the ambitious, broad, goals to achieve free flow of services, especially in the case of Mode 3 trade, that is, in liberalizing foreign investment ("commercial presence") in services. But it is important to recognize the valuable role of AFAS commitments in reducing policy risks, as shown in the limited instances of reversal of liberalization.

13. **ASEAN countries have made modest progress toward creating a more regionally integrated market.** There is little evidence that ASEAN economies are more open vis-à-vis each other in services trade than vis-à-vis non-ASEAN economies. For the seven broad sectors (and relevant modes) for which policy data were collected for this study, this report found little difference between policy treatment of intra-ASEAN and extra-ASEAN trade. ASEAN Member States therefore received virtually the same treatment as nonpreferential or most-favored-nation (MFN) policies.

14. **Market access in many of the ASEAN economies is uncertain and unpredictable due to a discretionary licensing regime.** From banking to transport, entry is restricted by the explicit and implicit limit on new licenses, and the licensing process can be opaque and discretionary. In several ASEAN countries, licenses and foreign equity ownership are decided on a case-by-case basis, subject to requirements or approvals that involve several regulators and ministries. Some countries, particularly newer

Member States, do not have regulations in some sectors pertaining to the supply of services through the cross-border and consumption abroad modes. In such cases, even though the supply of services is usually allowed in practice, the absence of regulation makes it difficult to identify and define the policy regime affecting the supply of services, creating a less predictable policy environment.

15. **There are two areas, however, where progress in services integration is noticeable.** First, in air transport, ASEAN countries have taken some steps toward regional open skies. Second, in certain professional services, mutual recognition agreements have been negotiated and concluded. These initiatives suggest that regionalism could have incremental value when it focuses on areas which are not being addressed multilaterally. This is not surprising, given that regionalism offers a potentially valuable avenue for liberalization in areas where multilateral cooperation is difficult, such as in professional services and transportation. However, even in these areas, regional integration efforts are incomplete. In professional services, domestic regulations have not yet been aligned with the ASEAN Mutual Recognition Agreements or Arrangements (MRAs), while some MRAs need to be complemented with further bilateral negotiations to make them operational. In air transport, further liberalization will be necessary to achieve a truly integrated regional air transport services market.

16. **In the financial sector, also, ASEAN Member States are working to deepen financial services integration in the ASEAN context.** Initiatives by ASEAN Member States have aimed to strengthen and harmonize capital market disclosure standards. To further deepen regional financial integration, the ASEAN Central Bank Governors' Meeting (ACGM) in December 2014 endorsed an ASEAN Banking Integration Framework (ABIF), which will enable "Qualified ASEAN Banks" (QABs), to have a greater role in promoting intraregional trade and investment. The ABIF guidelines were also approved by ACGM in December 2014, and the provision for enabling QABs implementation was signed by ASEAN Finance Ministers in March 2015, as part of the Protocol to implement the 6th Package of Financial Services under the AFAS.

17. **Successful liberalization also requires supporting reforms of domestic regulation.** These range from prudential regulation in financial and professional services to pro-competitive regulation in telecommunication and transport services. In these areas too, there is scope for regional coordination and cooperation, to reap economies of scale in regulation and to prevent the fragmentation of the regional market because of divergent national regulation.

What lessons can be derived from past experiences of services sector reform?

18. **ASEAN economies have accumulated valuable experience in reforming their service sectors, which can be useful for regional integration.** A key lesson is that national governments have an important role to play not only in shaping the regional and international integration agenda, but also in ensuring there is a supporting domestic reform process. Governments have to work closely with the private sector to ensure that the domestic regulatory framework and other complementary policies are in place to support the development of a more competitive services sector. Setting standards, accreditation processes, and quality control measures, which enable the development and trading of services, while protecting domestic consumers, have been key elements in these developments. Five country-sector experiences of services reform offer valuable lessons for future reforms.

19. **Malaysia successfully established itself as one of the pioneers in private higher education by opening up the sector, fostering cross-border trade in education services, and implementing both the requisite regulatory framework and quality assurance infrastructure.** As a result, the number of privately and foreign-controlled educational service providers, and the number of foreign students studying in Malaysia, increased markedly. The government's willingness to liberalize higher education and cede some control over the sector's development to private service providers, establish a regulatory framework

for the new private universities and set up the quality assurance infrastructure that made it possible to avoid a slide toward "degree mills," and support the outward orientation and international benchmarking when setting standards for courses and degrees, all helped anchor the credibility of the new educational offerings. Finally, the active pursuit of partnerships with foreign universities through the establishment of branch campuses or twinning programs brought foreign expertise and competition to the country.

20. **After the Asian Financial Crisis in 1997, Singapore retained and strengthened its position as the region's financial center by combining market opening with active preparation of the domestic financial sector and reformed regulatory framework.** Since the late 1960s to the start of the Asian Financial Crisis, Singapore actively promoted the development of its financial sector with the aim of becoming a financial center in the region. Yet, until the Asian Financial Crisis, local banks and financial institutions continued to be shielded from international competition by separating the activities of the offshore financial center from the domestic banking and insurance sector. The crisis highlighted the deficiencies of this system and subsequently triggered a multitude of gradual reforms that included opening the market to foreign banks and insurance companies, and the active preparation of the domestic financial sector for the coming increased competition. Moreover, the Monetary Authority of Singapore scrutinized the foreign service providers and granted a limited number of operating licenses to select companies that best met its set of criteria and, thus, kept control on the country's financial system.

21. **Thailand has been one of the frontrunners with respect to patient insourcing in Southeast Asia through its ability to respond effectively to the initial challenges posed by market opening and being proactive in targeting the high-value-added markets.** Thailand was able to respond to the challenge of polarization of public-private health care and a brain drain of health professionals from the public sector through complementary policies such as compulsory public service for medical graduates and financial incentives for rural doctors. The country initially focused on tourism-related activities such as spas, traditional massages, and herbal treatments. Yet, in recent years, private hospitals have discovered that they can profitably attract and treat foreign patients not only for essential treatment such as heart bypass procedures, but also for elective medical procedures, such as plastic surgery. The ensuing growth of private hospitals has given rise to a brain drain of health professionals and other resources from the public sector toward the private sector. The Thai government responded to this challenge by devising a set of complementary policies such as the imposition of a three-year compulsory public service for medical graduates, with two-thirds of the latter being sent to work in rural areas, along with other financial incentives for doctors to work in rural areas.

22. **The Philippines has been very successful in capturing a significant share of the international business process outsourcing (BPO) market through a holistic approach to developing the sector.** Competitive salaries and low compensation costs, a large pool of suitably qualified talent, low telecommunication and real estate costs, the opening of the telecommunication sector, the availability of investment incentives for firms in the BPO sector, and the fostering of tertiary education have been the keys to this success. The Philippines has been trying to benefit from the growing trend in high-income countries for firms to outsource back-office and information technology functions in order to take advantage of advanced skills and lower labor costs of specialized service providers. The government has facilitated the success of the BPO industry in the country through investment and export incentives supporting tertiary education. Most important was the liberalization of the telecommunications industry in the mid-1990s. In particular, competition in local long-distance services and the authorization of international simple resale led to a sharp drop in telecommunication rates.

How can the services integration process be enhanced?

23. **ASEAN Member States have made progress in the liberalization of trade and investment in services under AFAS, but there is room for improvement in terms of sectoral coverage and depth of**

commitments. Reinforced by the negotiating goals set out in the AEC Blueprint, AFAS has provided a strong platform for reducing formal restrictions to services trade. Eight rounds of negotiations have committed ASEAN Member States to opening up services trade more so than commitments made or offered under GATS. But ASEAN now faces the challenge of completing the final two rounds in 2015. Further, a comparison with other agreements—including the bilateral agreements made by some ASEAN countries with other countries outside the region—highlights the more modest ambition of the AFAS in terms of sectoral coverage and depth of commitments.

24. **Completing the intraregional liberalization of services trade and investment, as envisaged in the AEC Blueprint, will set the foundation for the establishment of an ASEAN Economic Community.** This will entail the removal of all limitations to market access and the elimination of discriminatory measures, including caps on foreign equity. On occasion, however, public order, safety of services, or prudential reasons may justify some restrictions.

25. **To facilitate this process, the foundation of the ASEAN services integration process, the ASEAN Framework Agreement on Services, and other sector-specific initiatives—or any successor agreement—needs to be strengthened.** AFAS follows GATS's main substantial obligations, including provisions on market access and national treatment, and the typology for scheduling commitments. As such, market access prohibits a number of quantitative restrictions, and the national treatment obligation covers both de jure and de facto discrimination. That is, a measure is deemed discriminatory when it alters the conditions of competition in favor of domestic services and service suppliers, regardless of whether the measure is openly discriminatory in its text. Typical examples of discriminatory measures include sectors reserved to nationals, training requirements imposed only on foreign suppliers, or language requirements that are not directly relevant to the exercise of a profession.

26. **To create greater certainty, more clarity is needed on the extent of applicability of GATS disciplines, including their interpretations and supporting documents, to AFAS.** For example, the GATS provisions on market access and national treatment have been interpreted by WTO panels and the Appellate Body in several dispute settlement cases. These interpretations help clarify the meaning of these provisions in the WTO context. But it is not clear what significance such interpretations have under the AFAS. One way forward could be for the ASEAN bodies such as the ASEAN Secretariat or the ASEAN Member States to clarify the scope of these provisions in the context of AFAS.

27. **Establishing an Implementation Monitoring Mechanism for AFAS will help achieve the full potential of the agreement.** Such a mechanism needs to go beyond the current legal compliance monitoring of the AEC scorecard and improving the existing ASEAN dispute settlement mechanism. A major shortcoming under the current AFAS is the inability to monitor and, where needed, compel the implementation of commitments in services trade. In fact, the lack of information on the level of implementation is such that there is no clear understanding of to what extent and how liberalization commitments are actually reflected in the ASEAN Member States' domestic laws and regulations. An Implementation Monitoring Mechanism that goes beyond legal compliance, once established, would review the level of implementation of AFAS commitments by ASEAN Member States, including through information provided by other Member States and/or other appropriate parties, including private service suppliers. Ongoing efforts to improve the system should be strengthened with a view to coming to a prompt conclusion. A renewed dispute settlement mechanism could include an interpretative procedure, which ASEAN Member States could consult on the terms of the agreements and commitments without the need for a formal dispute with another member. This would be in line with the successful experience with these procedures in other regional integration processes. The ASEAN Secretariat could also consider issuing informal "notes" that reflect some general understanding on the services integration process for greater clarity and transparency, but would not have any legal implication for the ASEAN Member States.

28. **Removal of quantitative and discriminatory limitations or formal restrictions will not be sufficient for regional services integration if regulatory barriers that fall outside current services negotiations are not addressed.** Even when full commitments are undertaken in all services sectors, a number of limitations to trade in services will remain in place. While the elimination of quantitative and discriminatory limitations would help reduce formal barriers to trade within ASEAN, regulatory barriers would fall beyond the main obligations of the agreement and could be maintained. The region has focused so far on the elimination of formal barriers to trade and investment in services, but ASEAN countries have done little to complement the reduction of formal barriers with positive actions such as coordinated regulatory policies in services.

29. **Without a stronger agenda on regulatory cooperation and implementation of liberalization commitments, the ASEAN intraregional services integration agenda will likely be overridden by more ambitious free trade agreements with third parties.** This may undermine the goal of creating a regional services market. To further expand integration in services in the region, ASEAN's clear priority should be on reforming regulatory barriers to trade and investment. The current framework provided by AFAS fails to deliver effective integration in services due to pervasive regulatory barriers, bringing about a shallow level of integration.

30. **Regulatory cooperation may be more important for ASEAN countries because of the diversity in quality of regulations.** Although regulatory matters are still to a large extent outside the work of the AFAS, the services integration process in ASEAN can play a positive role in fostering services regulatory quality and governance. For all ASEAN Member States except Singapore, regulatory weaknesses remain since the entry into force of the AFAS, even though there have been improvements. For the lower-income ASEAN countries, the challenges in terms of improving regulatory quality are high, and strong support from other ASEAN countries and bodies and knowledge partners will be required to improve it.

31. **In the context of ASEAN, a specific and important example of integration in the services market that can be pursued through regulatory cooperation lies in the area of company law.** Following the EU experience, ASEAN Members States may evaluate addressing basic requirements for the establishment of companies, including areas like compulsory disclosure of information, and power of representation of company organs. Requirements on disclosure, in particular, may include the harmonization of information requirements and the establishment of an official company register accessible by all Member States. Another example is the case of harmonizing capital markets disclosure requirements to facilitate capital flows, where work has already started in providing common guidelines and standards.

32. **The scope for regulatory cooperation in ASEAN is broad, and concerted efforts are needed to better coordinate and create synergies among ASEAN institutions working on services.** At present, regulatory cooperation is uneven, and there is potential to reap substantial additional benefits. For example, in the area of professional services, ASEAN Member States have agreed on mutual recognition arrangements for eight professional activities, but their operationalization may be impeded by the lack of follow-up measures, institutional infrastructure for implementation, and other legal considerations. There are also positive stories. While AFAS discussion has been focusing on incorporating commitments on road or maritime transport services, concrete progress has been made in the harmonization of safety standards for road transportation and in investment in port infrastructure that is being undertaken under the umbrella of the Infrastructure Division. Scope for regulatory cooperation also exists in many other sectors. Some regulatory cooperation in financial services and air transport is being advanced outside of the AFAS negotiating framework.

33. **ASEAN countries should pursue regulatory cooperation on two different levels.** First, cooperation at a horizontal level may require establishing common general principles that would guide

domestic regulation on services trade and investment. At a minimum, ASEAN Member States could recognize that domestic laws and regulations should conform to certain principles of good regulation, such as transparency, consultations (both public and interagency), due process, and efficiency. Agreeing on such common regulatory goals is an essential step toward ensuring greater regulatory coherence and eventual mutual recognition of licenses and authorizations. Second, more detailed regulatory principles could be developed on a sectoral basis, in particular for heavily regulated services. This would follow the steps already taken in ASEAN in some services, like air transport and some financial services. Other key services sectors that would greatly benefit from common regional rules include land and water transport, telecommunications, and professional services. The report provides more detailed recommendations on the way forward, drawing on experiences from other countries, including Europe.

34. **To make progress, the ASEAN services integration agenda needs to be more comprehensive, going beyond removal of formal restrictions to also cover regulatory cooperation and implementation of commitments.** Services trade can be both increased as a share of total trade, and diversified into new and more dynamic activities such as business services, professional services, and information and communications technology (ICT) and ICT-enabling services. Despite the progress achieved in incorporating services in the integration agenda and the success in increasing binding commitments in their services schedule, looking forward, there is a need to reduce the level of restrictiveness that still remains for a number of sectors and countries in the region. In addition, there is a need to reduce regulatory heterogeneity and improve the governance of services regulations across the region.

Chapter 1. Why Is the Services Trade Agenda Important for ASEAN, and How Are ASEAN Economies Performing?

This chapter makes the case for boosting the performance of ASEAN services sectors and services trade and integration. It draws on a survey of economic research and provides fresh empirical results to show how the growth of services trade and productivity boosts income and productivity levels. Services, which have become more tradable in the last few decades due to increased fragmentation in production processes and advances in information and communication technology (ICT) and digital technology, serve as a vital intermediate input for manufacturing and other services. This development is particularly relevant for ASEAN countries that are mostly middle income or about to become middle income. Further, a heuristic assessment of global production and trade in value-added terms, such as measuring the forward linkages of services sectors to other sectors, all suggest that the importance of services in ASEAN economies is being underestimated. Services sectors and services trade in ASEAN economies have grown rapidly in recent years, but they still relatively lag behind other countries at similar stages of development, as indicated by a variety of measures: the size of services sectors, the share of services trade and exports, and the "traditional" content of services trade in ASEAN countries.

A. Services and ASEAN Economies

1. **The services sector is a critical part of any modern economy.** It makes a direct and significant contribution to income and job creation, and provides crucial inputs for other parts of the economy. Some backbone services, such as energy, finance, telecommunication, and transport, are of central importance for the international competitiveness of agricultural and industrial producers, while others, such as the health, education, water, and sanitation, are directly relevant to achieving poverty reduction and long-term development objectives.

2. **The ASEAN economies grew rapidly over the last four decades primarily as manufacturing and trading powers.** From 1967—when ASEAN was formed—to 1997, the middle-income ASEAN countries and Singapore grew at a rate of nearly 7 percent per year. While growth has slowed since the Asian Financial crisis of 1997, it has still been a robust 5 percent per year over the last decade. Over the last two decades, the lower-income countries of Cambodia and Vietnam have also joined the growth bandwagon. Supported by robustly performing agricultural sectors, the export-oriented manufacturing sector has led growth in ASEAN economies.

3. **Services sectors have also become significant providers of both output and employment in ASEAN economies in recent years.** On average, services contribute more than 40 percent of total value added and accounted more than 50 percent of total employment. Trade in service has also risen sharply, although there are notable differences across countries due to the differences in the countries' levels of economic development, resource endowments, and trade intensities.

4. **In the future, as ASEAN economies grow to become middle- and upper-middle-income economies, the services sector will become an even more important source of growth and employment.** This will be true in two senses. First, in the accounting sense, the increasing share of services in GDP and employment means strong growth in services, and service productivity will be required for overall growth. Second, it will be important for its spillover effects: productivity growth in services will raise productivity in other sectors, as well.

5. **Moreover, recent economic research has found that while productivity gaps among countries across the globe are being substantially reduced in agriculture and industry over time, they are not being reduced by nearly as much in services** (Duarte and Restuccia 2010). Hence, low productivity in services explains to a large extent the lack of catch-up of developing countries toward high-income countries. The productivity differentials are thereby particularly pronounced for financial, telecommunication, and transport services. Policy action to foster stronger, higher-productivity services sectors are thus a critical component of economic policy making in developing and emerging economies.

6. **The services growth agenda for ASEAN countries is thus closely related to another big challenge facing them: how to overcome the "the middle-income trap."** Worldwide, only 14 countries have managed to grow from middle-income to high-income countries since 1960. This failure to make the transition is because most middle-income countries are unable to boost their productivity adequately to remain competitive as their wages increase. Most middle-income countries are unable to innovate and diversify their economies to more productive manufacturing and services. As a result, on one side, middle-income countries are outcompeted in traditional sectors by other developing countries where wages are low. On the other side, the middle-income countries cannot compete with high-income economies where productivity and technological sophistication are much higher. Increasing the productivity and competitiveness of the services sector will be central, because services—transport, finance, health, education, research, and professional services—are essential inputs for increasing innovation and productivity in all sectors of the economy.

7. **In this context, international trade and integration in services also have a key role.** Trade in services can help create opportunities for countries to expand their outputs of services in sectors where they have a comparative advantage, thus creating jobs, contributing to growth, and generating foreign exchange. Indeed, services exports can be a critical part of a developing country's growth strategy. India, for example, has been capitalizing on a boom in exports of IT-enabled services, as firms in high-income countries have increasingly outsourced certain administrative functions to lower-cost providers overseas. Trade in services can significantly improve economic performance by bringing greater competition, international best practice, advanced technologies, and investment capital. The entry of foreign, including regional, services providers may yield better-quality services for domestic consumers at reduced prices, and hence improve the performance and competitiveness of domestic firms by lowering their input costs. Given that much trade in services is brought about through foreign direct investment, it can also serve to bring much-needed capital and managerial know-how into the country. In some cases, the temporary movement of workers can equally represent a substantial economic boost, either through additional income via remittances, or the elimination of supply bottlenecks for particular skills or professions in the labor market.

8. **ASEAN economies are aware of the key role that the services sector and services trade can play in their development, and have made services integration integral to the ASEAN Economic Community Agenda.** The ASEAN Economic Community Blueprint has provided a bold vision of deep integration where goods, services, investment, and skilled labor would move freely across the borders of ASEAN countries. Detailed targets were set for achieving the integration of services by the end of 2015. Pursuing services market integration at the regional rather than the global level has the advantage of more easily tailoring reform efforts to the adjustment capacities of countries within the region, and of facilitating the convergence and harmonization of regulatory measures among similar, like-minded countries.

9. **This report takes stock of ASEAN's achievements in the area of services market integration, and discusses issues that need to be addressed to accelerate progress toward integration and enhance competitiveness.** A previous report from this work, the *ASEAN Integration Monitoring Report* (ASEAN Secretariat and World Bank 2013), looked at the overall progress of regional integration in trade in goods, trade facilitation, and investment flows and services. Both the earlier report and other work (ERIA 2013) have identified services integration as one of the most important challenges facing ASEAN. This report

takes a detailed look at services sector integration issues. It reviews (a) the importance of services trade and the current state of ASEAN services and trade integration and it potential (Chapter 1); (b) services trade policies, including both commitments to liberalize and actual policies concerning services trade, to measure progress in liberalizing and integrating services trade (Chapter 2); (c) case studies of successful services sector liberalization and developments in ASEAN countries that can provide important lessons for the future (Chapter 3); (d) the current ASEAN Framework Agreement on Services (AFAS), which serves as the institutional basis of services negotiations, and the issues that constrain progress (Chapter 4); and (e) the central issue of services-related regulatory reforms and cooperation, which this report identifies as the main priority for making progress with services sector integration. The approach taken is broad, comprising statistical analysis of services market outcomes, quantitative appraisals of services trade restrictions, regulatory assessments of the services market framework, case study analysis of services reforms, and descriptive evaluation of the status of regulatory cooperation. Particular emphasis is placed throughout on comparisons among countries or groups of countries, both within ASEAN and with suitable comparators outside the region. The findings are intended to inform the policy process and help ASEAN decision makers in devising the next steps for the regional integration agenda.

10. **The remainder of this chapter lays the foundation for the subsequent analysis by examining the economic importance of the services sector and services integration for ASEAN.** The chapter first surveys the economic literature and international evidence on the role of the services sector and services trade in enhancing productivity and economic growth (Section B). The discussion then turns in Section C to the current state of development of the services sector and services trade in ASEAN economies. Section D discusses the role of services for international competitiveness, and how services can be leveraged in the development of global value chains within ASEAN. Section E looks at the potential for regional integration in services, drawing a gravity model of trade among ASEAN countries. A brief summary concludes the chapter.

B. Importance of Services: International Evidence

11. **There are both demand- and supply-side reasons that explain why the services sector will become more important for ASEAN economies.** On the demand side, consumer demand for services has high-income elasticity—as incomes rise, demand by consumers for services rises more than proportionately for health, communication, tourism, and financial services, and for high services-content products. The demand for services in production also grows more rapidly. As countries grow richer, manufacturing and construction firms tend to specialize in more high niches, and want to outsource design, transport, and financing. The need for professional services thus increases across the board. As ASEAN countries climb up the middle-income country ladder or become a middle-income country, as Vietnam has recently become and Cambodia and Lao PDR will become in the next few years, the demand for services—from both consumption and investment—will grow rapidly. The trend toward higher demand for services will be strengthened even more as the population of ASEAN countries becomes older, as demographic projections indicate. Consumers will demand diversified and differentiated products such as hospitality, entertainment, and higher-quality health services and education.

12. **On the supply side, economic thinking about the services sector has changed markedly in the last few decades, in two respects.** First, services were previously thought to be highly embodied in labor and, thus, inherently labor-intensive compared to manufacturing. Also, the scope for raising productivity and technological progress was deemed to be less than in manufacturing. Second, services were thought to require proximity between producers and consumers of services, which reduced the scope for trade and productivity gains that arise from trade. All this led to the formulation of "Baumol's cost disease"—that is, how costs would go up and productivity fall because an increasing demand for services and more resources being allocated to producing less productive services would lead to a decline in overall productivity.

13. **Two developments in the 1990s sharply changed this traditional view of services.** First was the proliferation of global value chains, where international fragmentation of production saw production activities—including those requiring services inputs—to be located in multiple locations or countries, lengthening the distance between producers and the final consumers of services. Second was the revolution in information and communications technology (ICT), which saw rapid growth of transportability, and tradability of services with the advent of the internet age. Both events profoundly raised the scope for both productivity increases and tradability of services (Baumol 1967; Ghani and Kharas 2010; Mishra et al. 2011).

14. **Digitization has led to services becoming more amenable to technological progress that boosts productivity in services.** A rising number of services can now be stored and traded digitally, and are not subject to many of the trade barriers that physical exports have to overcome. However, this does not mean that trade in services is less restricted. On the contrary, trade in services is inherently more complex, since there are often manifold regulations under the purview of different authorities that apply and that can make monitoring difficult. Yet, services have become similar to manufacturing goods in the sense that they benefit from technological advancement, and their costs depend on economies of scale, agglomeration, networks, and division of labor. More important, these sophisticated services mostly require digital labor mobility, which provides an opportunity for relatively innovative, high-tech job creation in low- and middle-income economies. On the supply side, the services sector becomes more important due to differences in sectoral factor proportion, that is, introduction of skill-based technological changes.

15. **As a result of these technological developments, both manufacturing and services have become unbundled, and services have become important intermediate inputs for manufacturing and other sectors.** At the same time, the dichotomy of manufacturing and services becomes increasingly blurred. Services are an important component of global value chains. Production activities or tasks along the global value chains can now be fragmented and done separately at different geographic locations. Fragmentation also occurs in service sectors providing prospects for specialization, which did not exist previously. Factors such as relatively low (sometimes even negligible) transportation and telecommunication costs, lower capital intensity, and a mix of regulations may drive competitiveness among service-exporting countries. A well-integrated and sophisticated logistical supply chain service network and a competitive services market have become critical for unleashing productivity in manufacturing. This in turn may drive specialization, sophistication, and trade in services.

16. **The unbundling and fragmentation of services in global production networks and value chains have led to rapid growth in the trade in services.** The global value of cross-border services exports in 2007 was US$3.3 trillion (20 percent of total world trade). However, the share of services rises to almost 50 percent if transactions are measured in terms of direct and indirect value-added content, which would address the risk of double counting of imported intermediates used in final products for export (Hubert Escaith 2008). Adding the sales of services by foreign affiliates of multinational firms, which are often unrecorded in the balance of payments, makes the value of trade in services rise even further. Data for 15 Organisation for Economic Co-operation and Development (OECD) countries put the value of such sales at some US$1.5 trillion in 2007 (Francois and Hoekman 2010; WTO 2009). This has resulted in rapid growth of what can be called modern services that do not necessarily require face-to-face contact, such as communication, banking, insurance, business-related services, remote access services, transcribing medical records, call centers, and education.

17. **A productive service sector and trade also helps to draw foreign direct investment, including regional investment, and stimulate domestic investment in higher-value-added manufacturing and services and create more competitive markets.** Modern services are thus deemed to be important for overall economic growth both directly and indirectly by improving efficiency in other sectors of the economy. Many service sectors, such as finance, communications, and transport not only provide inputs

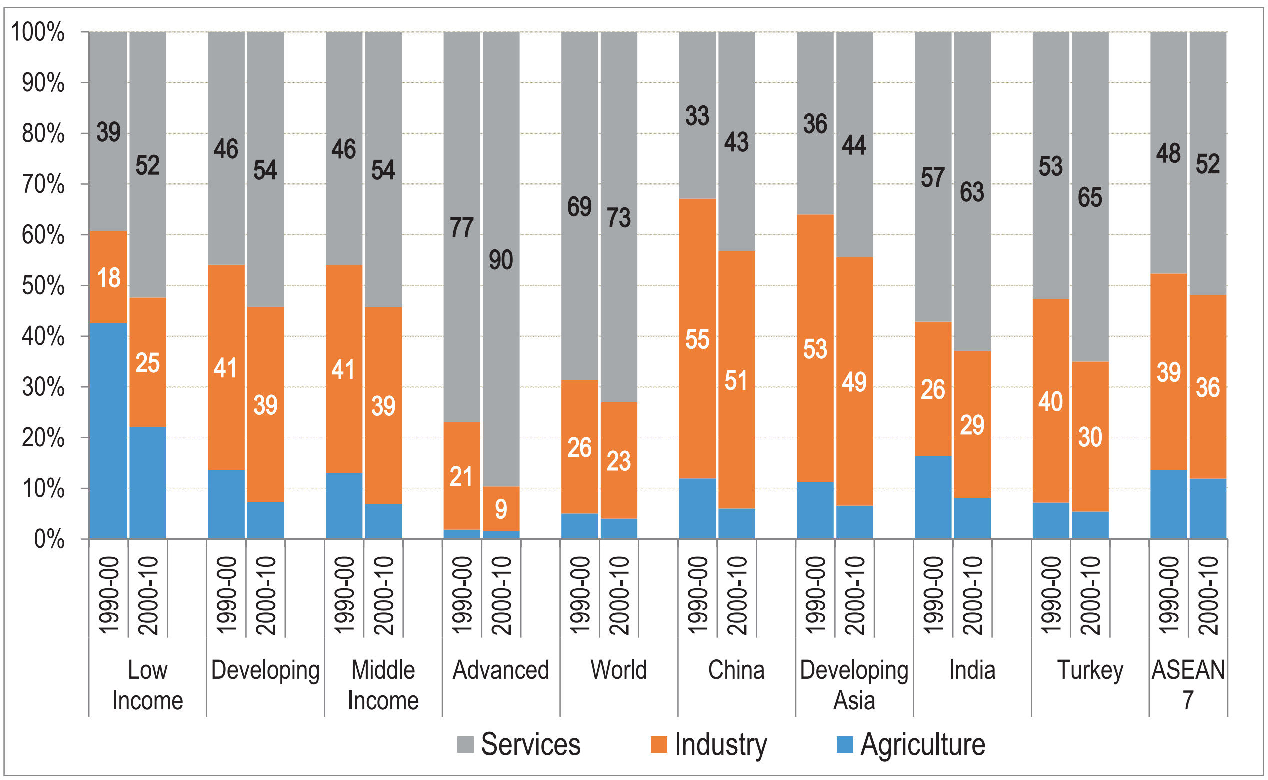
for the manufacturing sector, but also facilitate trade by supporting transactions through space (transport and telecommunications) and time (finance).

Evidence from research

18. **Services account for over 70 percent of global GDP and an even bigger component of productivity and GDP growth in both developing and advanced economies.** Two-thirds of the total output in the services sector of Europe (which is the largest commercial service exporter), and four-fifths of its growth in recent years is due to the service sector (Uppenbarg and Strauss 2010). Similarly, over 70 percent of the surge in labor productivity in the post-2000 U.S. economy is attributed to productivity gains in services (Bosworth and Triplett 2007). Productivity growth driven by services requires both fixed investment in building and ICT technologies, but also intangible capital in terms of new computer software and skills in other disciplines, so as to create new organizational structures and business models, sometimes based entirely on a new services product. There is also evidence that services contribute more to GDP growth than industry, both in developed and developing countries.

19. **Services now account for almost 75 percent of global economic growth (55 percent in developing economies).** Figure 1.1 shows the composition of services and industry-to-GDP growth in the last 30 years for developed and developing countries. In both cases, the contribution of services to total growth is higher than industry's contribution. Also, services have made an increasing contribution to growth.

Figure 1.1 Decomposing GDP Growth in Developed and Developing Countries, 1990–2000 and 2000–10



Source: Derived from WDI data.

20. **A large body of evidence links service sector development and trade with growth and development.** In the case of high-income OECD countries, research on seven countries (Australia, Canada, France, Germany, the Netherlands, the United Kingdom, and the United States) (Inklaar, Timmer, and van Ark 2007, 2008) suggests that differences between aggregate productivity levels and growth rates of these countries were largely explained by differences of the performance in the service sector. As may be expected, manufacturing and industrial productivity across the high-income countries are largely the same due to increasing tradability of technology. Going further, research at industry levels suggests that differences in productivity are largely explained by the difference in productivity in business services. Research on an advanced economy such as the United States suggests that productivity growth of distribution and financial services largely explained the growth of economic productivity after 1995. This research across sectors suggests that technology has led to new business practices, particularly greater use of outsourcing and specialization. For instance, the emergence of "big box" stores (for example, Amazon) has transformed the retail industry. One specific example is that the ability of U.S. firms to offshore many of their services explained 11 percent of the productivity growth in the manufacturing sector between 1992 and 2000 (Amiti and Wei 2006).

21. **Services sector performance has a key role in the development of middle-income countries.** Research work that looks at firm-level data particularly highlights the importance of the services sector in raising productivity growth in manufacturing. Evidence supporting this has been found in countries and regions as diverse as Africa, India and, in the Asia and the Pacific region, Indonesia. Arnold, Mattoo, and Narciso (2008) focused on Africa, using data from 1,000 firms in 10 Sub-Saharan African countries, and found a positive effect of performance of communications, electricity, and financial sectors on manufacturing total factor productivity. Fernandes and Paunov (2008) used firm-level data of Chilean manufacturers combined with FDI stocks in the services sector to examine the impact of the latter on manufacturing firms' productivity, and found a significant positive effect both economically and statistically. Interestingly, they also found that those manufacturing firms furthest from the technology frontier had most to gain in terms of productivity improvements as a result of service sector liberalization. Finally, Arnold, Javorcik, Lipscomb, and Mattoo (2010) used data from Indian manufacturing firms and constructed indicators of service sector reform in the same country, and found that potential productivity gains appear to be greatest from reforming those service sectors most closely related to trade: transport, communications, and finance. They found the effects on foreign firms to be stronger.

22. **Within the region, there is similar supporting evidence in the case of Indonesia.** Here, the reliance of the manufacturing sector on inputs from each services sector was examined by using Indonesian input-output tables. The main finding was that relaxing policies toward FDI in the services sector was associated with improvements in perceived performance of the Indonesian services sector (Duggan, Rahardja, and Varela 2013). The gains accrue largely to the most productive firms and are related to the relaxation of restrictions in both the transport, and the electricity, gas, and water sectors. Total factor productivity gains are associated, in particular, with the relaxation of foreign equity limits and screening and prior approval requirements, but less so with discriminatory regulations against multinationals on hiring key personnel.

23. **Trade in services has significant impact on growth and trade in other sectors of the economy, especially manufacturing.** For instance, a 10 percent increase in services trade is found to lead to a 6 percent increase in the trade of goods (Blyde and Sinyavskaya 2007). Higher efficiency in transport and communications services created by greater liberalization, and competition in services creates the strongest gains in goods trade. In general, quantitative analysis based on general equilibrium modeling suggests that reducing costs, markups, and penalties by 10 percent through service sector reforms leads to a four times higher gain than would be obtained from liberalization of services. Further, trade in services also seems to help technological progress. In particular, a study on OECD countries suggests that greater imports of

producer services have been found to increase the skill and technological sophistication of exports (Francis and Woerz 2008).

24. **Trade in services is very closely linked to FDI.** This is partly unsurprising given that a large part of trade in services takes place through supply of services through Mode 3, that is, by a service supplier through commercial presence, in the territory of the trading partner. In the case of the United States, for instance, sales of services by U.S. foreign affiliates (US$530 billion) were some 50 percent higher than total cross-border services exports as registered in the balance of payments (US$360 billion). More broadly, as much as 60 percent of the global stock of FDI of US$15 trillion in 2007 was in services. The services provided by foreign affiliates of OECD countries were estimated to be around US$3 trillion. But beyond the direct contribution of FDI in services, evidence also suggests that manufacturing FDI from a country closely follows trade in services to that country (Francois and Hoekman 2010).

25. **Emerging evidence also suggests that improvements in service sector efficiency have an impact beyond economic sectors to improving human development outcomes.** To some extent, this impact should be intuitive, since health and education services constitute a significant part of the service sector. As efficiency and productivity in these services increase, they can translate directly into welfare improvements for the population. The supporting evidence suggests that greater restrictiveness and barriers to entry such as education are linked to worsening in human development outcomes such as school enrollment (Shepherd and Pasadilla 2011). It is worth stressing, also, that opening the services market will not, by itself, address human development concerns, such as ensuring universal access to basic services, such as telecommunications, education, health, and financial access.

Cross-country empirical evidence

26. **While the discussion above highlighted the importance of services in general, the expectation would be that services productivity and trade will affect low-, middle-, and high-income countries differently.** Service sector growth will affect growth in all cases simply because of the large size of the services sector. However, productivity of services will differ across income groups. Lower-income countries are more dependent on agriculture and labor-intensive manufacturing. While the services sector may still be large as a source of GDP and employment, in lower-income economies, most of the employment will be of low-productivity levels. Given low levels of human capital, low-income countries are unlikely to have a comparative advantage in the service sector, and hence are less likely to depend on exports of services than on imports. This, however, should not ignore the fact that services have a significant role even in traditional sectors such as agriculture and labor-intensive manufacturing. As countries pass through the middle-income-country stage and infrastructural, technological, and human development take place, it creates comparative advantage in services.

27. **It can be expected that services productivity growth will have more impact on income levels and aggregate productivity growth as countries become middle income and higher income.** Such a view is broadly supported by the analysis of cross-country data carried out for this report. As figure 1.2 shows, services productivity levels (measured in logs) and per capita income levels are most robustly correlated in middle-income countries and higher-income countries.[2] A 1 percent increase in service sector productivity levels increases per capita incomes by 0.6 percent or more in middle- and high-income countries. The impact for ASEAN middle-income countries is even higher. This impact is not found in the case of low-income countries. This suggests that the contribution of services to growth comes not only

[2] These correlations, however, account for country and time effects and hence account for the time or place invariant omitted variable.

through its direct effect but also through its indirect effect of increasing the productivity of manufacturing sectors (figure 1.3).

28. **Services contribute to income growth not just through its direct effect, but also through their impact on industrial productivity.** The role of services as an input into high-value-added manufacturing is quite intuitive. High-quality services provide access to energy (cheap and reliable), finance and trade support, telecommunications (for example, for e-commerce or electronic transfers), transport, and so forth (see Cattaneo et al. 2013). In a recent OECD-WTO survey, access to finance (for 52 percent of the firms surveyed) and transport infrastructure (for 39 percent of the firms surveyed) were the two most serious national supply-side constraints identified by developing-country global value-chain suppliers as affecting their ability to enter, establish, or move up global value-chains (OECD-WTO 2013c). The organization of the domestic segment of the value chain is as important as the international one.

29. **The cross-country evidence for this is highlighted in figure 1.3.** Here is it clear that the impact of services productivity on industrial productivity is significant and high for countries in all three stages of development, which suggests that as labor productivity rises in the service sectors by 1 percent, it raises productivity in the industrial sector by more than 0.8 percent in middle-income countries, including those in ASEAN. The effect is slightly lower in higher-income countries and much lower in lower-income countries.

Figure 1.2 Services Labor Productivity and Per Capita Income Levels (using 3-year averages)

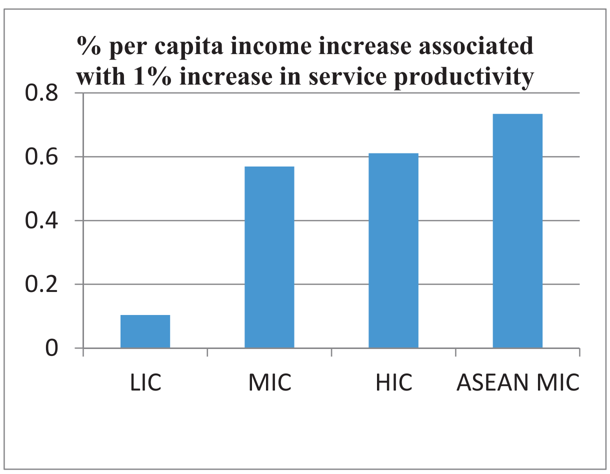
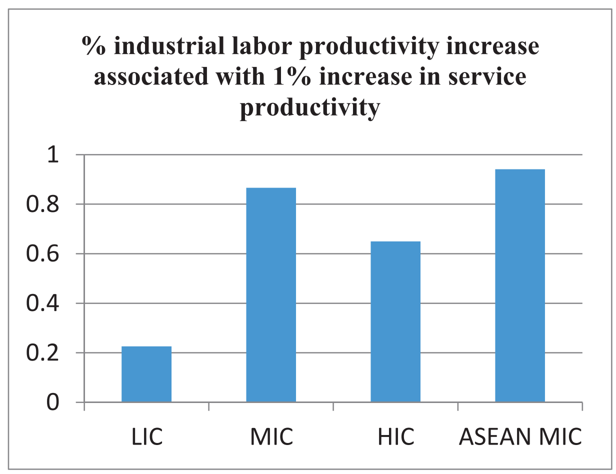


Figure 1.3 Services Labor Productivity and Industrial Labor Productivity (using 3-year averages)



Source: WDI data.
Note: These estimates account for country and time fixed effects and hence can be seen as more than correlations. LIC = lower-income countries; MIC = middle-income countries; HIC = high-income countries.

30. **International trade in services appears to be closely linked to per capita income and productivity in both industry and services.** To some extent this is to be expected, since international trade in services can only take place in high-end services that provide higher-quality and more efficient inputs and services to producers. Figures 1.4 and 1.5 provide evidence of this effect. Increase in trade in services—the sum of both exports and imports—appears to be closely linked to per capita income levels in both lower-income and middle-income countries. But exports of services are most robustly linked to per capita income in middle-income countries. The linkages between services exports and productivity levels are, however, most robustly linked to both productivity levels in all income groups. The relationship between services trade and services productivity (not shown here) is also robustly linked in both lower- and middle-income countries.

Figure 1.4 Services Trade and Per Capita Income

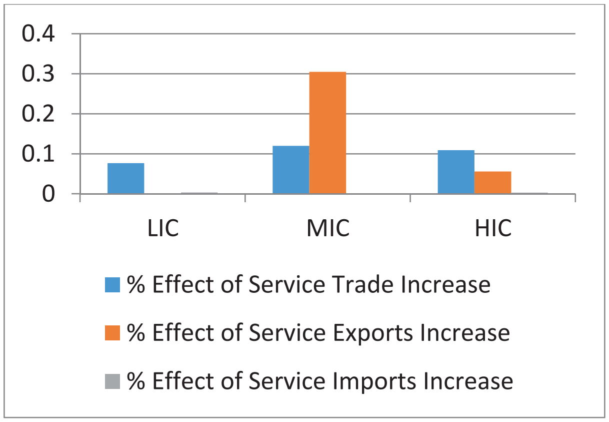
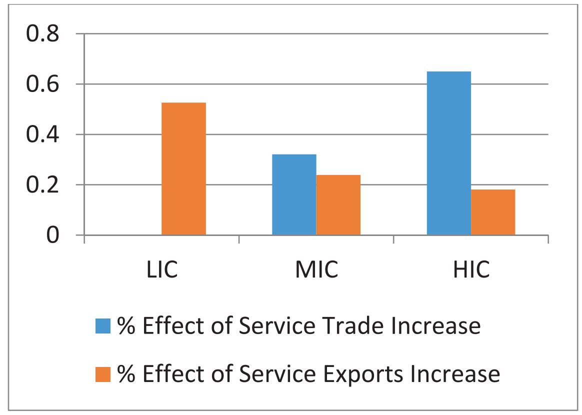


Figure 1.5 Services Trade and Industrial Productivity



Source: Computed from BPM5 Data.
Note: LIC = lower-income countries; MIC = middle-income countries; HIC = high-income countries.

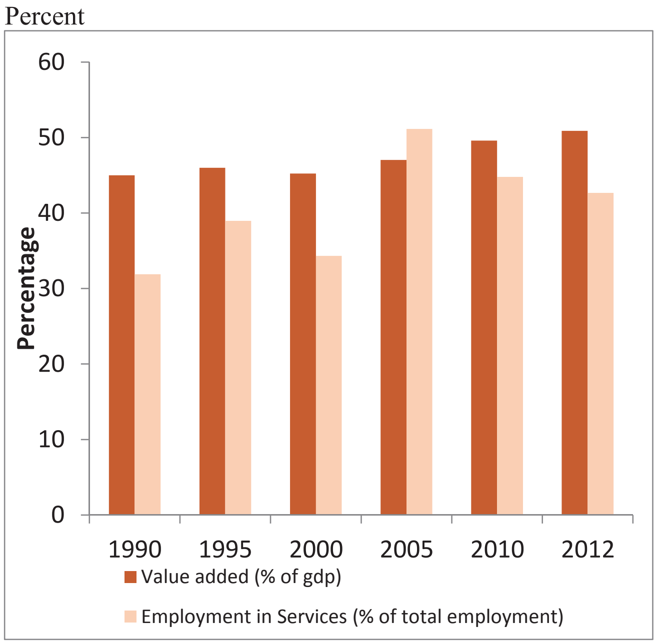
C. How Do ASEAN Countries Perform in Services?

31. **With some exceptions, there is room for ASEAN countries to improve the performance of their service sectors, measured by several indicators.**[3] While the contribution of services to GDP and trade has picked up in the last decade (figures 1.6 and 1.7), the share of services in GDP remains relatively low for ASEAN and East Asian economies (including China and Mongolia) compared to countries in other regions. Given the rapid pace of integration of ASEAN economies into the global trading system and the intensifying pace of free trade agreement negotiations, it would be timely now for ASEAN member countries to deepen and widen services integration. Local services providers will be able to take advantage of new market openings, and to benefit from new ideas and processes arising out of the opening up of the services sector.

32. **Against this backdrop, this section examines services competitiveness performance in ASEAN countries**.[4] The main question is how countries in the ASEAN region perform in the services sector and in services trade. The focus is principally on service exports and service sector performance compared to countries in other regions at similar levels of development.

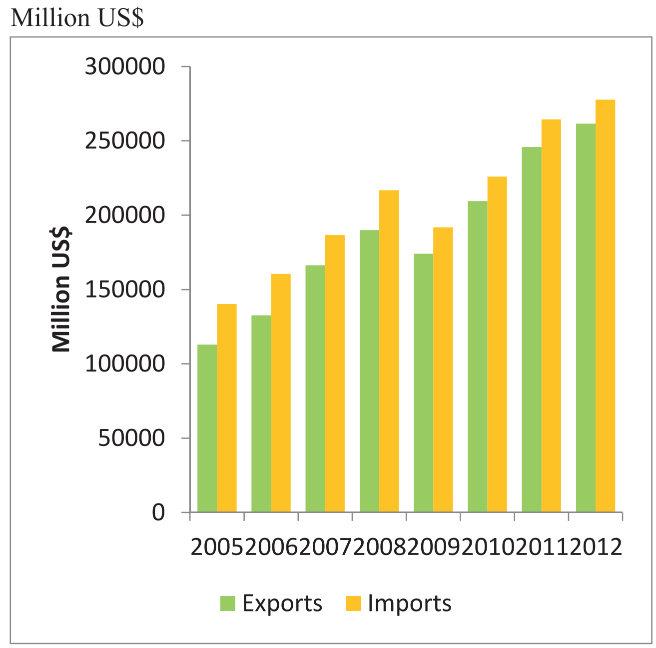
[3] This analysis follows Sáez et al. (2015).
[4] Another analysis is provided in Annex 1.A of this chapter. To provide this comparative perspective, ASEAN countries are classified into two groups: the Middle-Income country (Group1) includes the middle- and high-income countries of Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore, and Thailand. For group 1, Brazil, China, India, and Korea were chosen as comparator countries, based on their relative development stage in the region. Group 1 (lower-income countries) includes the lower-income countries of the region, Cambodia, Lao PDR, Myanmar, and Vietnam. For group 2, Bangladesh, India, and Pakistan were chosen as comparator countries, but only for select aspects of trade in services. India is chosen as a comparator for both groups because it has both middle- and low-income-country characteristics. For most aspects of trade in services, the period looked at ranges from 1996, that is, from the stage before most integration took place among the ASEAN Member States, and the most current data available (2011 in most cases). Due to data gaps, select countries are not shown in certain graphs. The report uses data from the World Development Indicators, IMF Balance-of-Payments Statistics (BPM5), and a newly constructed services trade database by the World Bank to simulate outcomes for service sectors in ASEAN countries.

Figure 1.6 Services are Important for Value Added and Employment in ASEAN Countries



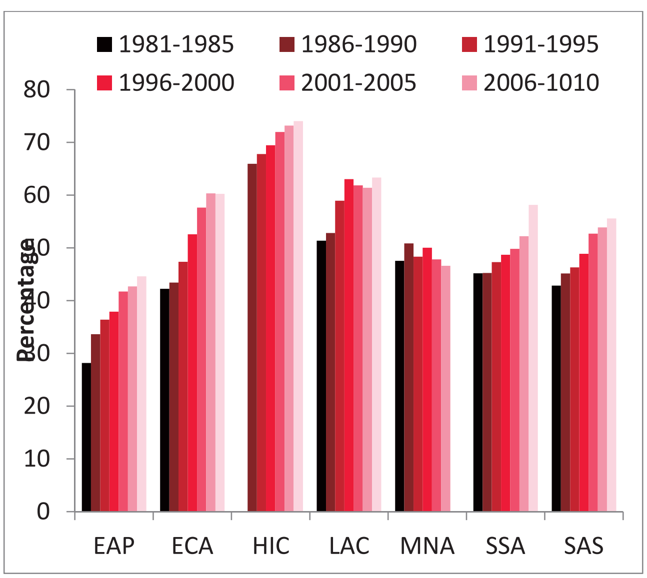
Source: WDI.

Figure 1.7 ASEAN Trade in Services have also Increased Significantly since the 2000s



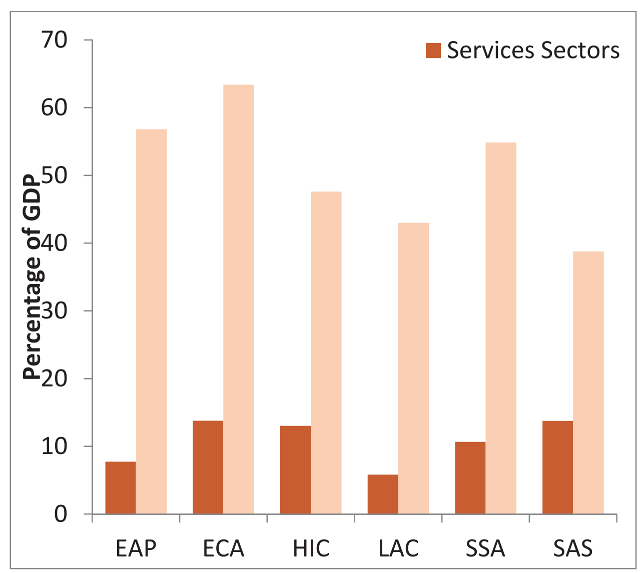
Source: WDI.

Figure 1.8 Services' Share of GDP in East Asia Remains Relatively Low (%)



Source: WDI.
Note: Ratio of nominal GDP.

Figure 1.9 Trade in Services Remains Substantially below Goods Trade



Source: WDI. Data for 2012.

33. **In terms of services trade performance indicators, ASEAN Member States perform below other countries with similar levels of income.** Typically, ASEAN service sectors are smaller compared to those in other countries with the same level of income. ASEAN exports' share in GDP similarly lag behind, and not only do they lag behind other countries, but the share of services in GDP and trade has been slow to increase. In addition, while services trade growth in the region is significant, it still lags other goods

sectors. Further, ASEAN Member States mainly exporting "traditional services" such as transportation and travel and tourism services, are less successful in tapping into new services opportunities such as information technology (IT) and business-related services. The Philippines and Singapore are the main exceptions. In the case of the Philippines, in recent years its business processing outsourcing (BPO) and IT-enabled services exports have become a success story. Singapore services exports of modern services such as professional and other business services have developed significantly since the mid-1990s.

Services in GDP and trade

34. **The share of a country's value added from services activity provides a first indication for the potential of the services sector to make a contribution to export growth.** While the share of services in GDP generally increases with economic development, there are significant variations among countries with similar level of development. For example, the share of services in Brazil is about 70 percent, while in Malaysia it is about 40 percent, despite the two countries having a similar per capita income (see Annex 1.A). Also, the share of services in GDP in ASEAN lower-income countries was well below what could be expected by their per capita income levels in both 1996 and 2011. Hence, the services sector appears to be relatively underdeveloped in many ASEAN countries.

35. **Over the last two decades, trade in services has grown rapidly across the globe.** The geographic and organizational separation of production in different stages and the development of trade in tasks, intermediate products, and services has become a dynamic component of trade and an alternative for export diversification. One of the most significant outcomes of production fragmentation is the growth of exports of so-called "modern services" that allow the cross-border exchange of services, such as business services, that previously required provider and consumer proximity to be delivered. Their share in world services exports has increased to more than 50 percent, while the share of transport and travel and tourism services exports has declined.

36. **ASEAN economies in both the higher- and middle-income country group, and in the lower-income country group (Cambodia, Myanmar, and Vietnam), also show considerable dynamism in services exports.** Trade in services grew between four and eight times for ASEAN economies in the middle-income country group over the last two decades, and even more strongly in the lower-income countries. However, unlike general trends in international markets, the share of commercial services grew less dynamically than exports and imports of transport services.

37. **The share of services exports in GDP in ASEAN countries, however, did not increase noticeably between 1996 and 2010, with the exception of Cambodia and Singapore.** In fact, Cambodia has experienced rapid economic growth over the last two decades, partly as a result of determined regulatory reform and economic modernization. In 2004, it became the first least-developed country to join the World Trade Organization (WTO). It has also become one of East Asia's most open economies, especially in the services sector. Service exports grew more than 20 percent a year for most of the last decade, mainly led by the expansion in tourism (World Bank 2013).

38. **At the subsectoral level, there is considerable heterogeneity across countries.** Indonesia's and Thailand's exports show significant increases of trade in traditional service sectors such as transport and construction, along with some rise in professional services in recent years. Malaysia shows good performance in computers, information services, and financial services. The Philippines shows a good rise in other professional services and insurance. Singapore shows the most diversified growth, with strong financial services.

Exports of services measured in value added

39. **Another evaluation of ASEAN's services performance is obtained by measuring the value added of their trade and exports.** Services are an important component of the economy and can directly enhance regional integration through bilateral services trade. In the following discussion, the contribution of services is measured taking into account its role as inputs into other domestic and export sectors for ASEAN Member States. This measure uses the new *World Bank Export of Value Added Database*, developed by Francois, Manchin, and Tomberger (2013).[5] Direct measures of trade statistics are registered in customs or balance of payments. Trade data are usually registered at transaction value, that is, the price actually paid or payable for the goods and services. Transaction values represent the gross value of goods and services (value added plus intermediate inputs). This measure may underestimate the real contribution of services to trade. To highlight this, new measures of exports are examined here using a new database on Input-Output Tables developed by the World Bank.

40. This measure includes the direct contribution of service sectors to total exports measured in terms of their value-added content, as well as their indirect contribution through sector linkages. Indirect contribution to total exports is measured by sectoral forward linkages, which look at the value added within a sector embodied in forward links, in the final exports of other sectors. Forward linkages show which sectors contribute to the value added to final exports. In other words, forward linkages show how important services are as inputs to other export activities (see box 1.1).[6]

Box 1.1 Value Added in Exports

Value-added indicators in exports include the following measures:

- ***Gross export:*** Total value of exports as shown in the business processing outsourcing (BOP) (for both goods and services). This captures both the value added embodied in the production of exported products and all domestic and imported inputs.
- ***Direct value added of exports:*** Domestic value added embodied in exports, that is, gross exports less domestic and foreign inputs. This measure captures the true sector-specific value added of exports. This is increasingly important in an environment where global production is fragmented across production-sharing networks. For example, a BPO service from India contains telecommunication services, from both local providers and from foreign owners of satellites. The delivery price of the BPO service accounts for the cost of such inputs. This measure nets out domestic and foreign inputs and captures the true value added generated in the BPO sector in India.

[5] The database uses input-output data from the Global Trade Analysis Project (GTAP) to construct country-specific measures of the direct and indirect contribution of services to the value added contained in a given country's domestic production and exports. The dataset contains two matrixes, a domestic value-added table and an export value-added table, which identify the value-added contribution of particular inputs to sectors that either sell the final good to the domestic market or export it. The cross-country dataset covers about 100 countries spanning intermittent years from 1992 to 2007.
[6] This database contains indicators of the services content of downstream sectors (goods and services). It is derived from a global input-output dataset covering about 100 countries using the most recent versions of the Global Trade Analysis Project (GTAP) model. This allows the computation of the value added of exports (goods or services). Because the GTAP database has information on the geographic origin of inputs, it can quantify value added specific to inputs produced domestically.

Box 1.1 Value Added in Exports (continued)

- ***Total value added of exports:*** This measure adds to the direct value added of exports the portion of the value added of the inputs that are produced domestically. For example, in the above example, the measure captures the value added of the BPO service plus the value of the domestic satellites used as input in the underlying telecommunication service, but not the value of the foreign-owned satellite input. This measure captures the full domestic component of an exported service. This in turns can be expressed in terms of forward and backward linkages.

Formally, the value added contained in exports is measured as follows.

First, direct cost shares linked to demand for intermediate inputs are measured by the following:

$$ {}_{z,i} \quad \frac{e_{z,i}}{\underset{j}{} \; e_{j,i}} \quad 100 $$

Direct value added in exports:

$$ {}_{z} \quad v_z x_z $$

Total (direct and indirect) value added in exports based on forward linkages:

$$ F_z \quad {}_{z} \quad \underset{i\ z}{} \; .01 \quad {}_{z,i} v_z x_i $$

Total (direct and indirect) value added in exports based on backward linkages:

$$ B_z \quad {}_{z} \quad \underset{i\ z}{} \; .01 \quad {}_{i,z} v_i x_z $$

where: $e_{i,j}$ represents expenditure in sector j on inputs indexed by i, including both value added or primary inputs (capital, labor, land) and intermediate inputs; v_j represents expenditure on primary inputs as a share of total costs of production in sector j; and x_j represents the gross value of exports from sector j.

Source: Francois, Manchin, and Tomberger (2013).

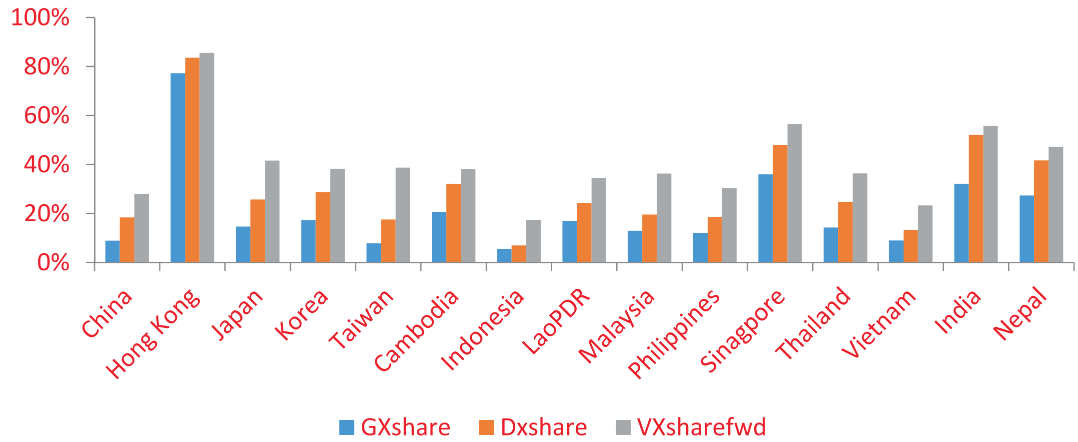
41. The implication of this analysis for the ASEAN region is shown in figure 1.10. The measures correspond to the share of services to total exports (goods and services) in terms of gross value (or as reported in the balance-of-payment statistics), the direct measure of services measured in terms of value added, and the total contribution of services measured in terms of value added and including the forward linkages to other export activities. This is considering services as inputs to other exports of goods and services.

Services trade measured in value added

42. **When trade is measured in terms of value added, the direct contribution of services in total exports increases significantly.** Figure 1.10 depicts the three measures of the share of services to total exports for ASEAN Member States and other countries in Asia. The blue bars indicate that when trade is measured in terms of gross value, the share of services is relatively low for all ASEAN Member States, except Singapore. Figure 1.10 also shows that in general, gross values are well below 15 percent, except (again) Cambodia, Lao PDR, and Singapore. Among the countries in the region, Indonesia has the lowest share. When services trade is measured in terms of value added (red bars), there is a significant increase in

the share of services in total exports, except for the case of Indonesia. In the case of Cambodia, this share increases to more than 30 percent, and in the case of Singapore, it is below 50 percent.

Figure 1.10 Service Exports as Share of Total Exports: Gross, Value Added, and Total



Source: World Bank Export of Value Added Database.
Note: GXshare = Gross Exports Share; DXshre = Direct Exports Share; VXshsrefwd = Total Exports Share.

43. **The strong forward linkages confirm the importance of services as inputs to other economic sectors, and in particular exports.** Accordingly, a key measure here is "forward linkages": the share of services as inputs to other goods and services measured in value added. This is the third measure included in figure 1.10. Again, when the share of services is measured in terms of value added, including value added in other activities, the share of services in total exports increases significantly for all countries, including ASEAN countries. While Indonesia's share is still relatively low, when forward linkages are considered, the share of services to total exports increases from 7 percent to about 17 percent.

44. **The sectoral composition of services exports differs across ASEAN economies, which to an extent can be explained by their level of development and economic structure.** Figure 1.11 shows that transport, distribution, and other services play a significant role in total exports for all ASEAN countries, except for Indonesia and Vietnam. In these two cases, figure 1.12 (other private services) shows that professional, business, and other services have a higher share in total exports than for any other ASEAN member (except Lao PDR). Also, in the cases of Cambodia and the Philippines, professional, business, and other services represent a relatively high share, considering their relative level of development.

45. **There is no uniform trend in services exports structure across ASEAN countries.** Figures 1.13 and 1.14 assess changes in services exports structure. They show the information for 1995 and 2007 for total services exports, and for services exports excluding transport, distribution, and other services, including for both forward linkages, respectively.[7] Figure 1.13 shows that there is no uniform trend among ASEAN countries. For some Member States, the share of total service exports in total exports increased, while for other it decreased. For example, in the case of Malaysia, Singapore, and Thailand, this share increased, while for Indonesia, the Philippines, and Vietnam, it decreased. Figure 1.14 shows that in the case of other private services (which include professional, business, and other services), their share in total exports increased between 1995 and 2007 for all countries except Indonesia and the Philippines.

[7] There are no data for 1995 for Cambodia and Lao PDR.

Figure 1.11 Share of Transport and other Services in Total Exports

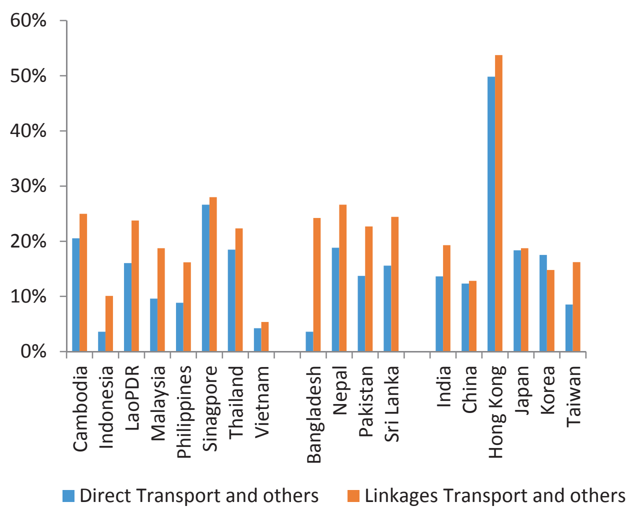
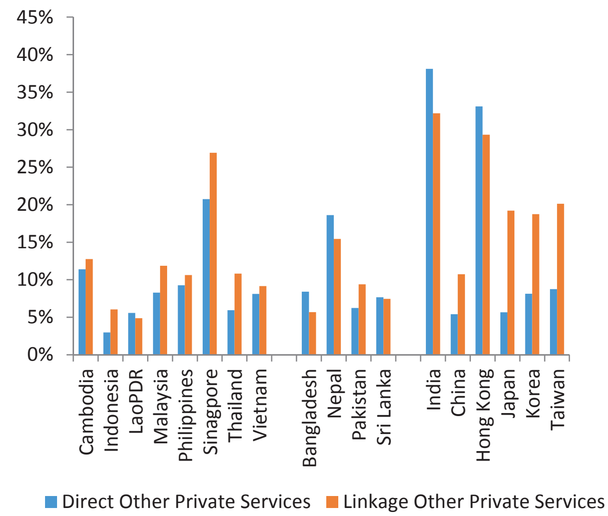


Figure 1.12 Share of other Private Services in Total Exports



Source: World Bank Export of Value Added Database.
Note: Due to data limitations, two broad sectoral categories are used. The first category corresponds to transport, distribution, and tourism activities, broadly speaking. The second category (Other Private Services) corresponds to activities such as professional services, business services, financial, entertainment services, and others.

Figure 1.13 Share of Services in Total Exports

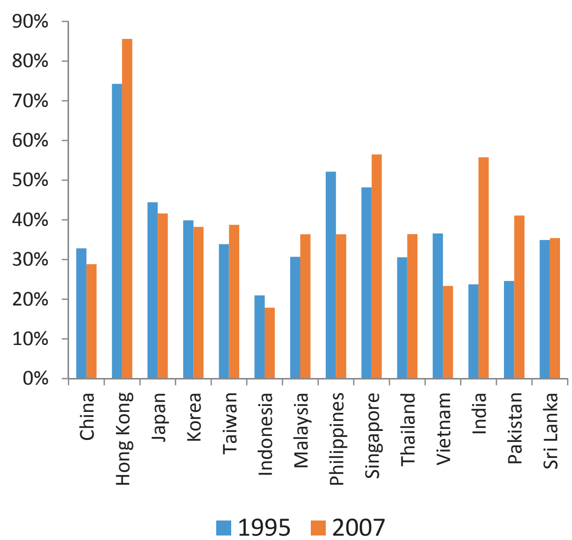
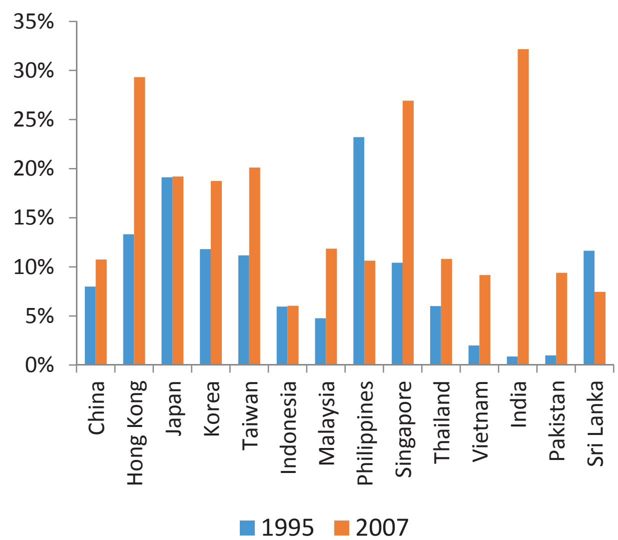


Figure 1.14 Share of other Private Services in Total Exports



Source: World Bank Export of Value Added Database.
Note: Due to data limitations, two broad sectoral categories are used. The first category corresponds to transport, distribution, and tourism activities, broadly speaking. The second category (Other Private Services) corresponds to activities such as professional services, business services, financial, entertainment services, and others.

46. **The analysis of forward linkages of the services sector to other input sectors, including agriculture, energy extraction and minerals, manufacturing, and other (public services and dwellings) highlights the important contributions that services make to other sectors.** Forward linkages are the contributions to value added of a particular sector to other sectors in the economy. The

analysis differentiates between the domestic and export value added contribution. Table 1.1 presents the contribution to the overall economy, while tables 1.2–1.4 are the contributions to other sectors of the economy. These four service sectors (electricity, gas, and water; construction; trade and transport services; other private services) contributed between 25 percent (Lao PDR) and 57 percent (Singapore) of total domestic value added, and between 17 percent (Indonesia) and 56 percent (Singapore) of total export value added in 2007. For most developed ASEAN Member States, Indonesia, Malaysia, the Philippines, Singapore, and Thailand, manufacturing uses services relatively intensely, with services providing about one-third of the value added contributions of manufacturing. The exception is Indonesia, with a contribution closer to 23 percent. For lower-income ASEAN Member States (group 2), Cambodia, Lao PDR, and Vietnam, the share in services in the value added of agriculture, as well as energy extraction and minerals, is above one-third, reaching almost 47 percent in the case of Lao PDR. The largest services contributions are from trade and transport services.

Table 1.1 Forward Linkages of Selected Inputs in All Sectors (%)

	Indonesia		Malaysia		Philippines		Singapore		Thailand		Cambodia		LAO PDR		Vietnam	
	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export
Electricity, gas, & water	0.94	0.81	4.40	3.91	4.45	3.22	1.04	0.92	2.99	3.07	0.16	0.09	2.06	5.65	10.40	8.51
Construc-tion	6.85	0.39	3.65	1.82	3.69	0.23	5.66	0.65	2.40	0.18	4.64	0.24	3.04	0.10	7.80	0.31
Trade & transport services	14.17	10.09	19.02	18.75	17.69	16.20	25.72	27.98	26.67	22.33	19.38	24.97	15.53	23.77	7.61	5.36
Other private services	8.59	6.04	20.58	11.86	14.06	10.63	24.22	26.93	10.29	10.82	13.41	12.76	4.56	4.87	7.87	9.16
Total services	30.56	17.33	47.65	36.34	39.89	30.29	56.64	56.49	42.34	36.39	37.60	38.06	25.19	34.40	33.68	23.34
Agricul-ture, energy extraction, & minerals	27.06	45.02	20.07	23.03	13.63	9.08	0.85	1.16	10.80	11.22	32.03	16.68	46.62	28.97	32.15	46.28
Manufac-turing	22.84	36.52	29.81	40.16	30.54	59.93	30.25	40.41	34.87	51.32	22.31	44.07	22.29	34.88	22.37	28.98
Other (public services & dwellings)	19.54	1.13	2.47	0.47	15.93	0.70	12.26	1.94	11.99	1.07	8.06	1.18	5.90	1.75	11.80	1.40

Source: World Bank *Export of Value Added Database*.

Table 1.2 Forward Linkages of Selected Inputs in the Manufacturing Sector (%)

	Indonesia		Malaysia		The Philippines		Singapore		Thailand		Cambodia		LAO PDR		Vietnam	
	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export
Electricity, gas & water	0.86	1.08	4.30	4.30	3.28	2.99	1.07	1.06	3.19	3.36	0.08	0.08	0.85	2.26	11.83	12.92
Construction	0.19	0.22	1.24	1.29	0.06	0.05	0.26	0.26	0.06	0.06	0.13	0.14	0.04	0.03	0.00	0.00
Trade & transport services	11.60	11.29	16.62	16.84	10.07	12.63	9.02	8.95	13.59	13.78	12.86	14.78	8.74	16.77	3.60	3.79
Other private services	4.60	5.09	6.95	6.92	3.24	3.37	7.59	7.59	6.96	6.79	4.27	5.18	0.75	1.16	3.75	3.93
Total services	17.26	17.68	29.11	29.35	16.65	19.04	17.95	17.86	23.80	23.99	17.33	20.18	10.39	20.21	19.18	20.64
Agriculture, energy extraction & minerals	26.38	24.09	14.43	13.88	15.35	5.36	0.33	0.34	9.95	9.23	35.11	15.08	49.46	23.50	28.78	25.34
Manufacturi ng	55.69	57.52	56.30	56.62	67.87	75.54	80.76	80.83	65.86	66.38	47.51	64.67	40.13	56.26	51.75	53.72
Other (public services & dwellings)	0.67	0.70	0.16	0.15	0.13	0.05	0.96	0.96	0.39	0.39	0.05	0.06	0.02	0.03	0.28	0.29

Source: World Bank *Export of Value Added Database*.

Table 1.3 Forward Linkages of Selected Inputs in Agriculture, Energy Extraction, and Minerals Sector (%)

	Indonesia		Malaysia		The Philippines		Singapore		Thailand		Cambodia		LAO PDR		Vietnam	
	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export	Domestic	Export
Electricity gas & water	0.14	0.19	0.61	0.64	1.20	1.75	6.45	6.70	0.67	0.65	0.01	0.01	2.52	11.27	2.00	2.00
Construction	0.18	0.25	0.55	0.59	0.21	0.52	0.30	0.31	0.03	0.03	0.03	0.04	0.05	0.11	0.02	0.02
Trade & transport services	2.36	2.18	6.59	6.73	1.21	1.41	10.32	10.22	6.69	5.89	2.48	2.68	4.38	14.52	1.27	1.44
Other private services	2.07	2.11	2.70	2.69	2.61	5.51	11.52	11.63	5.62	6.72	1.08	1.18	0.69	1.72	3.25	3.19
Total services	4.75	4.72	10.45	10.65	5.23	9.20	28.59	28.85	13.00	13.30	3.60	3.91	7.64	27.62	6.54	6.65
Agriculture, energy extraction & minerals	92.84	93.58	87.81	87.75	89.71	85.82	66.52	66.49	81.14	81.67	95.41	95.07	90.05	70.36	90.83	90.92
Manufac-turing	2.21	1.46	1.62	1.48	4.46	4.59	3.90	3.70	5.70	4.84	0.98	1.01	2.28	2.01	2.39	2.14
Other (public services & dwellings)	0.20	0.23	0.12	0.13	0.60	0.39	0.98	0.95	0.16	0.19	0.01	0.01	0.02	0.02	0.23	0.29

Source: World Bank *Export of Value Added Database.*

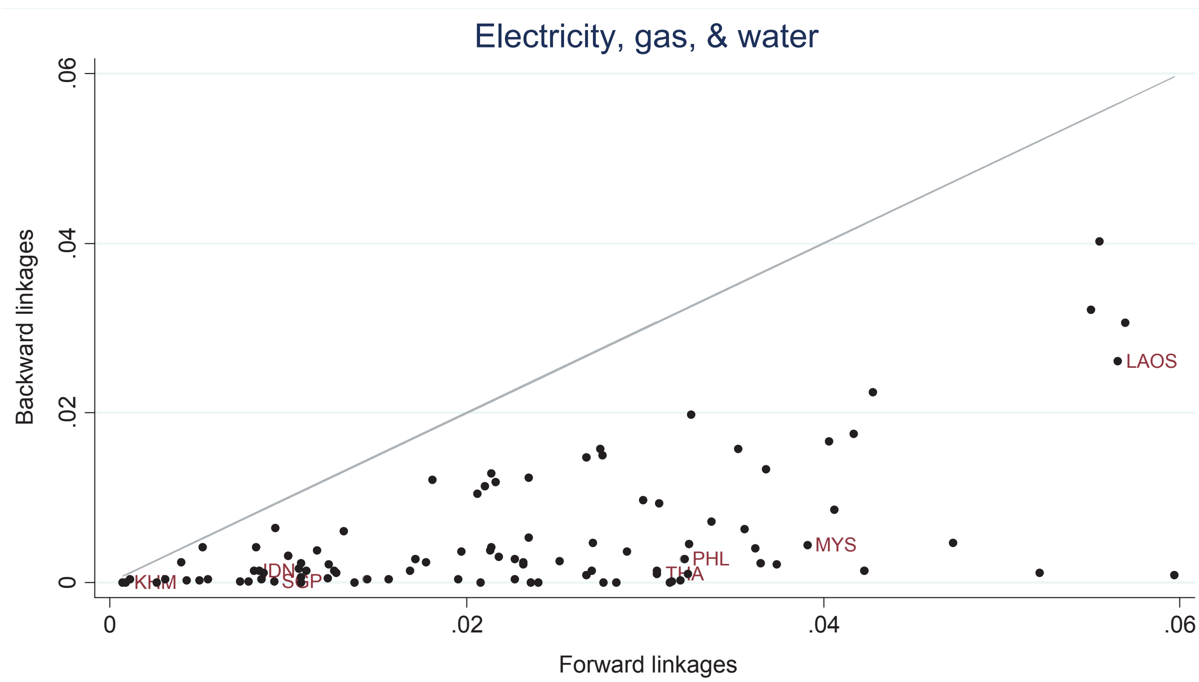
Table 1.4 Forward Linkages of Selected Inputs to Exports in Service Sector (%)

	Indonesia		Malaysia		The Philippines		Singapore		Thailand		Cambodia		LAO PDR		Vietnam	
	Domestic	**Export**	**Domestic**	**Export**	**Domestic**	**Export**	**Domestic**	**Export**	**Domestic**	**Export**	**Domestic**	**Export**	**Domestic**	**Export**	**Domestic**	**Export**
Electricity, gas & water	1.85	1.42	5.98	4.95	7.30	4.70	0.86	0.60	3.64	2.51	0.33	0.12	4.88	11.48	18.38	9.56
Construction	20.62	2.68	7.53	5.00	9.89	0.95	10.57	1.04	6.82	0.64	13.78	0.49	15.76	0.29	27.24	2.74
Trade & transport services	28.85	38.71	27.70	36.74	37.77	37.57	43.47	47.54	56.25	58.47	39.22	53.74	51.47	60.61	20.58	25.98
Other private services	19.61	36.18	46.13	39.50	33.08	45.69	39.83	46.52	18.59	27.11	31.26	32.14	18.91	20.84	18.81	53.84
Total services	70.92	79.00	87.33	86.20	88.04	88.91	94.74	95.70	85.30	88.73	84.59	86.50	91.02	93.22	85.02	92.11
Agriculture, energy extraction & minerals	13.09	10.74	6.99	8.32	4.39	4.04	0.12	0.13	6.38	5.09	12.83	11.47	2.90	4.58	4.38	2.85
Manufacturin g	14.33	8.01	5.39	5.19	7.46	6.92	4.20	3.16	7.90	5.72	2.50	1.95	6.06	2.18	10.29	4.51
Other (public services & dwellings)	1.67	2.25	0.29	0.29	0.11	0.13	0.94	1.02	0.42	0.46	0.08	0.08	0.02	0.02	0.31	0.53

Source: World Bank *Export Value Added Database*.

47. **Forward linkages of services inputs in exports appear stronger in most countries than backward linkages.** Figures 1.15–1.18 show cross-country comparisons of forward and backward linkages of services inputs in exports for electricity, gas, and water; construction; transport, distribution and other services; and other private services in 2007. While forward linkages represent the total share of a specific input being used across all sectors, analogously, backward linkages represent the total share of different inputs being used in a specific sector. Since most countries appear below the 45-degree line in each of the graphs, this indicates clearly that forward linkages in services are stronger in most countries than backward linkages. That is, these services contribute to export value added more strongly than they make use of export value-added contributions from other sectors. This is particularly true in the electricity, gas, and water sector (figure 1.15).

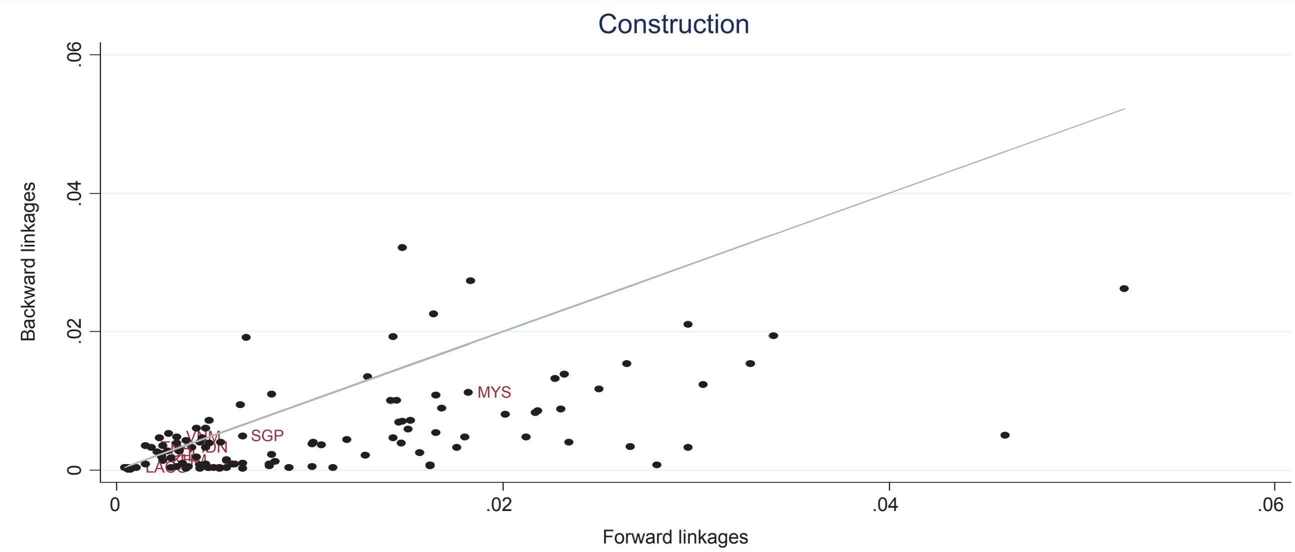
Figure 1.15 Forward and Backward Linkages, 2007



48. **With the exception of Cambodia, Indonesia, and Singapore, other ASEAN countries' forward linkages were very strong in electricity, gas, and water in 2007.** In the case of the Malaysia, the Philippines, and Thailand, the backward linkages are comparatively weak, while Lao PDR is a strong performer in terms of both backward and forward linkages. In the case of construction services, with the exception Malaysia, none of the ASEAN countries show strong forward or backward linkages (figure 1.16).

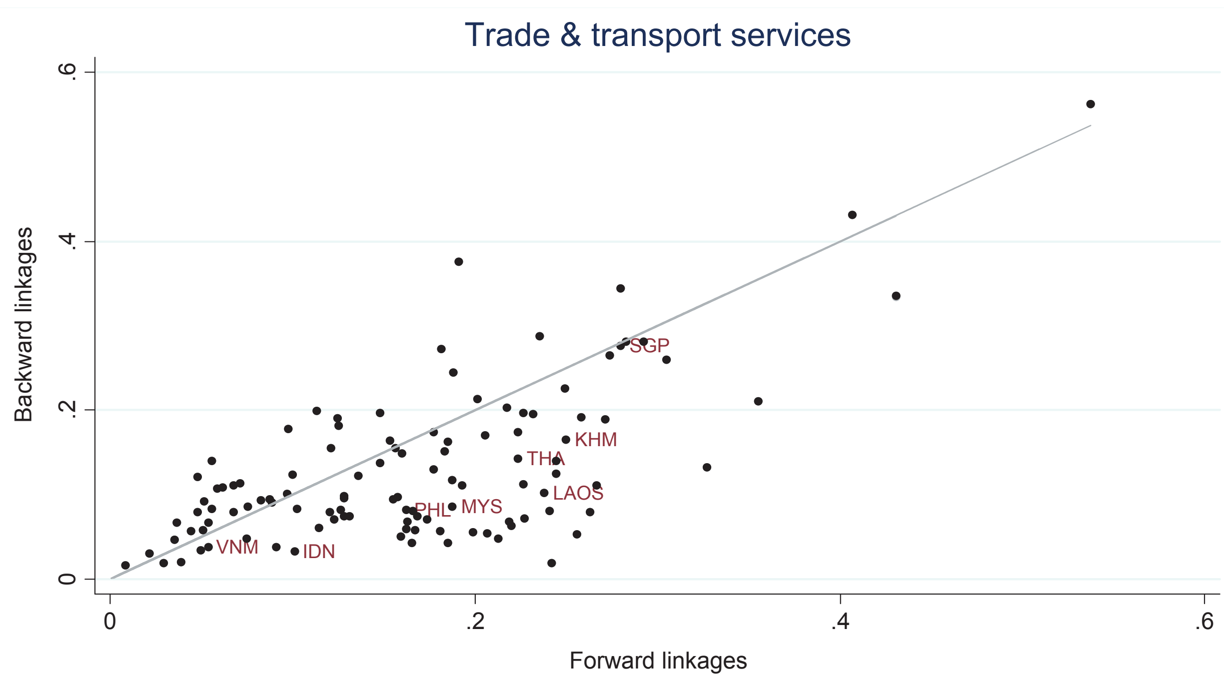
49. **Trade and transport services and other private services tend to have higher backward linkages for ASEAN Member States, although forward linkages are relatively more important.** Indonesia and Vietnam have particularly weak backward and forward linkages. In contrast, Singapore has strong linkages with other export activities, as shown by its position in figure 1.17. In the case of other private services, only Singapore has strong linkages to other export activities, as shown in figure 1.18. Indonesia and Lao PDR have particularly weak backward and forward linkages.

Figure 1.16 Forward and Backward Linkages, 2007: Construction



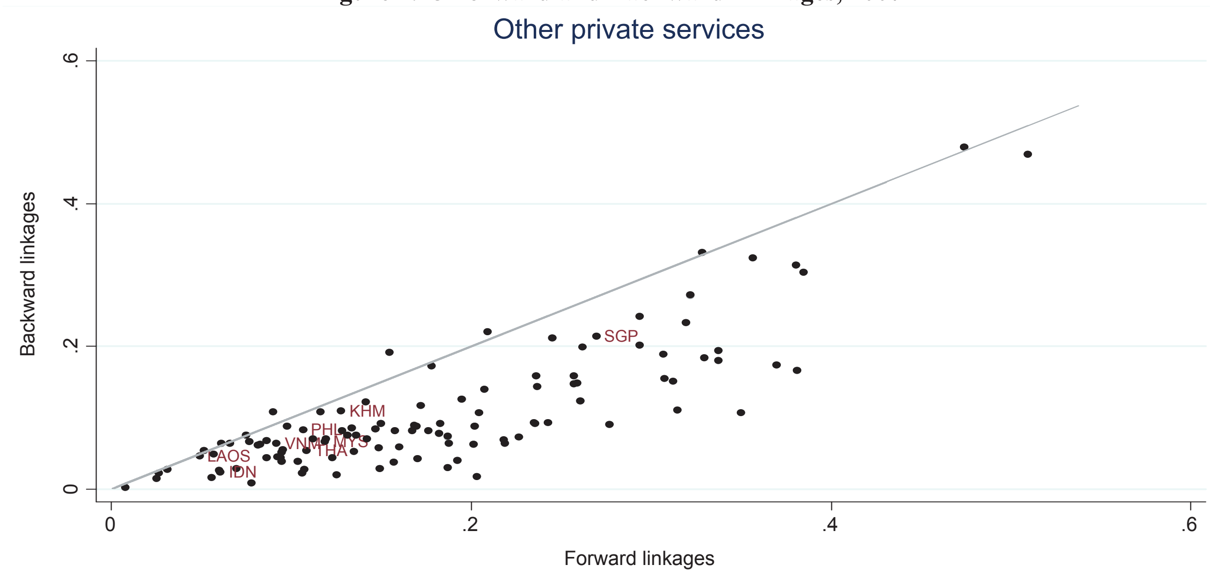
Source: World Bank *Export Value Added Database*.

Figure 1.17 Forward and Backward Linkages, 2007: Trade and Transport Services



Source: World Bank *Export Value Added Database*.

Figure 1.18 Forward and Backward Linkages, 2007



Source: World Bank *Export Value Added Database*.

D. The Effect of Services Integration on Competitiveness

50. **As noted earlier, changes in information and communication technologies are altering trade patterns.** More specifically, technological changes are reducing the need for proximity between producer and consumer of services, and have fragmented production functions into tasks that may be performed in different locations. These trends have increased the interdependence among trade, FDI, and temporary labor mobility of both high-skilled and low-skilled workers (Baldwin 2011; Cattaneo et al. 2013; Feenstra 2010; Grossman and Rossi-Hansberg 2008; Helpman 2011; Jones 2000).

51. **Services play a key coordinating role in international production sharing.** What are some of the implications of the changes in trade patterns? Baldwin (2011, 2012) defines the trade-investment-services nexus as the defining characteristic of 21st century trade, reflecting the intertwining of trade in parts and components; international movement of investment in production facilities; and movement of people, technology, and long-term business relationships. In this context, services coordinate the dispersed production in different geographic locations. A country's trade pattern is inseparable from its position in the supply chain. Consequently, strategic participation in an international supply chain, especially in manufacturing, can be a way for nations to industrialize.

52. **In terms of services export composition, ASEAN countries in general are still concentrated in traditional services, and appear less successful in tapping into higher-value-added services, with some exceptions.** Although services trade growth in the region is significant, ASEAN Member States are mainly exporting "traditional services" such as transportation and travel and tourism services, and are less successful in tapping into the new services opportunities such as IT and business-related services. The Philippines and Singapore are the main exception in the region. In the case of the Philippines, in recent years its BPO and IT-enabled services exports have become a success story. Singapore's exports of modern services, such as professional and other business services, have developed significantly since the mid-1990s.

53. **Regional integration, together with appropriate domestic policies, provides an opportunity to boost services competitiveness in ASEAN.** Regional integration, together with appropriate domestic policies, can increase the contribution of services to trade and economic growth by enhancing competitiveness. Services trade is affected by two broad sets of regulations: trade regulations that aim at

limiting the participation of foreign services and services providers in the domestic markets (trade restrictions), and regulations that aim to address a market failure that may impact services trade, as well (broadly: domestic regulations). Trade agreements aim at eliminating regulations that restrict trade to an unnecessary extent, while recognizing the need for regulations that pursue legitimate nontrade policy objectives such as health, environmental concerns, competition, and information asymmetries. For example, professional services regulations try to ensure the quality and standing of services providers, and provide information to consumers with regard to the professional qualifications of the supplier. However, these regulations might at the same time have a negative impact on services trade. The reduction of these adverse effects, for example, through the modification of residency or nationality requirements, requires cooperation among countries.

54. **The costs and benefits of preferential services integration requires further assessment.** The economic literature on services integration is relatively thin. Assessing costs and benefits of trade agreements have focused mainly on the impact of tariff changes on the flow in trade in goods and on countries' welfare (see Bhagwati, Krishna, and Panagariya 1999). More recently, Mattoo and Fink (2002), Fink and Jansen (2009), and Mattoo and Sauvé (2003, 2004, 2008, 2011) discuss the implications of services integration on countries' welfare and trade in services. Services trade has two important characteristics that need to be factored in when assessing the costs and benefits of preferential integration. First, because services trade requires the movement of factors of production—capital and labor—in addition to cross-border trade, preferential rules on establishment (FDI) and the temporary movement of labor should be considered. Second, unlike trade in goods, trade in services is restricted by domestic regulations, both discriminatory and nondiscriminatory, which may affect services and service providers (companies and people). Examples of the former are taxes that affect only foreign providers or services, and subsidies granted exclusively to firms established in the country or to nationals living in that country. Nondiscriminatory barriers, however, are barriers that affect both national and foreign services providers.

55. **Preferential access to foreign firms can be granted by, for example, reducing existing ownership restrictions to certain countries and not to others.** Alternatively, market access may be allowed in markets where access is limited, by allowing entry to firms established in countries that are part of an agreement. In the case of temporary movement of labor, preferential access may be granted by eliminating the nationality or residency requirements for workers of certain trading partners, or by facilitating visa or work permit requirements.

56. **Preferential access to services and services providers impact a country's competitiveness and welfare in different ways.** The literature has identified at least four transmission mechanisms, depending on the impact of regulations (a) on costs, variable or fixed; (b) on entry or the preferred mode of entry; (c) on sunk costs and sequencing of liberalization; and (d) on static and dynamic economies of scale.

57. **When regulations affect variable costs, preferential or regional access can lead to gains, but less than those provided by nonpreferential access.** Such regulations "impose a cost on foreign providers, without generating any benefit (such as improved quality) or revenue for the government or other domestic entities, welfare would necessarily be enhanced by preferential liberalization" (Fink and Mattoo 2002). However, nonpreferential liberalization would lead to an even greater increase in welfare nationally and globally because the service would then be supplied by the most efficient locations."

58. **When regulations affect fixed costs, a country may benefit even more from preferential liberalization.** Such liberalization would provide gains by eliminating, even on a preferential basis, any excessive fixed costs of entry imposed on foreign providers. Normally, these are regulations that affect entry or establishment, and thereby competition, such as local presence requirements, license fees for entry into the market, or the need to requalify for foreign professionals, for example, if the liberalization results in removing unnecessary qualification, licensing, and local-establishment requirements (Mattoo and Sauvé 2008). Also, the gain from preferential liberalization leading to the elimination of fixed-costs of entry depends on the competitiveness of the partner countries' service providers. Preferential access will

maximize welfare gains if countries have comparable regulations and the agreements are not exclusive—that is, if they do not apply restrictive rules of origin. In this case, there are benefits from both increased competition and greater diversity of services.

59. **For many service sectors, economies of scale matter, hence the potential benefit of regional integration.** This is the case, for example, for transportation, audiovisual, postal, and telecommunication services (Fink and Jensen 2009). By increasing market size, regional integration reduces the trade-off between competition and economies of scale. In a market of a given size, full exploitation of economies of scale may make it possible for only a limited number of providers to operate at an efficient scale. The enlargement of domestic markets beyond national boundaries brought about by regional integration reduces this restraint and allows increasing use of economies of scale, while also inducing more competition from trading partners' service providers and services. If the regional agreement does not have restrictive rules of origin, the agreement can also attract new FDI seeking to take advantage of a larger, more attractive market.

60. **Another way regional agreements in services may help economies is by allowing for the gradual development of domestic industries, starting with achieving regional competitiveness** (Mattoo and Sauvé 2008, 2011). An agreement such as ASEAN—focused mainly on developing and emerging countries—may help services providers compete in the global market later on by first exposing them to competition only within the regional market. For these authors, there is also the possibility that once competitiveness is reached at the regional level, these firms may be less likely to resist broader-based liberalization. There is the risk, however, that regional liberalization that does not generate internationally competitive firms might create vested interests that could resist further market opening later on. Moving up global value chains for services in ASEAN

61. **The recent development of global value chains (GVCs) provides another opportunity for using service sector growth and development in ASEAN economies.** ASEAN economies have already gained significantly from participating in global value chains in manufacturing. Increasing competitiveness in services will provide these economies the scope to climb up the value chains in both upstream and downstream activities where services can predominate. A major component of the trading tasks involved in the GVCs involves services, from the mundane such as cargo handling to the more skill-based ones such as financial advisory. Already, there is talk within regional groupings of conducting targeted capacity building for the development of innovative and open services within the GVCs. Indeed, services fulfil a vital and complex role in the GVCs, and these efforts have intensified recently with the increased presence of GVCs and seeing how they have transformed regional economic groupings such as Asia-Pacific Economic Cooperation (APEC). However, the intangibility of services makes them analytically and statistically elusive. The systematic effort to deepen understanding of the economic role afforded by services, particularly at the international level, has only recently occurred. One cause for this is the challenge of decoupling the dual aspects of services—one as an intermediate for manufacturing (that is, logistics services), and another as final products (for example, education, finance, and health care).

62. **While services have long occupied a dominant place in most economies, the recognition of their role and significance has increased only recently.** Even large manufacturing firms are seeing dramatic shifts in revenue derived from services (Spohrer and Maglio 2008). According to the World Bank's World Development Indicators (2012), the share of services value added in world GDP was 70 percent in 2010, up from 53 percent in 1970. By any account, this suggests that ASEAN is lagging this benchmark. Put simply, the world is clearly, albeit slowly, converging to a large service system, with a large portion of the labor force employed in services compared to agriculture and manufacturing, and ASEAN must follow suit. Besides reflecting the shift toward service economies in the advanced countries, the services share has also risen as a result of the structural changes in the economies. This trend is somewhat reflected in the case of ASEAN (see table 1.5).

Table 1.5 ASEAN Economies at a Glance

	GDP (US$ million)	GDP/capita (US$)	Size of Trade (as % share of GDP)	ASEAN Trade (as % share of GDP)	Value Added as % of GDP			Trade as % of GDP	
					Agriculture	Industry	Services	Merchandise	Services
Brunei Darussalam	16,969.7	42,445.5	99.3	19.6	0.7	71.1	28.2	100.0	
Cambodia	14,400.8	976.9	129.6	35.7	35.6	24.3	40.1	136.8	29.1
Indonesia	878,223.4	3,578.4	43.5	10.9	14.4	47.0	38.6	43.1	6.6
Lao PDR	9,083.1	1,394.3	67.8	25.7	28.0	36.2	35.8	54.2	9.8
Malaysia	305,154.4	10,337.9	138.9	37.9	10.1	40.9	57.1	139.0	26.3
Myanmar	51,597.5	846.2	35.9	14.6					
Philippines	250,542.7	2,567.2	46.8	9.9	11.8	31.1	73.2	46.9	13.3
Singapore	284,389.0	53,533.1	277.1	73.7	0.0	26.7	44.2	286.9	86.6
Thailand	366,126.6	5,391.3	130.4	27.2	12.3	43.6	41.7	130.4	28.1
Vietnam	141,669.1	1,595.9	160.8	27.0	19.7	38.6	49.1	146.6	14.2
ASEAN	2,318,156.4	3,756.1	106.8	26.0	NA	NA	NA	NA	NA
China					10.1	45.3	44.6	47.0	5.8
India					17.5	26.2	56.3	42.1	14.8
East Asia and Pacific Developing					10.9	44.5	44.6	54.2	7.7
OECD					1.5	24.1	74.4	46.2	12.1

Sources: ASEAN Statistics (2012a); WDI (2012) (data for 2012).

63. **ASEAN has traditionally been strong in contract manufacturing, particularly for electronics, serving as vital export nodes for the production network, and the concept of borderless production systems has been well leveraged.** This experience provides a better and more sustainable option to bringing on significant sustained growth and economic development through using the GVC in services. The role of services in GVCs can thus be viewed from the perspective of creating or engaging more deeply into GVCs, both services GVCs and the services components in other GVCs. In short, economies should consider participation in the high-value-added services components of GVCs as a viable means to achieve sustained growth and development. Just what are the high-value-added services and how to measure the value added in trade for such services is still an unanswered question.

64. **As ASEAN looks forward to regional economic integration in the form of the ASEAN Economic Community (AEC) serving a potential market of more than 600 million people, it is timely to use the full potential of another engine of regional growth—that of services.** Services contributed between 38 and 68 percent of the gross national income of ASEAN's economies in 2012 (ASEAN 2013). In terms of trade in services, ASEAN's trade in services represented 5 percent of world trade in commercial services, or US$343 billion, in 2009. In addition, foreign direct investment in the services sector has accounted for more than 50 percent of total ASEAN FDI. This clearly underscores the importance of services to ASEAN and the need to manage the role of services for specific ASEAN member countries in relation to their relative competitive advantages and economic maturity, and for the region in general to ensure the region's competitive advantage in international trade (Brunner 2013).

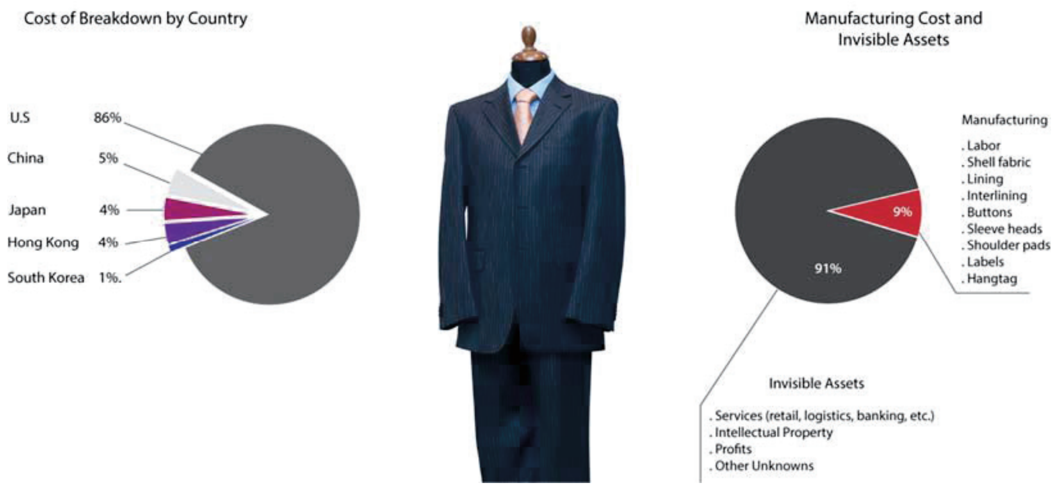
65. **If well implemented, the liberalization measures brought about by the ASEAN Framework Agreement on Services and the General Agreement on Trade in Services can assist in transforming the AEC into a global services hub, although this alone will not be sufficient.** Already, with the engine for the 12 priority sectors for ASEAN set in motion, five of which are services-oriented (see ASEAN [2012b] for the details and updates), there is now a concerted push to realize the goal of regional economic integration through making the service sector within ASEAN more efficient. The five service-oriented priority integration sectors are e-ASEAN, tourism, air travel, health care, and logistics. They are key sectors in themselves or serve as strategic inputs to all other sectors in the regional economy, both goods and services.

66. **Through the examples presented earlier and discussed below in box 1.2, it is clear that services have a role in the GVC either as an intermediate input or otherwise.** Indeed, services cannot and should not be decoupled from manufacturing, since services have the potential to increase the high-value-added content in manufacturing. The liberalization of such services and the harmonization of their standards, particularly in logistics package delivery across all modes of supply, is an imperative. By the same token, a manufacturing GVC can be more effective only when it is properly coalesced with competitive services inputs, such as telecommunication services, logistics delivery, and the associated financial services.

Box 1.2 The Contribution of Services in Global Value Chains

It is not easy to separately identify all the individual service components that constitute the full value of a product, not least because manufacturing and services often tend to be bundled together. The discussion below presents examples that try to disaggregate a range of different services (Low 2013). Figure B 1.2.1 provides a product cost breakdown.

Figure Box 1.2.1 Breakdown of Costs of a Jacket made in China and sold in the United States

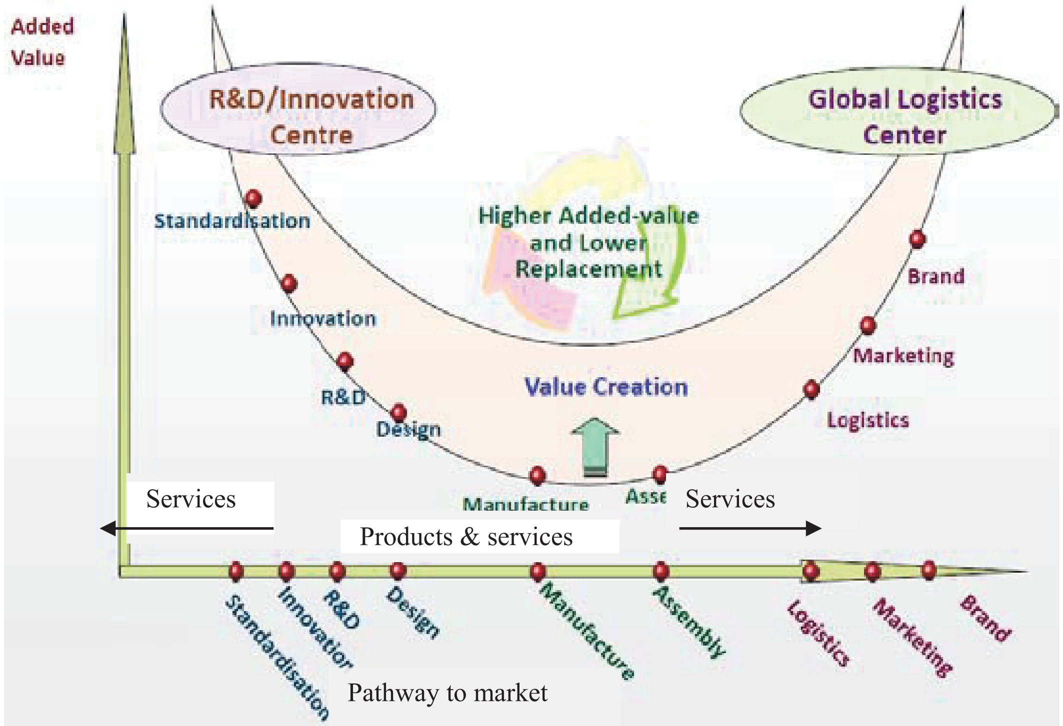


Only 9 percent of the US$425 retail value for the jacket is linked to the cost of tangible inputs for making the jacket. The remainder is attributed to "invisible" assets. Therein lies the identification challenge: what is contained in the invisible assets? There will be elements in both the preproduction (upstream) and postproduction (downstream) part of the process. In this GVC, the upstream sources of value will include creativity, design, intellectual property, and branding. The downstream elements include advertising, marketing, and retailing. Disentangling the sources of value, the individual services involved, and the implications of policy for these segments of the supply chain are formidable tasks, even for the enterprises (multinational and small and medium enterprises) directly involved in the business.

Recently, Ali-Yrkkö et al. (2011) presented a case study of the Nokia N95 phone and produced a detailed breakdown of the value chain for the N95. The parts (including processors, memories, integrated circuits, display, and camera) accounted for 33 percent of the product by revenue. Assembly accounted for only 2 percent. The remaining two-thirds of the product were accounted for by Nokia's internal support services (31 percent), licenses (4 percent), distribution (4 percent), retailing (11 percent), and operating profit (15 percent). This value-add breakdown concurs with the smiling curve presented by Shih (2005) (see figure B 1.2.2). The contribution of services to product revenue is 31 percent more than the parts revenue. Indeed, it is the other services that are provided within the context of the GVC that will add value to the product made, and generate higher profit margins for the firm, indirectly benefiting economies and the livelihood of the workforce. In short, a strong services sector spurs economic growth faster than manufacturing.

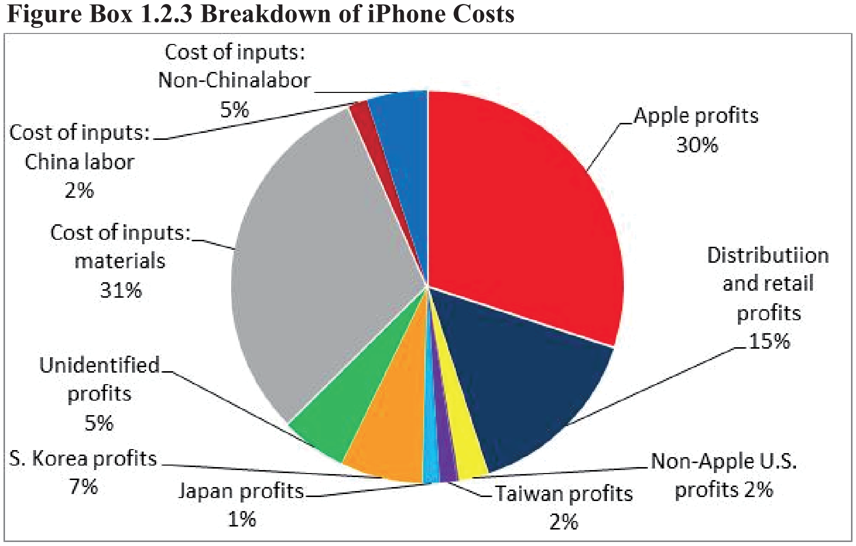
Box 1.2 The Contribution of Services in Global Value Chains (continued)

Figure Box 1.2.2 Shih's Smiling Curve



Source: Shih 2005.

Figure Box 1.2.3 Breakdown of iPhone Costs



Yet another example is that of the iPhone, as shown in figure B 1.2.3, where one Taiwanese company, Foxconn, is into various parts of the global value chain of Apple and is the final assembler (which has the lowest margin for the business and the industry). No doubt, more value can be extracted from services than relying largely on high-volume, precise automated assembling alone. While developing Asia is undertaking a major portion of the assembling of many electronics, apparel, and automotive industries, the developed countries elsewhere are reaping the real benefits in terms of profit and revenue recognition. There is little growth potential or innovation value from the assembling and testing of parts and components. The real value extractor is in the upstream work on research and development, including design and licenses, and downstream activities on outsourced distribution, product repairs, warranty component replacements, and product maintenance. These are the embodied and embedded services that affect supply chain connectivity and positioning in the GVC.

67. **This role for services in GVCs is also seen in the case of knowledge-intensive (value added) tasks such as education, health and Business Process Outsourcing.** This is the situation of Malaysia and Thailand, and to some extent the Philippines. Providing specialized education services is the natural next step in the services GVC in these countries since there is a need to level up the skilled manpower to match the requisite demand from the multinational corporations. This was the path taken by Singapore not too long ago, and more recently Malaysia, when Malaysia opened its doors for foreign universities from Australia, China, and the United Kingdom, such as Nottingham and Hull, to set up regional campuses to educate the local market and serve international students. A good percentage of these international students actually come from the region, notably Indonesia, Myanmar, and Vietnam. These students after receiving their education will return home and help increase the productive capacity of their countries. This creates a virtuous circle and increases Indonesia's and Vietnam's share in the production GVCs, especially for the high-tech and health care GVCs. The natural spinoff from all this is the deepening of regional integration of specific industries in ASEAN.

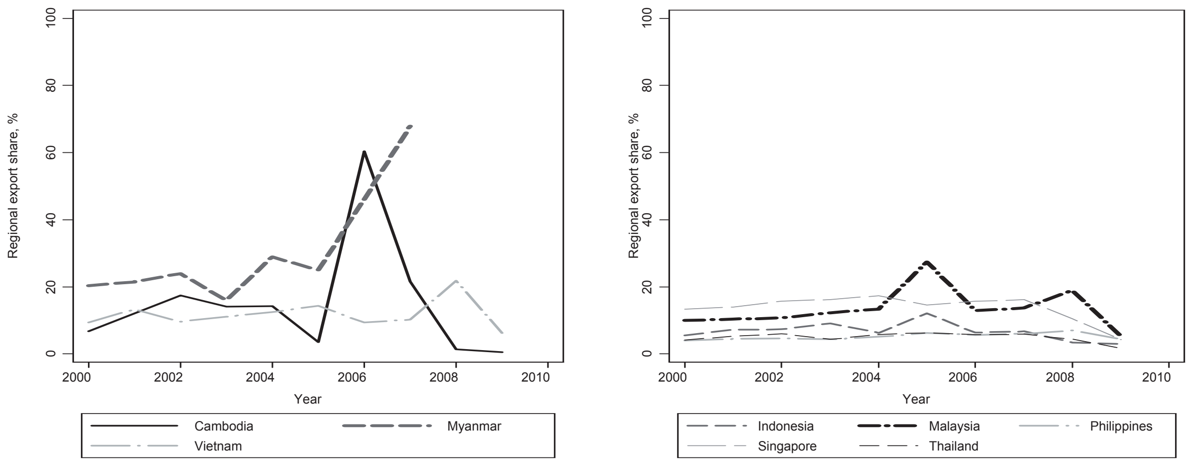
68. **Though small geographically, Singapore has successfully become a value chain location for more knowledge-intensive industries in the GVC, such as in pharmaceutical research and development, highlighting the potential of services to provide an entry point for competitive GVC participation even for smaller economies.** This in turn has led to more international pharmaceutical companies basing themselves in Singapore to undertake more active pharmaceutical ingredient production. By default, this moves Singapore up the GVC and opens new doors for other GVC activities, especially in drug testing and high-end medical tourism. This inevitably increases the variety of trade through horizontal diversification in the product space, increased opportunities for growth in new markets, and reduced vulnerability to economic disruptions (Brunner 2013, 2). Effectively, Singapore now sits on the right ends of the smiling curve. Singapore has research and development/innovation centers for respected multinational corporations such as P&G and GSK, and Singapore is the global logistics center for DHL. This is only made possible as the workforce becomes more educated, with strong institutional support for the investment in human capital, and with the existing government focus on policy reform to support services integration domestically and regionally. In the area of logistics services, virtually all the large shipping lines call at the Port of Singapore to offload cargo for the region and pick up cargo through feeder services for their destination markets in Asia, the Americas, or Europe. This resonates well with the Master Plan on ASEAN Connectivity (ASEAN 2011a), which recognizes the role of the various and specific services in reaching its goal of facilitating the movement of goods, people, and services themselves. However, this choice of a value chain location is not achieved by default, but more by deliberate and careful design, since it needs to be meshed with the associated financial services offered by the financial institutions and insurance houses to support this industry.

69. **Thus, GVCs in services should be exploited as strategically as possible to enhance trade and development, as regional integration through logistics and connectivity improvements.** This increases the potential for trade in services within the region and beyond. However, commitments from the member economies must be improved and implemented, and domestic regulatory reforms and cooperation must be undertaken if the region wants to achieve this reality by 2020.

E. Assessing the Untapped Potential for Regional Integration in ASEAN

70. **With a few exceptions, the trade flows of ASEAN economies in services with ASEAN partners have remained modest.** This can be seen in the trends in the share of exports of ASEAN countries that go to other ASEAN countries (figure 1.19). Among low-income countries, ASEAN has become over the years a very important destination market for Myanmar's services exports, while the region remains relatively unexploited by Vietnam. For Cambodia, the ASEAN market seems to be a rather unstable destination market. For Malaysia, the ASEAN market seems to be relatively important, while for middle-income countries, the ASEAN market seems to be relatively less important.

Figure 1.19 Share of Regional Exports in Total Services Exports



Source: World Bank *Trade in Services Database*.

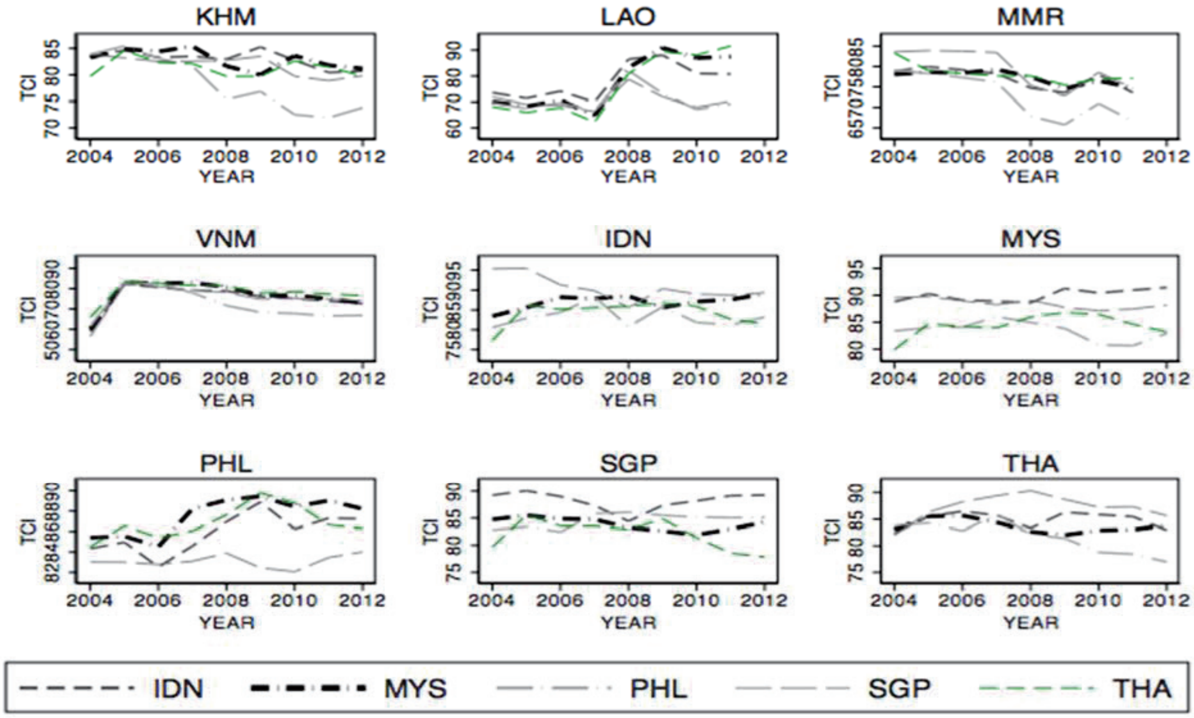
71. **The varying services trade exposure raises two important questions. First, are ASEAN countries trading to their potential, or are there untapped opportunities? And second, what are the impediments for enhancing integration?** These questions are assessed by looking at two indicators, the trade complementarity index and the Trade Intensity Index, and by estimating a gravity model of trade in services. The complementarity index looks at whether a potential importer buys services that a country exports abroad by measuring how well the export structure of one country matches the import structure of another country. The index is based on export and import data at the disaggregated service sectoral level that are then aggregated into a single index for each country pair. The index number varies between 0 and 100. The higher the index number, the higher the potential for that country to export to the other markets. Figure 1.20 depicts the development of the indexes of trade complementarity of each country of interest with all other ASEAN countries for which data are available.[8]

72. **In general, the services complementarity index values for Singapore and middle-income ASEAN Member States (AMS) with all ASEAN states (figure 1.20) are high—above 80 percent, except for trade with Cambodia and Myanmar.** The Philippines has increased its complementarity index with respect to Indonesia, Malaysia, and Thailand, while maintaining a stable index with Singapore. Indonesia's indexes with respect to ASEAN middle-income countries are relatively unstable. Something similar can be found in the case of Malaysia, except in the case of its index with Indonesia. Singapore also has high but unstable index values, while Thailand has decreasing index values compared to other middle-income countries, except Malaysia.

73. **The trade complementary index trends vary across ASEAN's lower-income countries, as presented in figure 1.21.** Lao PDR's complementarity indexes have increased in recent years compared to ASEAN middle-income countries, while in the case of Cambodia, there is comparatively less and decreasing complementarity. In the case of Myanmar, there is a declining trend in recent years. In the case of Vietnam, the indexes are above 80 percent and relatively stable over time.

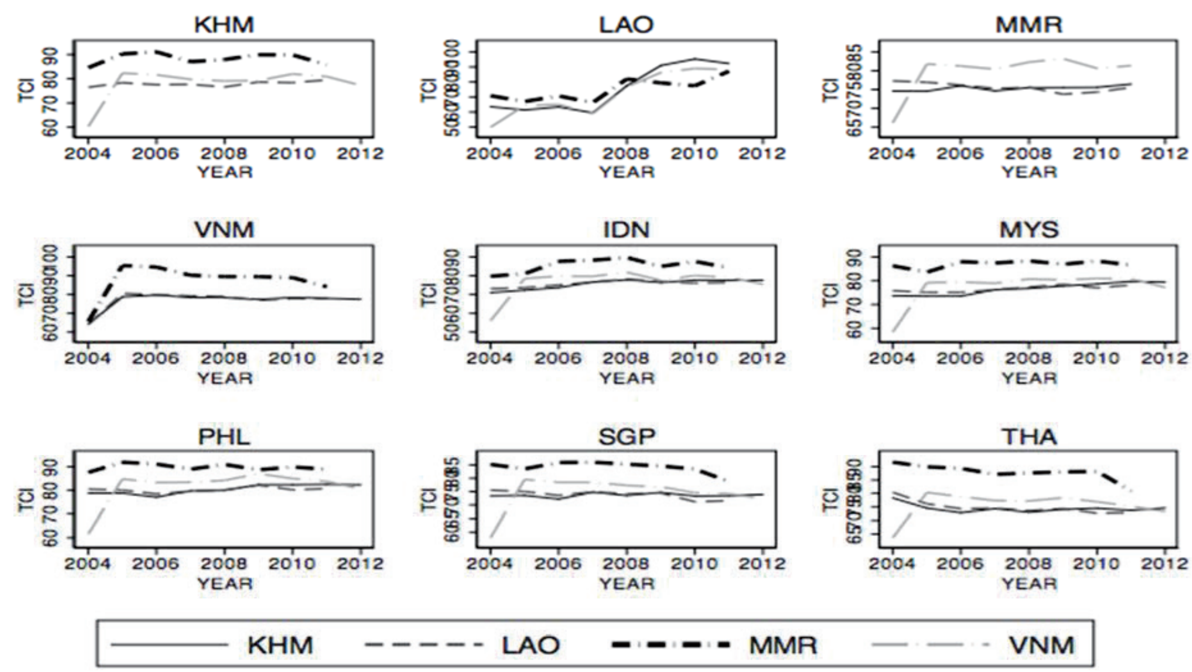
[8] Specifically, the trade complementarity index between exporter i and importer j is calculated as $TCI_{i,j} = \left(1 - \sum_p \frac{\left| {x_{i,p}}/{X_i} - {m_{j,p}}/{M_j} \right|}{2}\right) * 100$, where $x_{i,p}$ is exports from i in product p, X_i is total exports of i, $m_{j,p}$ is imports of j in p, and M_j is total imports of j.

Figure 1.20 Trade Complementarity of Singapore and ASEAN Middle-Income Countries



Source: Calculated using data from UNCTADstat.

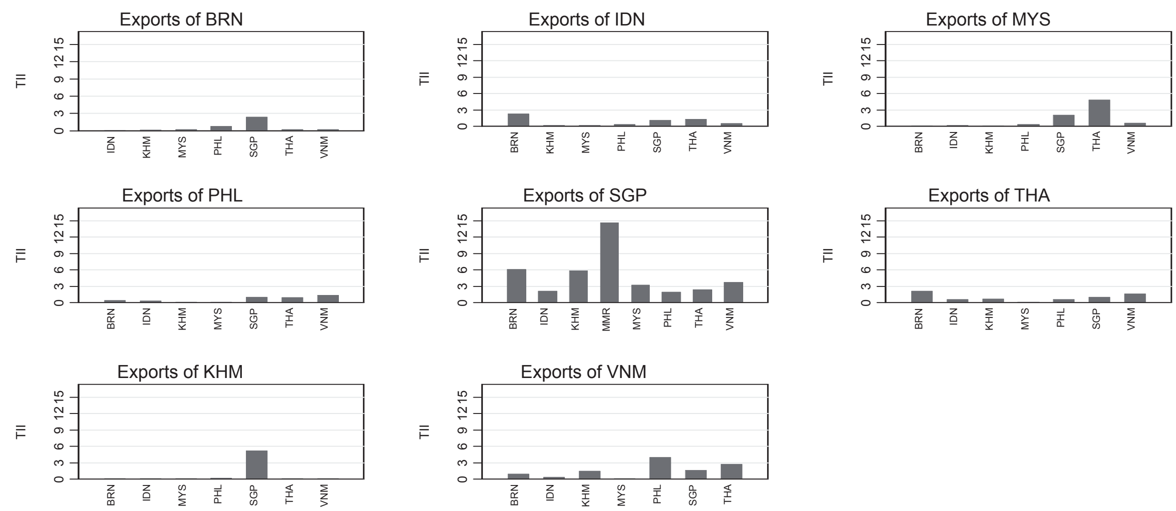
Figure 1.21 Trade Complementarity of Low-Income Countries



Source: Calculated using data from UNCTADstat.

74. **The second measure of services integration potential, the Trade Intensity Index (TII), indicates that there is still great scope for deepening services integration in the region.** The TII indicates a country's relative share of exports to a particular country compared to the rest of the world's share of exports to this country. A large index number suggests the trade between a country and its partner is more intense than trade with the country and the rest of the world. Figure 1.22 depicts the indexes of trade intensity of each bilateral pair observed in the database, averaged over 2005–09 to maximize the number of observations.[9] The TIIs are found to be relatively low for all ASEAN countries, except Singapore. This means that there is untapped potential to increase regional trade. This confirms the findings here that despite the significant progress achieved in the context of ASEAN Framework Agreement on Services, there is still great scope for deepening integration.

Figure 1.22 Trade Intensity Index (TII)



Source: World Bank Trade in Services Database.

75. **The estimated potential trade volumes predicted by structural trade determinants vary in comparison to the actual intraregional trade values between 2008 and 2009 for different countries in the region.** In order to identify if there are still regulatory constraints that may be acting as barriers to trade, a gravity model is estimated. The gravity model relates countries' bilateral trade flows to structural determinants of GDP, geographic distance, and other factors that affect trade barriers. The structural determinants for each pair of countries together with the estimated regression coefficients are used to compute the bilateral trade potentials. The level of bilateral trade between a pair of countries is compared with their trade potential to categorize bilateral exports as overtraded or undertraded, depending on the comparison between realized bilateral export values and the model's predictions. In addition, the regression includes a country's Services Trade Restrictions Index of the World Bank Services Trade Restrictions Database to assess if these are important determinants in explaining the level of bilateral services trade

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[9] Specifically, the TII between exporter i and importer j is calculated as $TII_{i,j} = \frac{x_{i,j}/X_i}{x_{w,j}/X_w}$, where $x_{i,j}$ is exports from i to j, X_i is total exports of i, $x_{w,j}$ is exports from the world to j, and X_w is total world exports.

among ASEAN countries. (See Annex 1.B for a detailed discussion of the methodology and a formal presentation of the results.)

76. The results indicate that while some countries appear to be overtrading, others undertrading, and still others trading at their potential, all ASEAN countries are shown to underexport with Malaysia and Singapore (and Malaysia and Singapore with each other). There also appears to be untapped potential for countries such as Brunei Darussalam, Cambodia, Malaysia, and Singapore to increase services exports with select countries in the region. In addition, countries with more restrictive services regulatory environments are significantly less likely to export services. At the same time, the results suggest there may be limited scope for further trade integration in the region unless structural domestic reforms are implemented in the participating countries. Thus, undertrading in services may suggest the existence of untapped potential to increase exports among these countries via the removal of trade-related obstacles.

F. Summing Up

77. **This chapter has made the case for the importance of boosting the performance of ASEAN services sectors and services trade as a way to enhance income and productivity levels to achieve sustained growth and development.** It has drawn on a survey of economics research and provided fresh empirical results to show how the growth of services productivity and trade boosts overall income and productivity levels. Services, which have become considerably more tradable in the last few decades due to developments in ICT and digital technology, serve as a vital intermediate input for manufacturing and other services, especially when countries are in the middle-income stages of development. This is particularly relevant for ASEAN countries, which are mostly middle income, or those about to become middle income. Overall, the integration of the services sector can foster competition and productivity due to large markets, and help ASEAN countries overcome the "middle-income trap."

78. The chapter then showed that while service sectors and services trade in ASEAN economies have grown rapidly in recent years, they still relatively lag behind other countries at similar stages in development, as indicated by a variety of measures: the size of services sectors, the share of services trade and exports, and the "traditional" content of services trade in ASEAN countries. Further, new measures such as exports of services in value-added terms, and measuring the forward linkages of service sectors to other sectors, suggest that the importance of services in ASEAN economies is being underestimated. Hence, addressing the relative underperformance of ASEAN service sectors and services trade becomes important. The next chapter discusses the causes behind the underperformance in services trade through a review of services trade policies and regulations and the ASEAN agreement on services integration.

Annex 1.A The Importance of Services (Illustrations)

1. To provide a comparative perspective, ASEAN countries are classified into two groups. Group 1 includes the middle- and high-income countries of Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore, and Thailand. For group 1, Brazil, China, India, and the Republic of Korea were chosen as comparator countries, based on their relative development stage in the region. Group 2 includes the lower-income countries of the region, Cambodia, Lao PDR, Myanmar, and Vietnam.

2. For group 2, Bangladesh, India, and Pakistan were chosen as comparator countries, but only for select aspects of trade in services. India is chosen as a comparator for both groups, since it has both middle- and low-income country characteristics. It is relatively poor but has one of the most dynamic services sectors among developing countries. The share of services in GDP is 57 percent. The share of services trade in GDP at 14 percent is one of the largest for a country of its size, and its annual services exports of US$148 billion (in 2013) is second only to China among developing countries.

3. For most aspects of trade in services, the period looked at ranges from 1996, that is, from the stage before most integration took place between the ASEAN Member States, and the most current data available (2011 in most cases). Due to data gaps, selected countries are not shown in certain graphs. The report uses data from the World Development Indicators, IMF Balance of Payments Statistics (BPM5), and a newly constructed World Bank Services Trade Database to simulate outcomes for services sectors in ASEAN countries.

4. Figure 1.A.1 through Figure 1.A.18 provide the comparative data discussed here.

Figure 1.A.1 Services Value Added as Share of GDP, Group 1, 1996

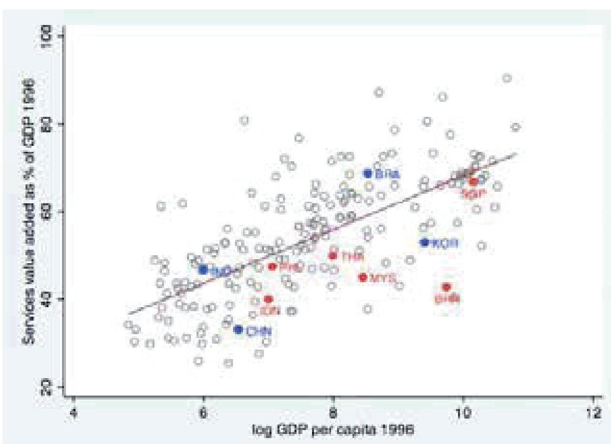
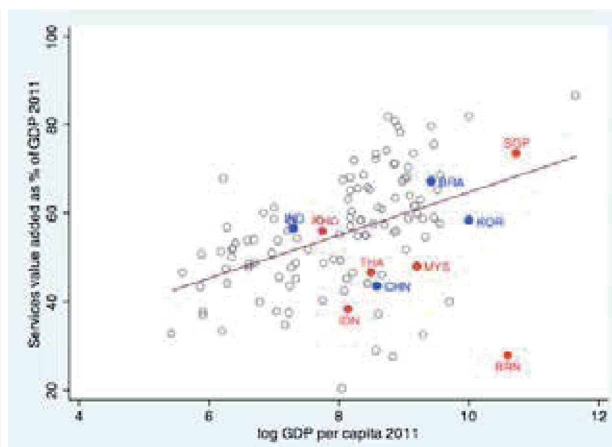


Figure 1.A.2 Services Value Added as Share of GDP, Group 1, 2011



Source: Calculated based on World Bank World Development Indicators 2012.

Figure 1.A.3 Services Value Added as Share of GDP, Group 2, 1996

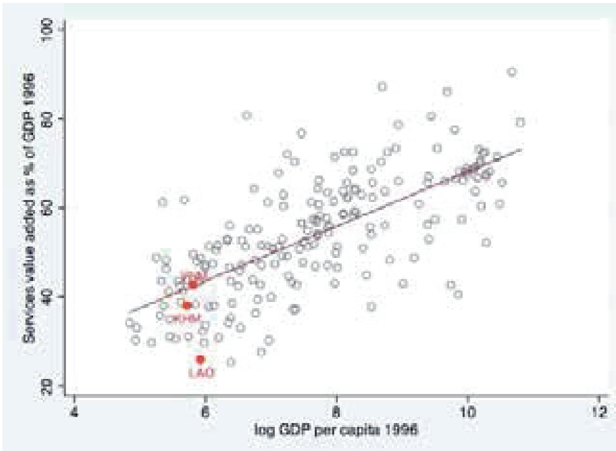
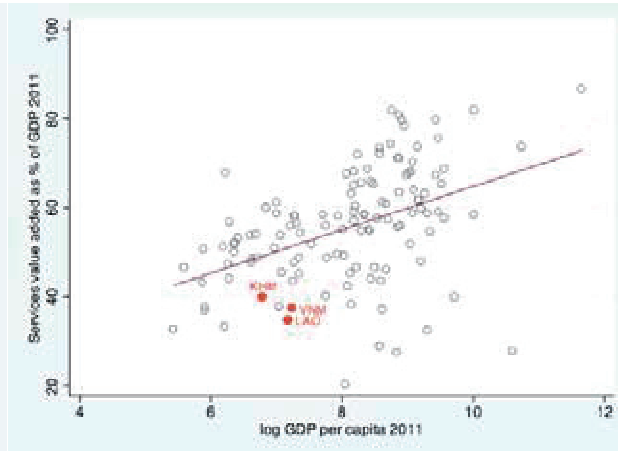
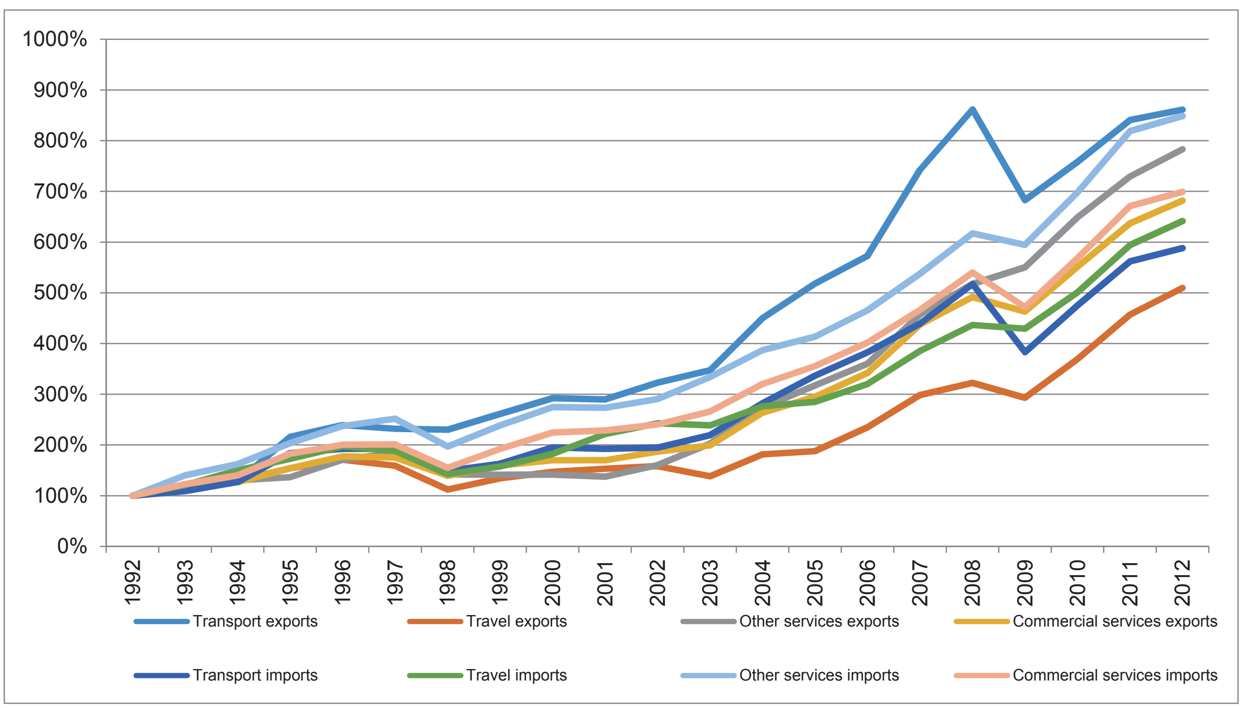


Figure 1.A.4 Services Value Added as Share of GDP, Group 2, 2011



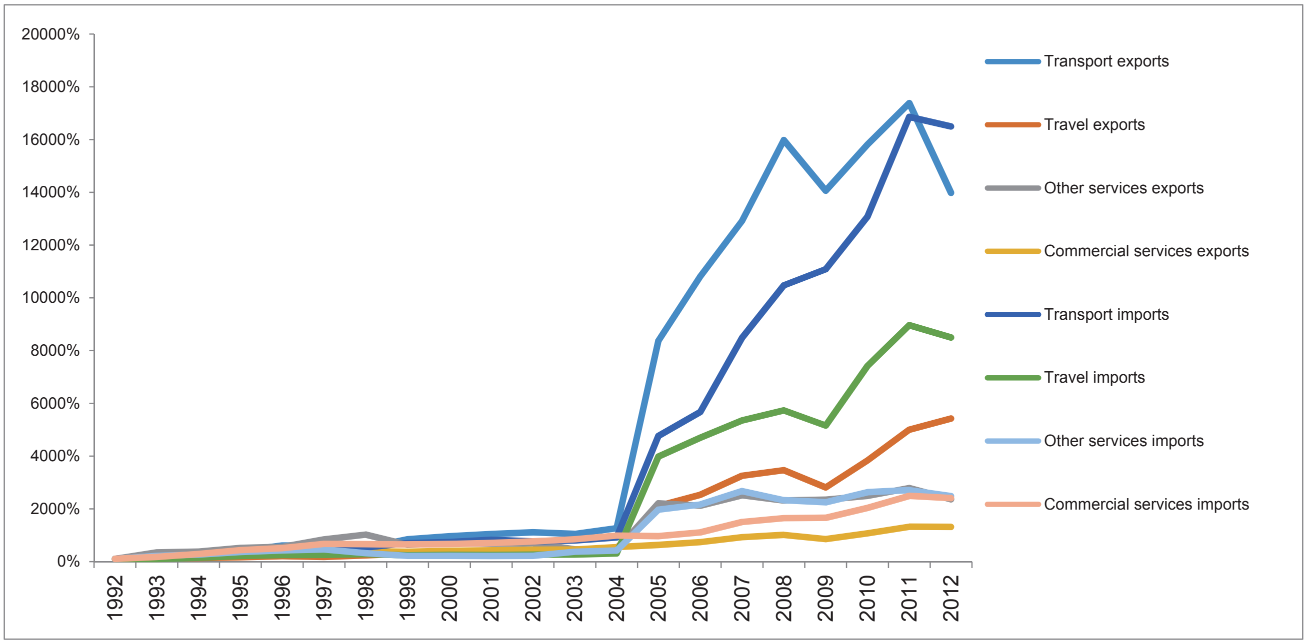
Source: Calculated based on World Bank, World Development Indicators, 2012.

Figure 1.A.5 Growth of Services Exports and Imports, Group 1 (combined), 1992–2012



Source: Calculated based on UNCTADstat, 2013.

Figure 1.A.6 Growth of Service Exports and Imports, Group 2 (combined), 1992–2012



Source: Calculated based on UNCTADstat, 2013.

Figure 1.A.7 Trade in Services as Share of GDP, Group 1, 1996

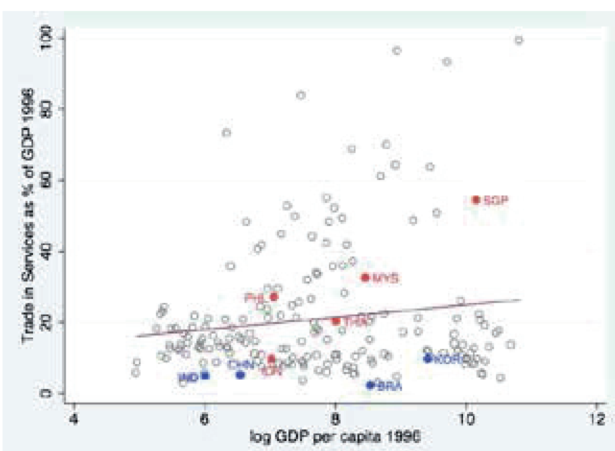
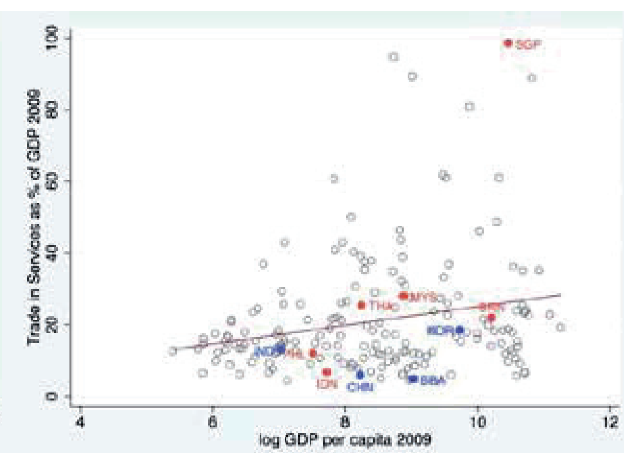


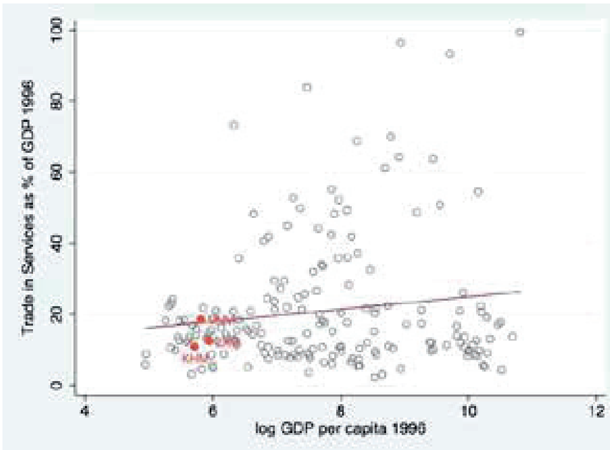
Figure 1.A.8 Trade in Services as Share of GDP, Group 1, 2009

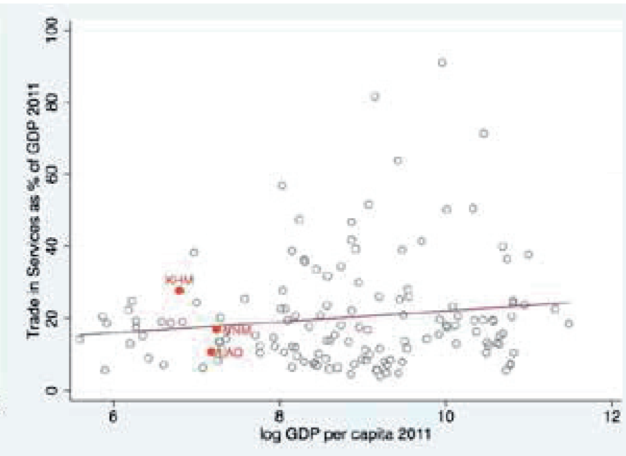


Source: Calculated based on World Bank, World Development Indicators, 2012.

Figure 1.A.9 Trade in Services as Share of GDP, Group 2, 1996

Figure 1.A.10 Trade in Services as Share of GDP, Group 2, 2011

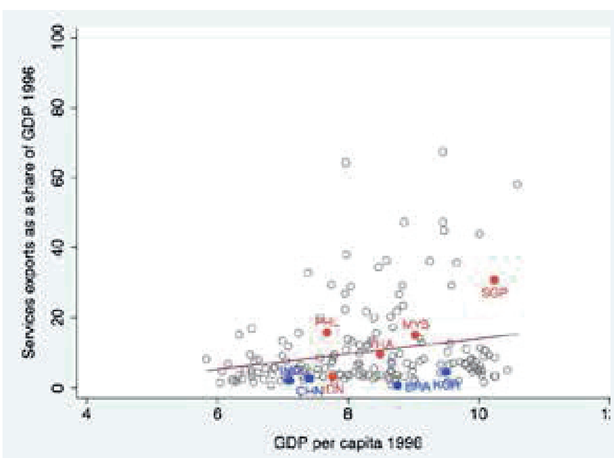


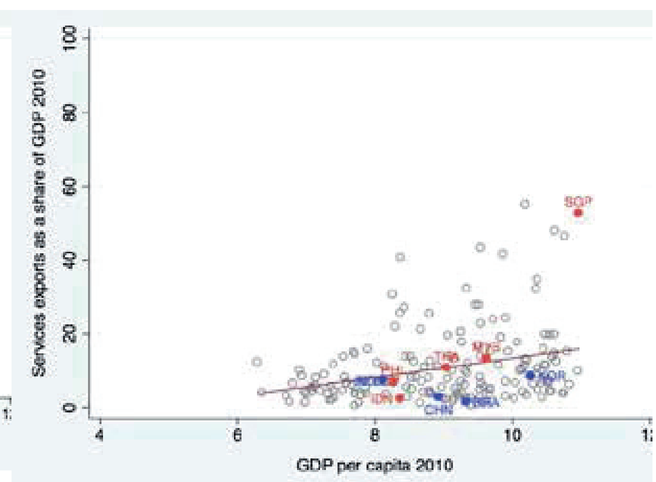


Source: Calculated based on World Bank World Development Indicators 2012.

Figure 1.A.11 Export Share of Services, Group 1, 1996

Figure 1.A.12 Export Share of Services, Group 1, 2010





Source: Calculated based on World Bank World Development Indicators 2012.

Figure 1.A.13 Export Share of Services, Group 2, 1996

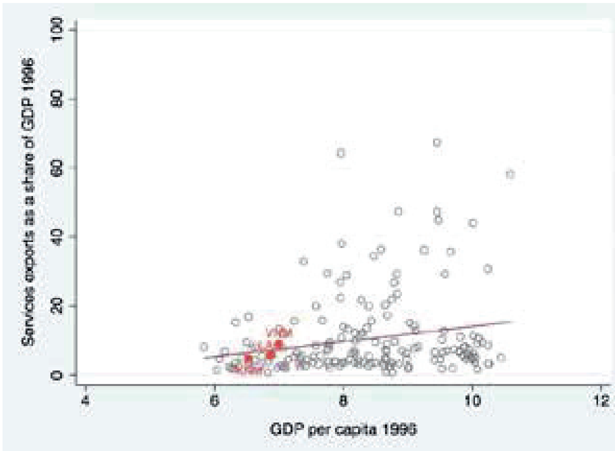
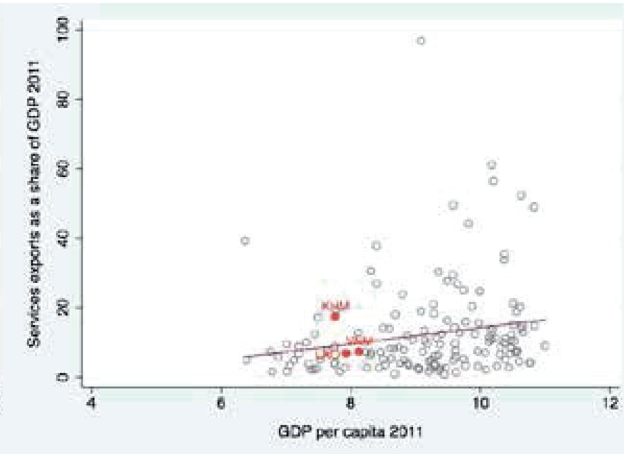


Figure 1.A.14 Export Share of Services, Group 2, 2011



Source: Calculated based on World Bank World Development Indicators 2012.

Figure 1.A.15 Services Imports as Share of GDP, Group 1, 1996

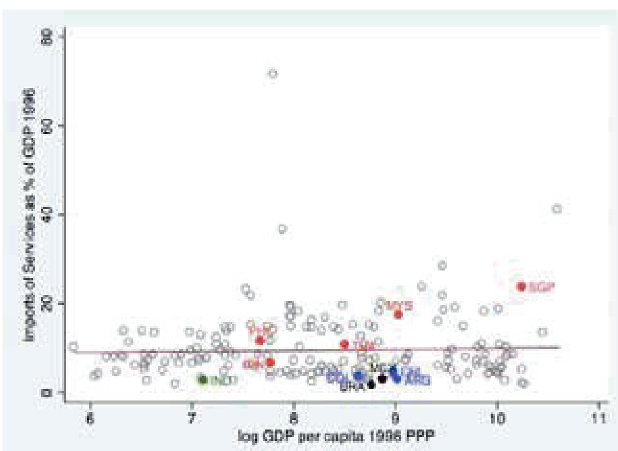
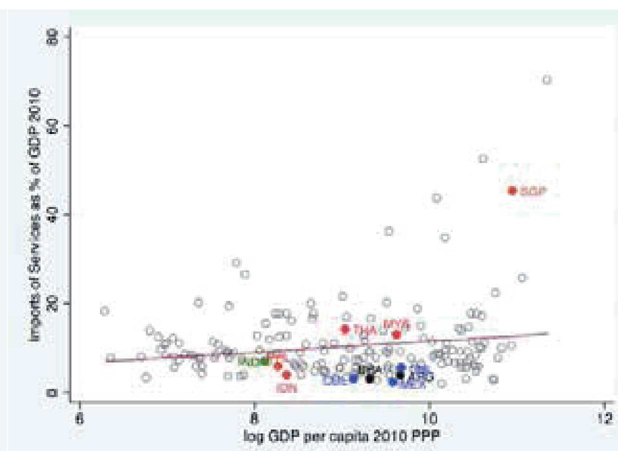


Figure 1.A.16 Services Imports as Share of GDP, Group 1, 2010



Source: Calculated based on World Bank World Development Indicators, 2012.

Figure 1.A.17 Services Imports as Share of GDP, Group 2, 1996

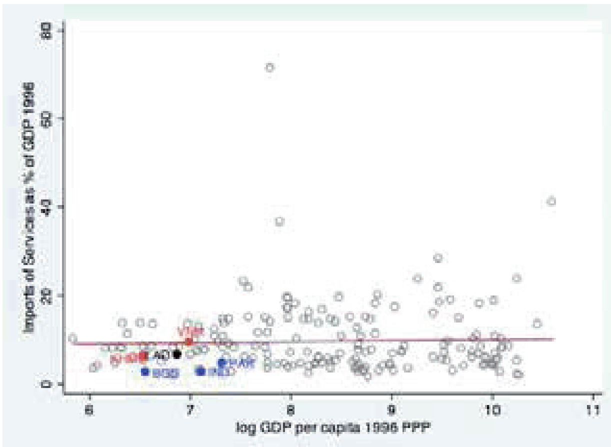
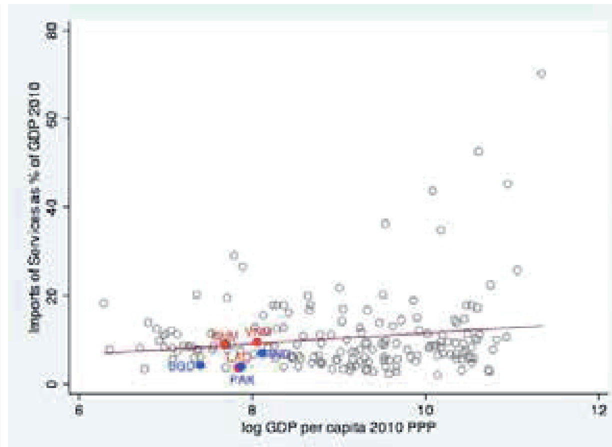


Figure 1.A.18 Services Imports as Share of GDP, Group 2, 2010



Source: Calculated based on World Bank, World Development Indicators, 2012.

Annex 1.B Gravity Model of Trade in Services

1. This annex assesses whether scope exists to increase services trade integration between ASEAN countries at the aggregate level. The main question is whether countries are trading to their potential, or whether potential remains untapped, and where barriers to enhanced integration may lie. The analysis is based on an estimated gravity model of trade in services that is based in economic theory. The gravity model of trade relates countries' bilateral trade flows to structural determinants of GDP, geographic distance, and other factors that affect trade barriers. The gravity model has been extensively used in international trade due to its intuitive empirical and theoretical appeal. Anderson and van Wincoop (2003), Feenstra (2004), and Baldwin and Taglioni (2006), among others, present exhaustive literature reviews on the gravity equation as applied to international trade. The gravity model estimation results can then be used as a framework to evaluate ASEAN countries' pairwise export relationships between 2008 and 2009.

2. The structural determinants for each pair of countries together with the estimated regression coefficients are used to compute the bilateral trade potentials. The level of bilateral trade between a pair of countries is compared relative to their trade potential to categorize bilateral exports as overtraded or undertraded, depending on the comparison between realized bilateral export values and the model's predictions. In addition, a country's Services Trade Restrictions Index (STRI) of the World Bank Services Trade Restrictions Database is included in the regression to assess if these are important determinants in explaining the level of bilateral services trade between ASEAN countries.

3. Bilateral trade flows are from the Trade in Services Database developed by Francois and Pindyuk (2012), which covers bilateral service flows for 248 countries across a multitude of service sectors on a cross-border basis. It uses multiple sources of bilateral trade data based on balance-of-payments statistics, including the OECD, Eurostat, United Nations, and International Monetary Fund. Its advantage over the original source data is that it provides broader coverage, since it is based on mirror flows (deducing a country's export values from its partners' import values). However, only data on cross-border trade (Mode 1) and consumption abroad (Mode 2) can be collected in the dataset, since these are reported in the balance-of-payments statistics of countries' national accounts. FDI (commercial presence or Mode 3) remains an important channel for foreign providers to supply services.

4. It should be noted that the quality of trade data for services is still far from being comparable to trade data for merchandise goods. Due to the long tradition of tariff revenues, trade data for goods have been collected with quite high quality and accuracy. Due to intangibility and nonstorability of services, at-the-border duties cannot be applied to services, which has resulted in much weaker compilation practices, with considerably less accuracy. Thus, the Trade in Services Database should be seen in this light as the best currently available approximation of a comprehensive picture of global trade flows in services.

5. Specifically, the average 2008–09 bilateral exports for 102 countries is regressed on the following country-specific and bilateral characteristics: log of distance, dummy variables for contiguity, common language, common colonial power, STRI of exporter and importer, and log of GDP of exporter and importer to proxy for economic mass. The results of the estimation are presented in the first column of results in table B.1.

6. An alternative specification for the gravity equation is also estimated in which the economic mass variable is picked up not by GDP, but by importer and exporter fixed effects (referred to as a dyadic gravity equation). In this specification, bilateral exports for 198 countries is regressed on log of distance and dummy variables for contiguity, common language, and common colonial power. Only bilateral characteristics can be included in the dyadic model, since the nation dummies prevent the inclusion of country-specific variables such as GDP and the STRI. However, this second specification controls for all country-specific factors that affect bilateral trade flows, and thus also corrects for unobservable omitted variables that could

be present in error terms of the first specification (also potentially biasing the point estimates). The results of the estimation are presented in the second column of results in table 1.B.1 (the coefficients on the fixed effects are repressed to save space).

Table 1.B.1 Gravity Model of Trade in Services

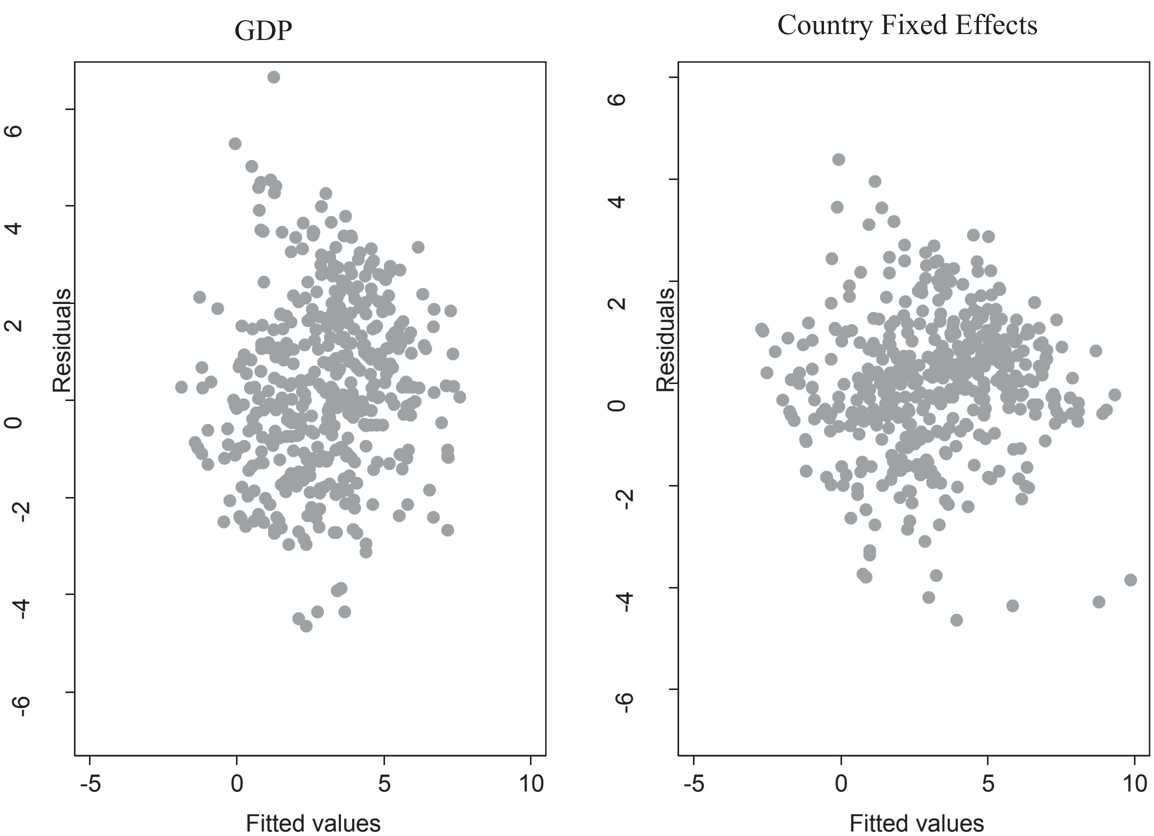
Dependent Variable: log(export value)	**Coefficient Estimates**	**Dyadic Coefficient Estimates**
Log(distance)	-0.8526***	-0.9059***
	(0.037)	(0.029)
Contiguity	0.3454**	0.4285***
	(0.168)	(0.110)
Common language	0.9000***	0.4314***
	(0.124)	(0.082)
Common colonial power	0.3089	0.6241***
	(0.217)	(0.109)
Importer STRI	0.0012	
	(0.003)	
Exporter STRI	-0.0141***	
	(0.003)	
Log(importer GDP)	1.0866***	
	(0.021)	
Log(exporter GDP)	1.0808***	
	(0.021)	
Observations	2,533	4,925
Adjusted R-squared	0.700	0.813

Sources: Authors' calculations using data from World Bank *World Development Indicators*, World Bank *Trade in Services Database*, World Bank *Services Trade Restrictions Database*, and Centre d'Études Prospectives et d'Informations Internationales (CEPII).
Note: Robust standard errors in parentheses. *** $p<0.01$, ** $p<0.05$, * $p<0.1$.

7. The results of the gravity model show that the STRI of the exporting country matters in determining the bilateral exports of that country. Countries with more restrictive services regulatory environments are significantly less likely to export services. The relationship between the level of services restrictions in the importing country and their bilateral services imports is not found to be statistically significant. However, only data on cross-border trade (Mode 1) and consumption abroad (Mode 2) can be collected in the dataset. The importance of FDI (commercial presence or Mode 3) as a channel for foreign providers to supply services could be one potential explanation for the insignificant coefficient on the importer STRI, since these service flows are not captured in the database.

8. Fixed effects (dyadic) estimations control for a wide variety of country-specific factors that affect bilateral trade flows. In other words, they control for the omitted variables that are too difficult to measure directly and that influence the ability of a country to trade, beyond what its economic mass suggests. This includes all country-specific (nonbilateral) trade policy barriers, beyond what can be measured by, for example, the STRI. In contrast, these nonmeasurable country-specific characteristics fall into the residual in the specification where GDP proxies economic mass. Figure 1.B.1 plots the residuals on the y-axis against the model's fitted values on the x-axis for the dyadic specification, and a specification that does not correctly control for such barriers. To properly make the comparison, the STRI has been removed from the specification to see more clearly what happens when these barriers (beyond distance and common language, for example) are not accounted for. Once properly controlling for these other obstacles in the specification with fixed effects, fitted values perform better.

Figure 1.B.1 Residuals Compared to Fitted Values Estimated with GDP and Fixed Effects, 2008–09



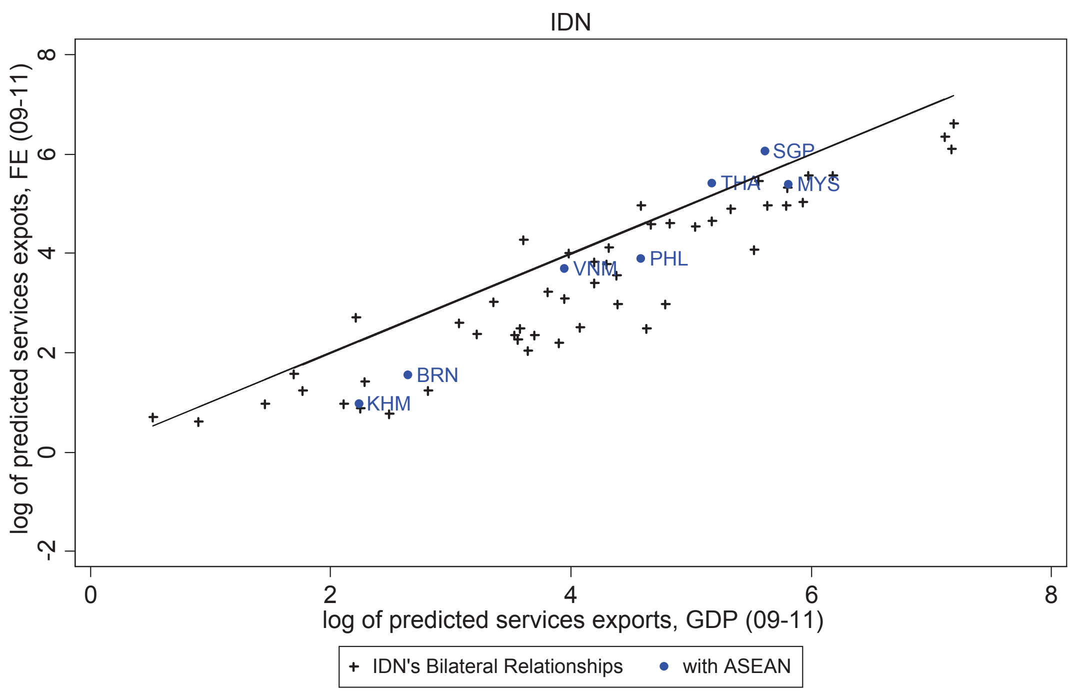
Sources: Authors' calculations using data from World Bank *World Development Indicators*, World Bank *Trade in Services Database*, World Bank *Services Trade Restrictions Database*, and CEPII.

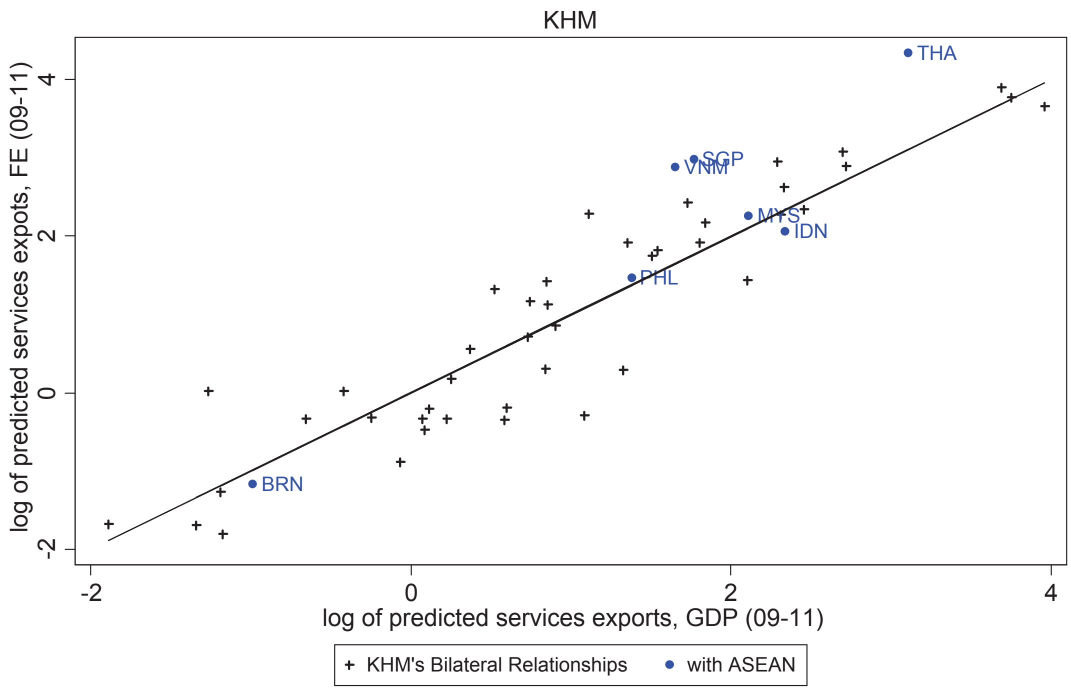
9. This is more clearly illustrated when comparing the differences in trade potential predicted by each of the two models (the dyadic and the specification with economic mass but without the STRI). Figure 1.B.2 plots for each ASEAN country the predicted bilateral trade levels from the specification with GDP

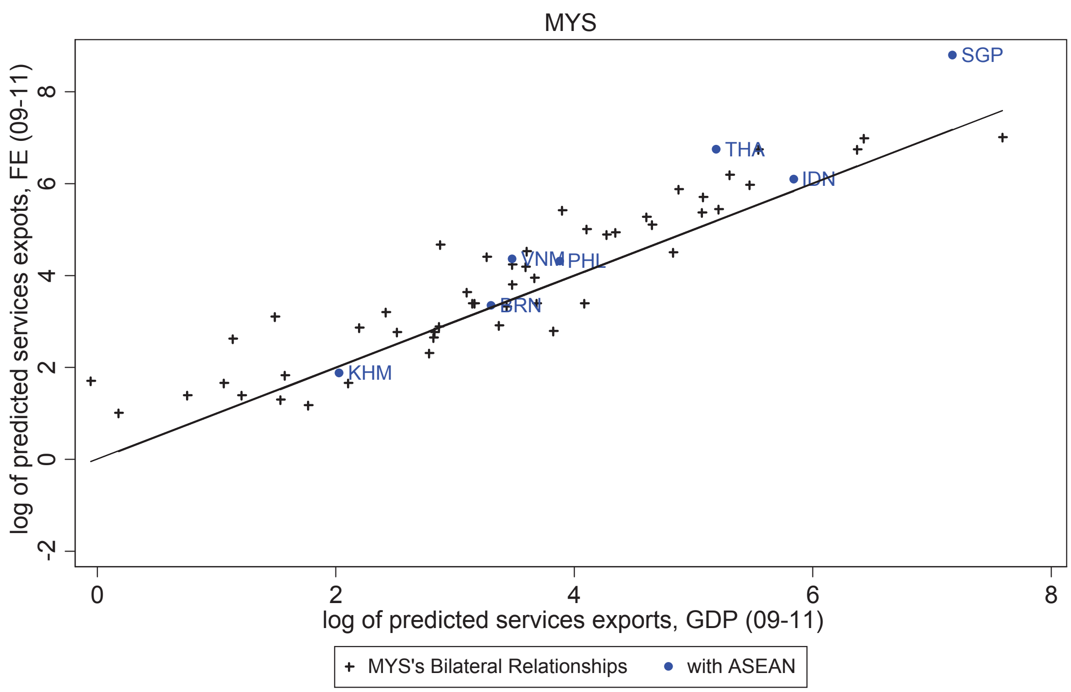
on the x-axis against the predicted levels from the specification with fixed effects (the dyadic gravity model) on the y-axis, in light gray dots. In the figure, each ASEAN country's bilateral exports with other ASEAN countries are in black and are labeled according to their three-digit International Organization for Standardization (ISO) code. Also included in each plot is a 45-degree line. Observations lying below the 45-degree line show that the predicted levels from the specification with fixed effects are lower than the specification with GDP. Because the specification with fixed effects properly controls for country-specific barriers to trade, such a result would suggest that there exist barriers to trade at the national level that are lowering a country's trade potential.

10. Since many observations lie below the 45-degree line, this shows that the predicted levels from the specification with fixed effects are lower than with GDP. Thus, lower potential trade after properly controlling for country-specific obstacles to trade suggests that these barriers are deterring services trade between many ASEAN countries of interest, in particular, but also with other countries in the world. Interestingly, this does not seem to be the case, however, for Malaysia and Thailand. This result is something to be explored further, but in general could suggest that high regulatory restrictions and low regulatory governance (as captured by the STRI, for example) are dampening trade potential.

Figure 1.B.2 Predicted Trade Estimated with GDP and Fixed Effects, 2008–09




KHM
THA
SGP
VNM
MYS
IDN
PHL
BRN
log of predicted services expots, FE (09-11)
log of predicted services exports, GDP (09-11)
KHM's Bilateral Relationships
with ASEAN


MYS
SGP
THA
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VNM
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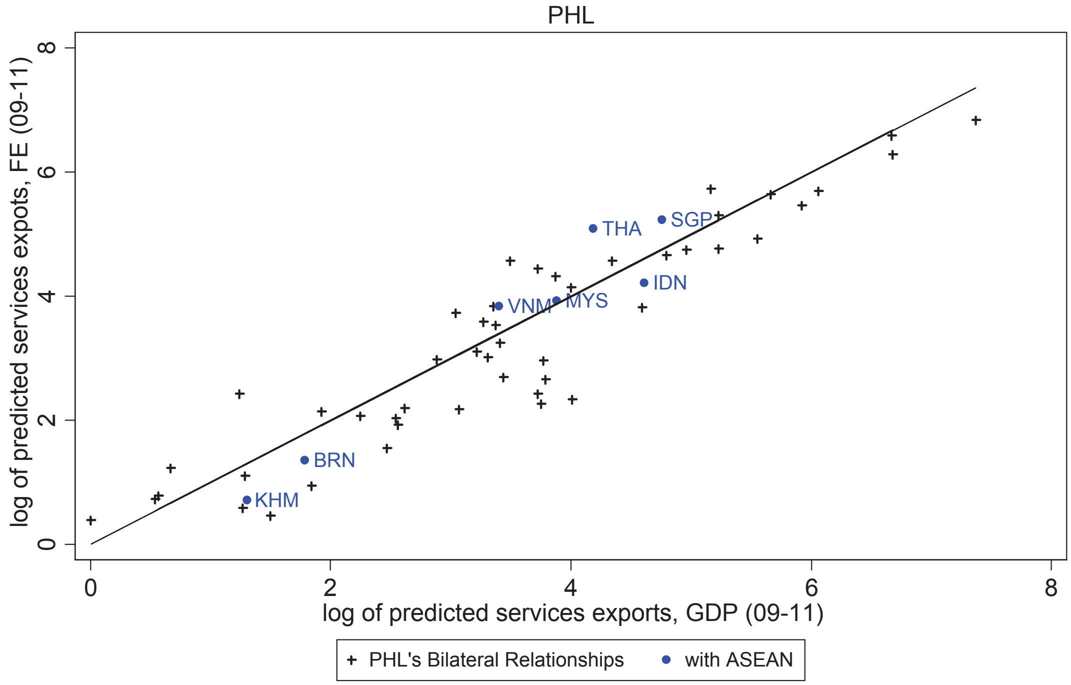
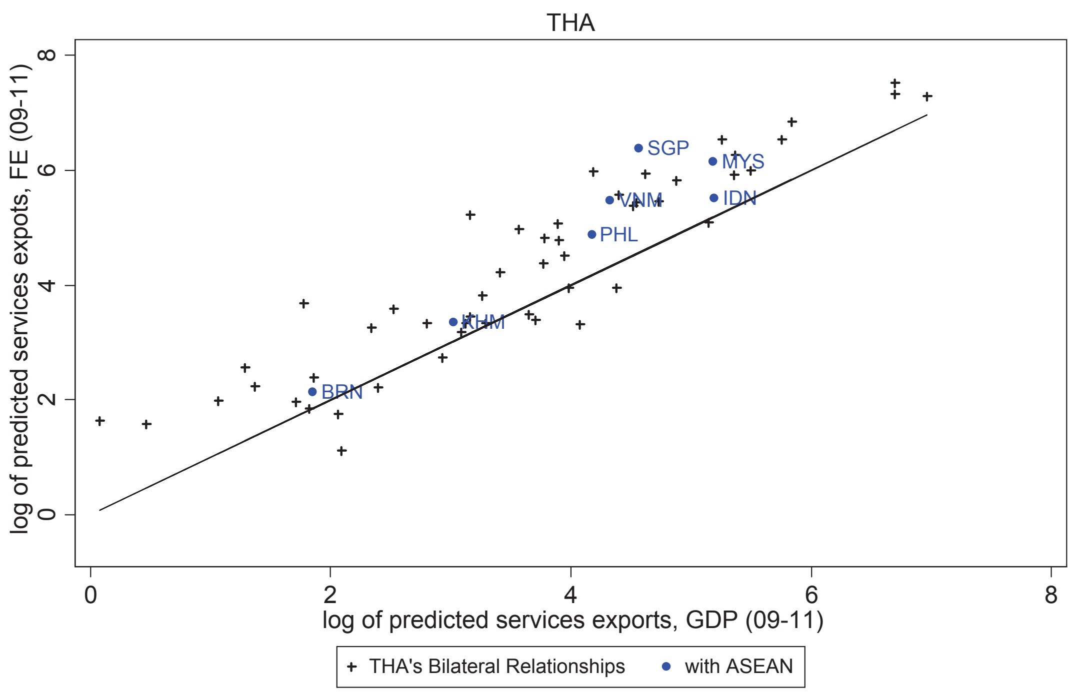
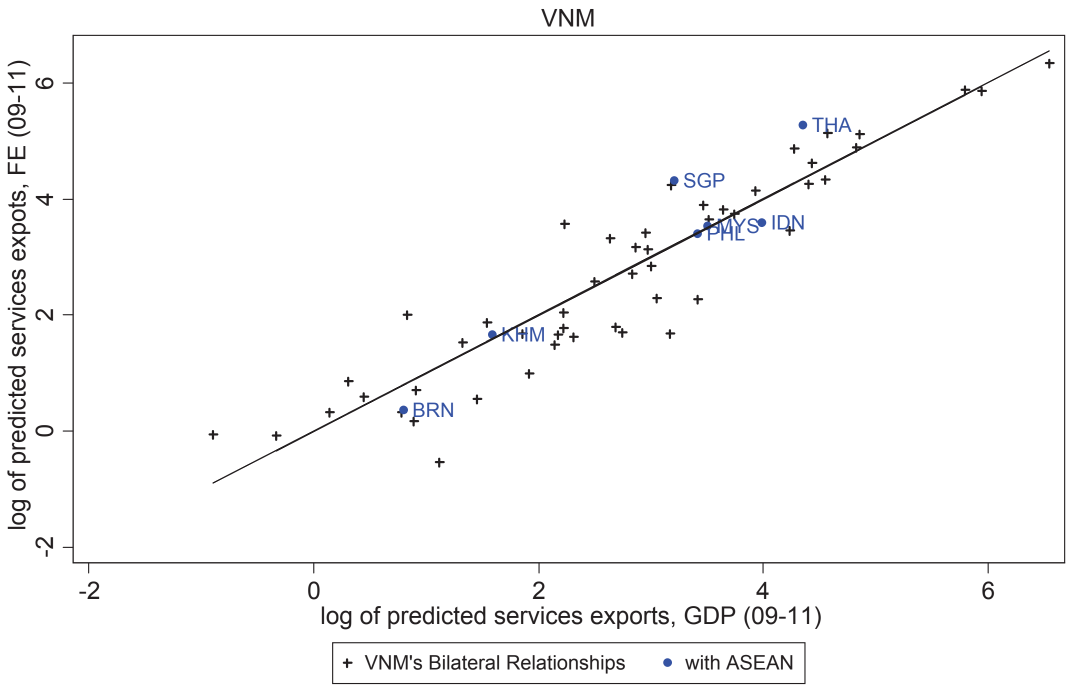
BRN
KHM
log of predicted services expots, FE (09-11)
log of predicted services exports, GDP (09-11)
MYS's Bilateral Relationships
with ASEAN


PHL
log of predicted services expots, FE (09-11)
log of predicted services exports, GDP (09-11)
THA
SGP
IDN
VNM
MYS
BRN
KHM
PHL's Bilateral Relationships
with ASEAN


THA
log of predicted services expots, FE (09-11)
log of predicted services exports, GDP (09-11)
SGP
MYS
VNM
IDN
PHL
KHM
BRN
THA's Bilateral Relationships
with ASEAN



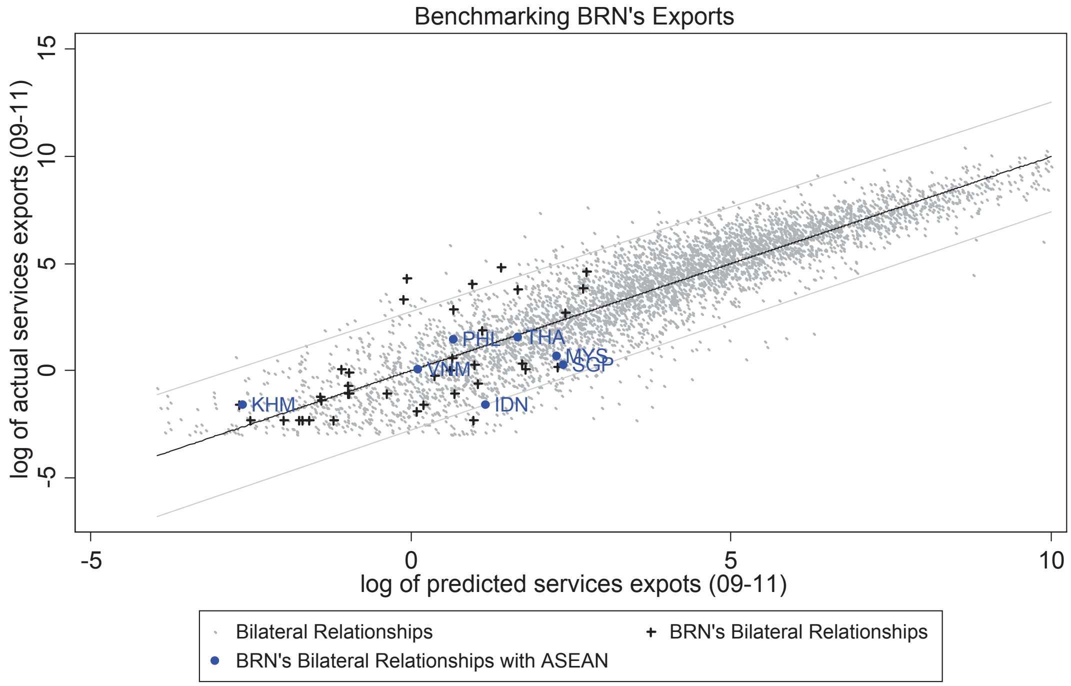
Source: Authors' calculations using data from World Bank *World Development Index*, World Bank *Trade in Services Database*, World Bank *Services Trade Restrictions Database*, and CEPII.

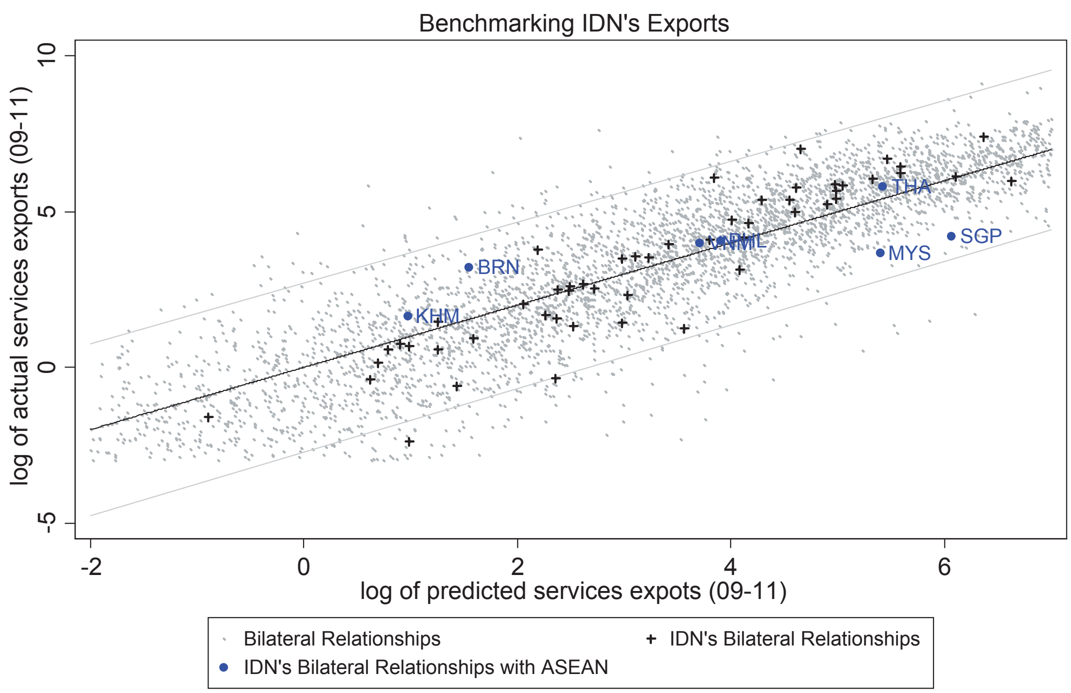
11. Figure 1.B.3 shows each ASEAN country's actual and predicted bilateral export relationships (given by the dyadic gravity equation) in this dataset, in light gray dots. Bilateral trade between ASEAN countries of interest are in black and are labeled according to their three-digit International Organization for Standardization (ISO) code. If an observation is above the 45-degree line, the average observed export relationship during 2008–09 is more than what the gravity model predicts—on the basis of countries' structural determinants—and the exporter is said to be overtrading with its trading partner. If an observation is below the 45-degree line, the average observed export relationship during 2008–09 is less than what the gravity model predicts—on the basis of countries' structural determinants—and the exporter is said to be undertrading with its trading partner.

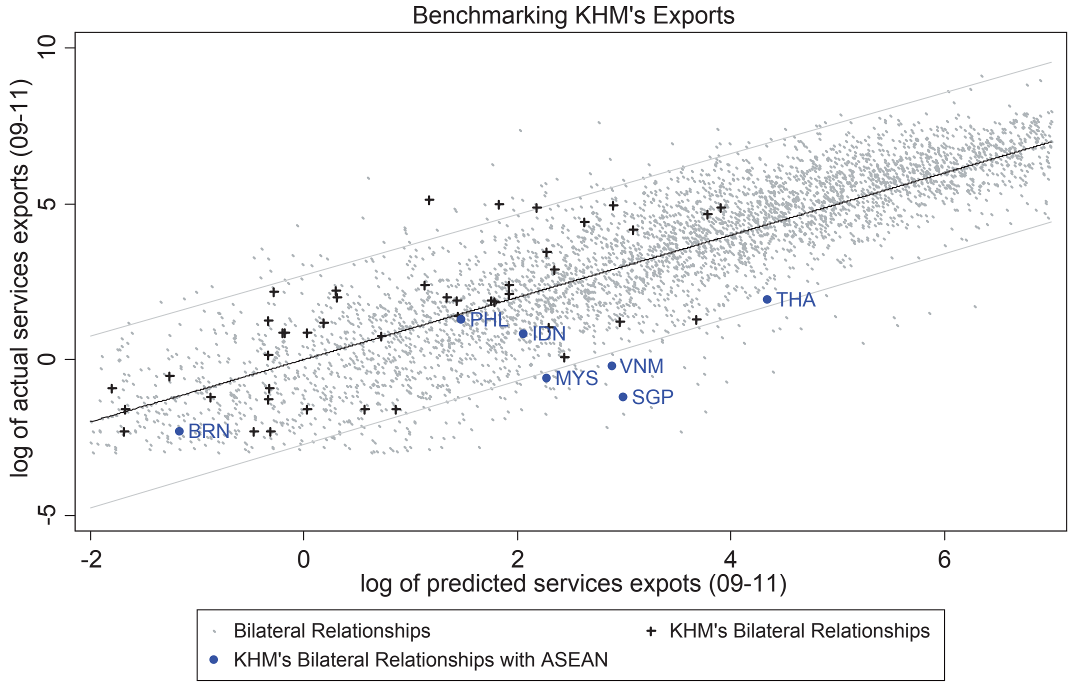
12. Gravity trade model estimates indicate that the estimated potential trade volumes predicted by structural trade determinants vary in comparison to the realized intraregional trade values between 2008 and 2009 for different countries in the region. While some countries appear to be overtrading, others undertrading, and still others trading at their potential, all ASEAN countries are shown to underexport with Malaysia and Singapore (and Malaysia and Singapore with each other). There also appears to be scope for countries such as Brunei Darussalam, Cambodia, Malaysia, and Singapore to increase services exports with select countries in the region.

13. At the same time, the results comparing the two separate specifications also show that some countries' trade potential is dampened when the model specification accounted for unobserved country-specific characteristics. This suggests there may be limited scope for further trade integration in the region, unless structural domestic reforms are implemented in the participating countries. Thus, undertrading in services may suggest the existence of untapped potential to increase exports among these countries via the removal of trade-related obstacles. Similarly, removal of such obstacles would increase countries' potential and could explain the result of overtrading.

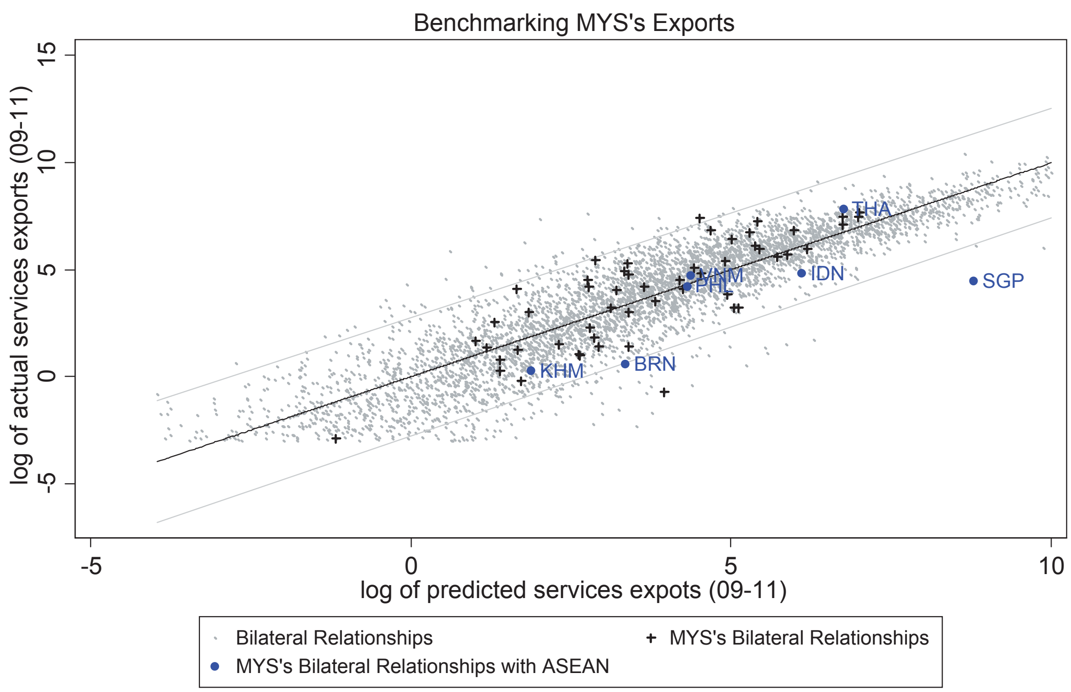
Figure 1.B.3 Gravity Model of Trade in Services, 2008–09



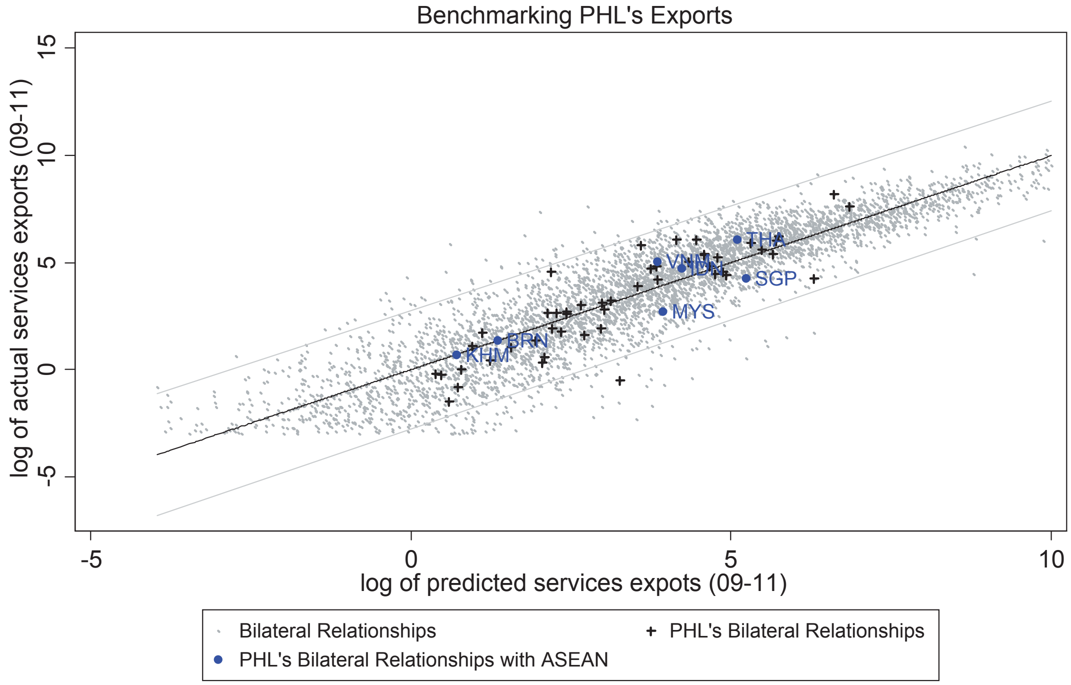


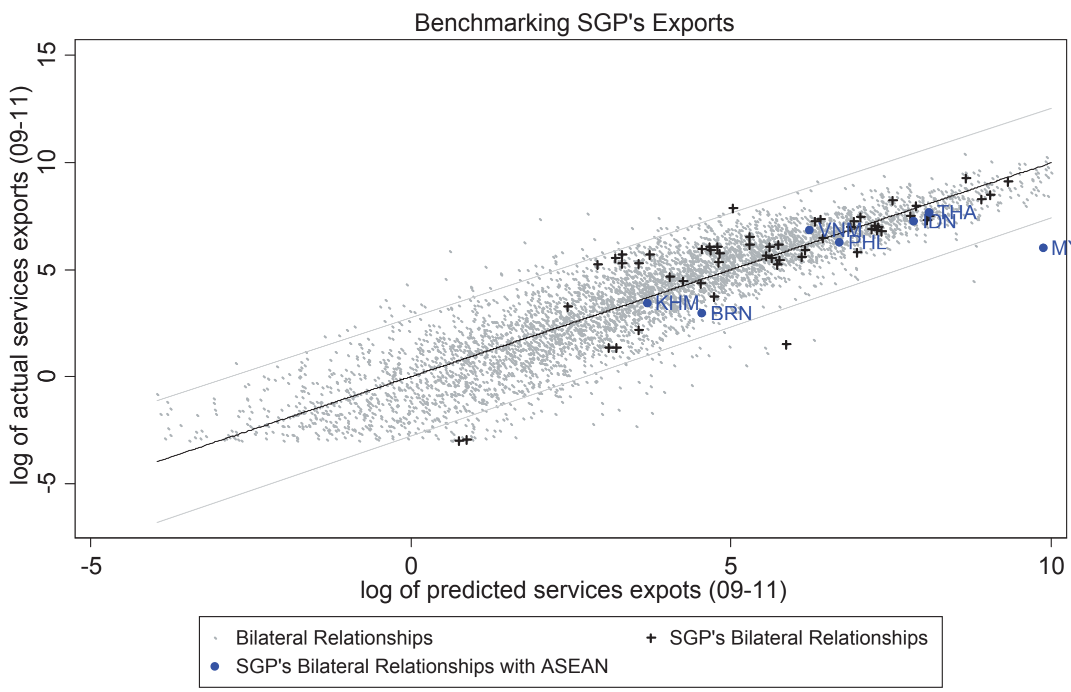


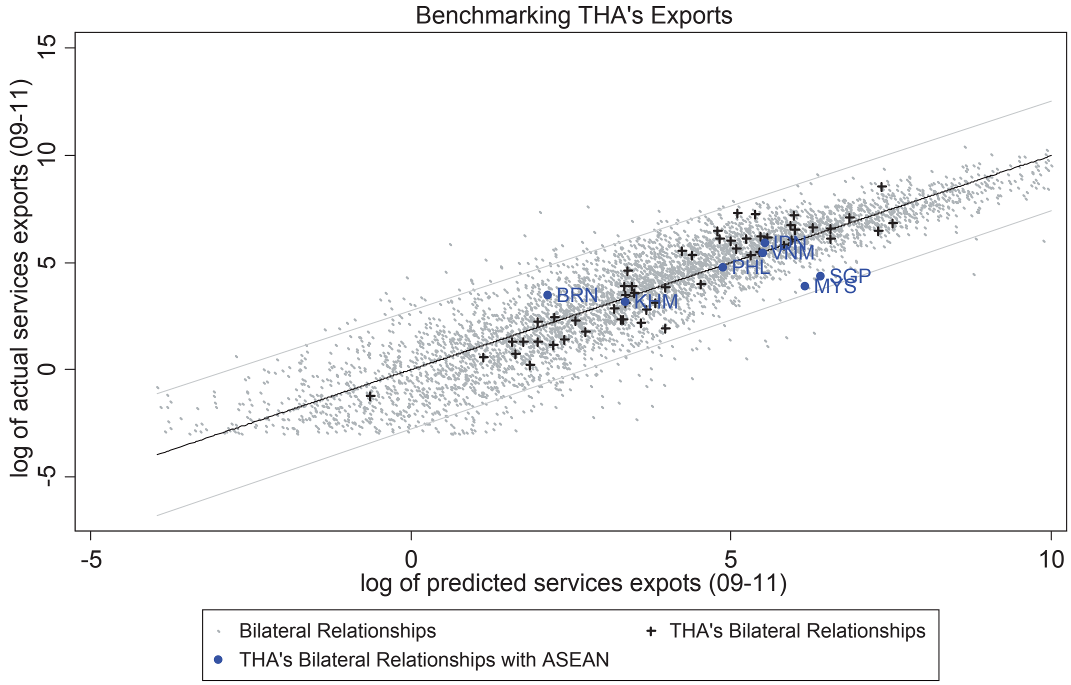
Benchmarking KHM's Exports
log of actual services exports (09-11)
log of predicted services expots (09-11)
-5
0
5
10
-2
0
2
4
6
PHL
IDN
MYS
VNM
SGP
THA
BRN
Bilateral Relationships
KHM's Bilateral Relationships
KHM's Bilateral Relationships with ASEAN

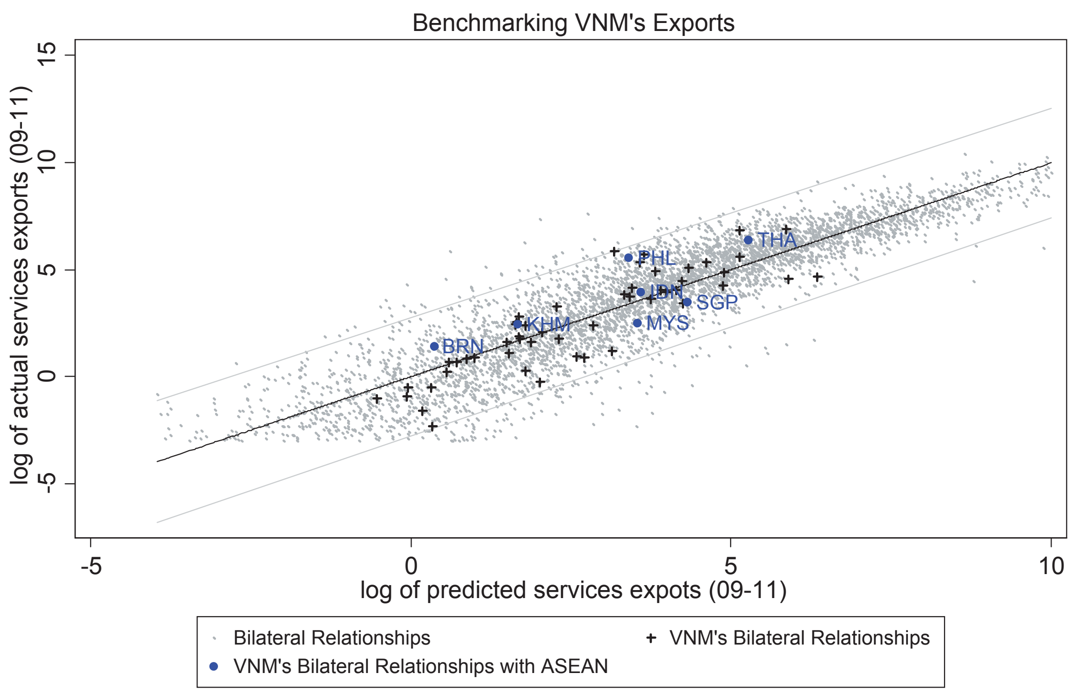


Benchmarking MYS's Exports
log of actual services exports (09-11)
log of predicted services expots (09-11)
-5
0
5
10
15
-5
0
5
10
THA
VNM
PHL
IDN
SGP
KHM
BRN
Bilateral Relationships
MYS's Bilateral Relationships
MYS's Bilateral Relationships with ASEAN


Benchmarking PHL's Exports
log of actual services exports (09-11)
log of predicted services expots (09-11)
-5
0
5
10
15
THA
VNM
IDN
SGP
MYS
BRN
KHM
Bilateral Relationships
PHL's Bilateral Relationships
PHL's Bilateral Relationships with ASEAN


Benchmarking SGP's Exports
log of actual services exports (09-11)
log of predicted services expots (09-11)
-5
0
5
10
15
THA
IDN
VNM
PHL
KHM
BRN
Bilateral Relationships
SGP's Bilateral Relationships
SGP's Bilateral Relationships with ASEAN





Source: Authors' calculations using data from World Bank *World Development Indicators*, World Bank *Trade in Services Database*, World Bank *Services Trade Restrictions Database*, and CEPII.

Chapter 2. Policy Barriers to Services Trade in ASEAN

Can regionalism do what multilateralism has so far failed to do—promote greater openness of services markets? While previous research has pointed to the wider and deeper legal commitments under regional agreements as proof that it can, no previous study has assessed the impact of such agreements on applied policies. This chapter focuses on the ASEAN region, where regional integration of services markets has been linked to the thriving regional supply chains. Drawing on surveys in 2008 and 2012 of applied policies in the key service sectors of ASEAN countries, this chapter assesses the impact of the ASEAN Framework Agreement on Services (AFAS) and the ambitious ASEAN Economic Community Blueprint, which envisages integrated services markets by 2015. The finding is that the measures applied to ASEAN countries' trade with each other are for the most part the same as the measures applied to trade with the rest of the world. Recent commitments scheduled under the AFAS are found to have produced moderate liberalization and, in a few instances, services trade policy seems to have taken a more cautious approach. The two exceptions are in areas that are not on the multilateral negotiating agenda: in air transport, steps have been taken toward creating regional open skies; and in professional services, a few mutual recognition arrangements have been negotiated. These findings suggest that regional negotiations add most value when focused on areas that are not being addressed multilaterally.

A. Overview

1. **Since the WTO's Doha Agenda failed to deliver meaningful services liberalization, many countries are turning to regional forums in the hope of greater success.** That raises the question of whether regionalism can do what multilateralism has failed to do, that is, promote greater openness of services markets. While previous research has pointed to the wider and deeper legal commitments under regional agreements as evidence that it can (for example, Marchetti and Roy [2008]; Fink and Molinuevo [2008]; Mattoo and Sauvé [2011]), no previous study has assessed the impact of such agreements on *applied policies*. The ASEAN region merits study because it is widely believed to be at the frontier of what Baldwin (2011) has called "globalization's second unbundling," with regional integration of services markets linked to the thriving regional supply chains. Drawing on surveys in 2008 and 2012 of applied policies in the key service sectors of ASEAN countries, this chapter assesses the impact of the ASEAN Framework Agreement on Services (AFAS) and the ambitious ASEAN Economic Community Blueprint, which envisages integrated services markets by 2015. The analysis on ASEAN's commitments under AFAS contained in this Report is limited to the eighth AFAS package in a wide range of service sectors under the purview of ASEAN Economic Ministers, fifth package in financial services under the purview of ASEAN Finance Ministers, and commitments in air transport services signed under the MAAS and MAFLPAS treaties signed under the Purview of the ASEAN Transport Ministers. ASEAN continues to improve its commitments under AFAS. Recently, the Protocol to Implement the Sixth Package of Financial Services Commitments was signed in March 2015 by the ASEAN Finance Ministers while the signing of the Protocol to Implement the Eight Package of Commitments on Air Transport Services was completed on 19 November 2014.

2. **With these caveats, this chapter addresses four questions.** How open are ASEAN services markets? Have these markets become more open since 2008, when the first policy survey was conducted soon after they agreed on the far-reaching ASEAN Economic Community Blueprint? Is ASEAN integrating faster internally than with rest of the world? How far have the ASEAN countries implemented their commitments under the AFAS, and how far are they from meeting the market integration goal set out in the Blueprint?

3. **The stark conclusion based on the analysis is that the recent commitments scheduled under the AFAS may have created greater regional policy certainty, but have in general produced moderate liberalization within ASEAN.** One consequence of these agreements—which cover primarily intra-ASEAN—could have been that ASEAN countries would today be more open vis-à-vis each other than vis-à-vis non-ASEAN countries. For the most part, they are not. For the seven broad sectors (and relevant modes) covered by the survey for ASEAN, the gap found between policy treatment of intra-ASEAN and extra-ASEAN trade is modest.

4. **The agreements have also promoted, at best, modest openness vis-à-vis countries outside the region.** First, ASEAN countries have higher Services Trade Restrictions Indexes (STRI) than any other region of the world on average, except the Gulf States. The average STRI for the region is 60 percent higher than the global average. But restrictiveness of applied policies varies across countries and income levels. Cambodia and Singapore have the most open policies in the sectors covered (see paragraph 10 below). Myanmar and Vietnam are fairly open, with a few restrictions, which are higher in most of the rest of the countries (Indonesia, Malaysia, the Philippines, and Thailand). The second reason that the agreements seem to have promoted only modest openness generally is because the trade liberalization in ASEAN countries, while encouraging in some respects, has proceeded unevenly during the last four years. While there are some instances of market opening, there are also instances of slight backtracking. For the six ASEAN Member States for which the same surveys were conducted in 2008, there was little change in the overall policy regime as of 2012 (the regional average STRI fell only about 16 percent from its high level). As a consequence, even though actual openness is greater than that promised by current AFAS commitments, there is still room for improvement to achieve the goals specified in the Blueprint. Nevertheless, the AFAS commitments have served the valuable purpose of reducing policy risks.

5. **There are two exceptions to these conclusions: in air transport, where ASEAN countries have taken some steps toward regional open skies; and in certain professional services, where some mutual recognition arrangements (MRAs) have been negotiated.** Even in these areas, the regional integration efforts are still ongoing: in professional services, domestic regulations are still in the process of being aligned with the ASEAN MRAs; and in air transport, further liberalization would help achieve a more integrated regional air market. Nevertheless, these initiatives suggest that regionalism could have incremental value when it focuses on areas that are not being addressed multilaterally (Mattoo and Fink 2004).

6. **There are some broad caveats to the analysis presented here.** Market access in many of the countries, as in other parts of the world, remains difficult to predict. From banking to transport, entry may be restricted by the explicit and implicit limits on new licenses, and the licensing process tends to be opaque and discretionary. In several ASEAN countries, licenses and foreign equity ownership are decided on a case-by-case basis, subject to requirements or approvals that involve several regulators and ministries. Some countries in certain sectors have no regulation at all, especially the lower-income countries in the region and pertaining to the supply of services through the cross-border and consumption abroad modes. In some of these cases, the supply of services is allowed in practice, while in others it is prohibited. In general, the high level of discretion and the absence of regulation creates a less predictable policy environment and makes it difficult to accurately define and assess the policy regime.

7. **Section B of this chapter describes the nature of services trade policy data and how it was collected and verified.** Section C presents the ASEAN policy patterns and places them in a global context. Section D takes a closer look at the policy measures used by ASEAN countries, highlighting certain aspects of the regulatory environment. Section E assesses whether ASEAN countries liberalized their policies between 2008 and 2012. Section F examines instances of where ASEAN countries are becoming more open vis-à-vis each other and provides two examples. Section G compares the regional and multilateral commitments of ASEAN countries with actual policy. Section H concludes.

B. Services Trade Policy Data and Measurement

8. **A detailed description of the original World Bank Services Trade Restrictions Database—including details on the data collection process, the policy measures covered, and the survey questionnaire used in the data collection—is provided in Borchert, Gootiiz, and Mattoo (2012a) and in supplementary material available at http://iresearch.worldbank.org/servicetrade.** The global policy patterns of services trade policy emerging from the database are presented in Borchert, Gootiiz, and Mattoo (2013). Here, the focus is on updating the 2012 information on the six ASEAN countries covered in the original 2008 survey, and on collecting information for the four ASEAN countries not previously covered.[10]

9. **The 2012 ASEAN survey focused, as did the earlier surveys, on policies that affect international trade in services, defined, as is now customary, to include the supply of a service through cross-border delivery, consumption abroad, establishing a commercial presence, or the presence of a natural person.** The perspective is one of a foreign supplier who wishes to provide services to a particular country, and the focus here is mainly on policy measures that discriminate against foreign services or service providers.

10. **The 2012 surveys updated the policy information obtained from the previous surveys of 2008 for Cambodia, Indonesia, Malaysia, the Philippines, Thailand, and Vietnam, and collected information for the first time for Brunei Darussalam, Lao PDR, Myanmar, and Singapore.**[11] The data collection process follows the same method used by the Services Trade Restrictions Database, but with a few changes. First, some new sectors and modes have been added to the questionnaire to reflect the regional liberalization priorities of ASEAN countries.[12] These include education, medical, architecture, engineering, and management consulting, as well as the cross-border mode in road transportation. Second, the questionnaire is designed to identify differences in intra-ASEAN and extra-ASEAN policy regimes in services, and in particular, instances of regional liberalization and preferences. Third, more than in earlier surveys, this survey examines whether there is in fact a regulation or policy in place for each specific subsector mode to take into account the conditions in countries like Lao PDR and Myanmar. The implications of the absence of explicit regulation or policy are also assessed, such as whether there are any implicit limits on the number of licenses allocated.

11. **The seven major service sectors are disaggregated into further subsector modes (as shown in Annex table A.2.2 at the end of this chapter): financial (banking and insurance), education (higher education), medical, telecommunications, retail distribution, transportation, and professional services (accounting, legal, architecture, engineering, and management consulting).** Within each subsector, the database covers the most relevant modes of supplying the respective service: cross-border trade in services (Mode 1) in financial, transportation and some professional services; establishing commercial presence or FDI (Mode 3 in WTO parlance) in every subsector; consumption abroad in education and medical services, and the presence of service-supplying individuals (Mode 4) in professional services.[13] The survey focuses on each country's most-favored nation (MFN)[14] policies affecting trade with

[10] Policy data collected via surveys for ASEAN Member States are not publicly available yet.
[11] The Brunei survey was delayed because there is inadequate information on its policies.
[12] The choice of sectors in the original database was based primarily on the assessment of their economic importance from a development perspective, and on the existence of meaningful restrictions on services trade.
[13] Regarding policies governing cross-border (Mode 1) trade in international air passenger transportation services, the WTO's QUASAR database has been used since it represents the most comprehensive source available on bilateral air services agreements, covering over 2,000 agreements.
[14] "Most-favored-nation," or MFN, means the country that is the recipient of this treatment must receive equal trade advantages as the "most favored nation" by the country granting such treatment.

non-ASEAN member countries, and its intra-ASEAN preferential policies affecting trade with other ASEAN member countries.

12. **The primary focus of the survey was to gather information on policies and regulations that restrict trade in services.** Measures that explicitly discriminate against foreign services or service providers impede trade almost by definition, and thus all these measures belong in the database. But these are not the only measures that obstruct trade. Certain measures that on the face of it do not discriminate against foreign service providers may nevertheless restrict trade. First, quantitative restrictions, such as those that limit the total number of providers, could hurt trade by preventing foreign entry, even though they also limit domestic entry. Second, regulations such as qualification and licensing requirements ostensibly address the asymmetric information problem in certain service sectors, but can impose a disproportionate burden on foreign providers, such as professionals who have already met these requirements in their home countries. Third, in some sectors the *absence* of regulations, such as those that ensure all (domestic and foreign) entrants have access to essential facilities such as ports and telecommunications networks, can be seen as a "sin of omission" because without such access, entry may not be feasible. To cover each possible sin of commission or omission in all sectors is virtually impossible, but the attempt here is to include at least those that are likely to have a significant trade impact.

13. **For each mode, the measures differ depending on the sector.** In general, for Mode 3, a core set of measures across sectors are used, which are supplemented with sector-specific measures, for example, limits on the size of loans in retail banking, and restrictions on the international gateway in telecommunication. The core set of measures that pertain to Mode 3 fall into the following four broad categories: requirements on the legal form of entry and restrictions on foreign equity, limits on licenses and discrimination in the allocation of licenses, restrictions on ongoing operations, and relevant aspects of the regulatory environment.

14. **Measures governing** Mode **1 are slightly different in that they typically stipulate conditions under which cross-border trade may take place, rather than conditions imposed on the service provider.** Mode 4 measures, covered only in professional services, focus on qualification and (re-) certification requirements, as well as entry and immigration rules, all of which strongly affect the movement of service-supplying individuals. The challenge in evaluating policy measures is to assess whether prudential or regulatory measures affect contestability of the market by restricting entry of foreign suppliers (Findlay and Warren 2000). While an effort is made to capture the important licensing regulations in professional services where they have a significant impact on trade, in future work more could be done to improve the coverage in this database of such measures in areas like financial services. Finally, to understand how the policy was measured and became the Services Trade Restrictiveness Index (STRI), please see the detailed note on the scoring in the Annex 2.1.

15. **First-hand information for ASEAN Member States was collected by administering a questionnaire in 2012 that was completed by local law firms familiar with the policy regime in the respective countries and sectors.** The information on policies received was evaluated, and its restrictiveness assessed, by a team of World Bank economists. To ensure data accuracy, the policy information was reviewed by government officials between March and May of 2013. Upon receiving government comments, the policy information and scores were revised. This chapter is based on the data that have been reviewed and validated by the government officials.

16. **It is notoriously difficult to quantify policies affecting services trade because of their variety and complexity** (see, for example, Hoekman [1996] and the overview by Deardoff and Stern [2008]). Instead, this chapter relies on a measure of the restrictiveness of a country's policy regime for any subsector mode, the STRI, which has the weakness of being subjective but the virtue of being simple, transparent,

and robust (Borchert, Gootiiz, and Mattoo 2012a).[15] This measure is most convenient for depicting overall patterns in policy, across countries, modes, and sectors. Essentially, the approach here is to assess policy regimes in their entirety and assign them into five broad categories: completely open, that is, no restrictions at all; completely closed, that is, no entry allowed at all; virtually open but with minor restrictions; virtually closed but with very limited opportunities to enter and operate; and a final residual "intermediate" category of regimes, which allows entry and operations but imposes restrictions that are neither trivial nor stringent. It is convenient to assign a value to each of these five categories of regimes on an openness scale from 0 to 1, with intervals of 0.25. The resulting score is called the Services Trade Restrictions Index (STRI). Once a score has been attached to each regime, STRI values can be aggregated across sectors and modes of supply, taking weighted averages that reflect the importance of the different modes in each sector and the individual sectors in a standardized country. A detailed description of the quantification method is provided in Annex 2.1.

C. How Open are the Services Markets of ASEAN Countries?

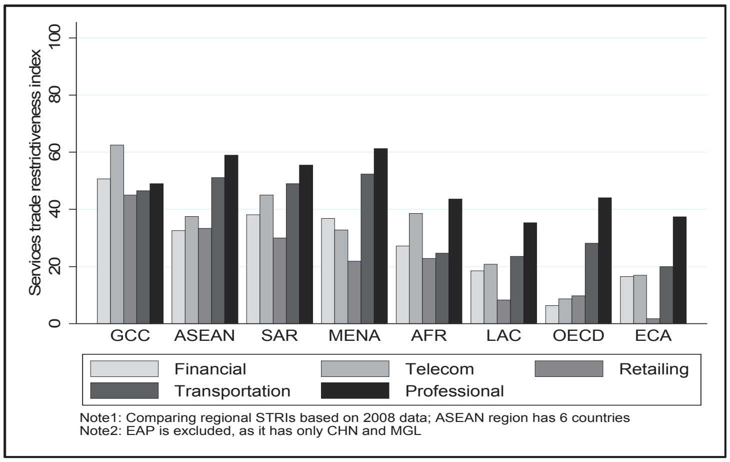
17. **The comparison of STRIs shows that ASEAN had on average higher STRIs than other regions in the world, except for the Gulf States.** The average STRI for the region was 60 percent higher than the global average. Figure 2.1 compares the sectoral policies of the ASEAN region with other regions of the world. It reveals that the policies of ASEAN countries were less restrictive on average than those of the countries of the Gulf Cooperation Council, were comparable to those of countries in South Asia, the Middle East, and North Africa, but were more restrictive than those of countries in Africa, Latin America and the Caribbean, high-income OECD countries, and Eastern and Central European countries. The country-level STRI shows that most of the individual ASEAN countries had higher STRIs than the global average at the corresponding levels of income, except for Singapore, Cambodia, and Myanmar. Figure 2.2 provides a comparison of the policies of individual ASEAN countries in five key sectors.[16] It is useful to look more closely at the nature of these policies.

18. **Financial services. As of 2012, when the survey was conducted**, banking sector policies in Malaysia, Thailand, and Vietnam were more restrictive than in the other countries, because they restricted greenfield entry (that is, the establishment of new financial entities rather than the acquisition of existing ones) and operations. In Thailand, the limit on foreign ownership in a "local bank" was 49 percent. However, such shareholding requirements could be relaxed with prior approval from the Ministry of Finance in cases where it is needed to strengthen operations and enhance financial stability. A foreign-owned subsidiary faced no limit on foreign equity participation, but there was a limit on operations: the number of branches allowed per subsidiary is 20, with an additional 20 off-premise ATMs, resulting in a total of 40 points of access. Foreign bank branches could operate up to three branches or off-premise ATMs without a location limit. In the Philippines, greenfield entry was no longer possible since the license limit of 10 has been reached, and for acquisition, the foreign ownership limit is 60 percent. (However, under the Republic Act (R.A.) No. 10641 enacted in 2014, after the policy survey was conducted, foreign banks can now apply to operate in the Philippines either as a branch or as a wholly owned subsidiary; in addition, the new law allows foreign banks to acquire up to 100 percent of the voting stock of an existing domestic bank). In Malaysia, primary entry as a branch was not allowed, and entry through a subsidiary was temporarily not allowed, since no new licenses were being issued, although there was no limit on foreign ownership in a subsidiary. For acquisition, the limit was 30 percent, and there was a restriction on expanding through additional branches; 10 microfinance branches were allowed per bank, and further branches were allowed based on the effectiveness of these branches in serving microenterprises. There has been a comprehensive modernization and streamlining of Malaysia's regime on licensing and foreign equity limits in the banking and insurance sector (conventional and Islamic) with the enactment of the Financial Services Act 2013 and

[15] The OECD has also developed a measure of services trade restrictiveness, drawing upon the more detailed data available for industrial and more advanced developing countries (OECD 2009a, 2009b, 2011).
[16] The focus here is on the five main sectors. Annex table A.2.2 also includes education and medical services.

the Islamic Financial Services Act 2013 in June 2013. In both conventional and Islamic finance, Application for a license is now based on the prudential and "best interest of Malaysia" criteria. Similarly, the acquisition of a significant foreign equity interest in Malaysian banks and insurance companies could be up to 100 percent, subject to meeting the aforementioned criteria. Vietnam allowed wholly foreign-owned subsidiaries but imposed a limit on the acquisition of banks. To acquire existing banks, the foreign ownership limit was 30 percent for aggregate foreign investment and 20 percent for a single foreign credit institution.

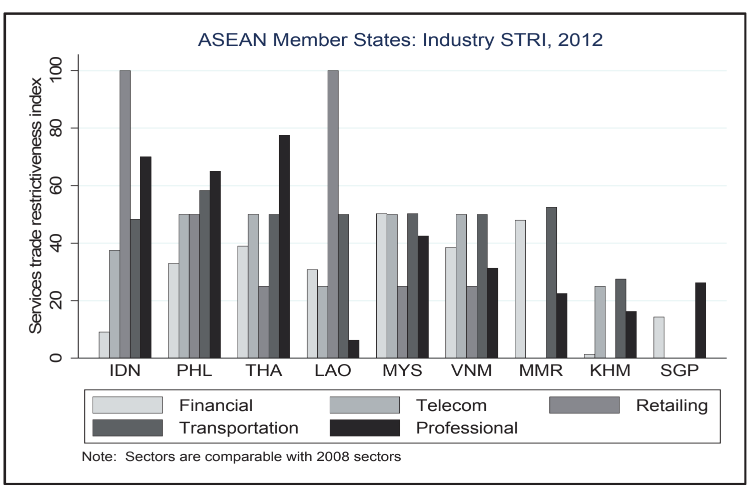
Figure 2.1: STRI by Industry, ASEAN Region Compared with other Regions, 2008



Source: All data in Chapter 2 Diagrams and Tables are derived from the World Bank's ASEAN Trade Restriction Database.

Note: The STRI at the regional level is calculated as a simple average of individual country's STRIs. The STRI in the cross-border air passenger transport subsector is excluded. The financial STRI includes scores for retail banking Mode 1 and Mode 3, automobile, life, and reinsurance Mode 1 and Mode 3, respectively. Telecom STRI includes scores for fixed line and mobile. Retailing STRI includes scores for retailing Mode 3. The transport STRI includes STRIs for air passenger international Mode 3, maritime international Mode 1 and Mode 3, road freight Mode 3, and rail freight Mode 3. Professional services STRI includes scores for accounting, auditing, legal advisory on domestic law and foreign law in Mode 1, Mode 3, and Mode 4. For comparability, the STRI scores for education, medical services, and some other professional services subsectors are excluded.

Figure 2.2 STRIs by Industry for ASEAN Member Countries, 2012



Note: When STRI score is zero, there is no bar. The Member States are ordered based on a descending level of average restrictiveness.

19. **Recently, in March 2015, ASEAN Finance Ministers signed the Sixth Protocol of Financial Services Commitments**, which also contains the enabling provision for the implementation of the ASEAN Banking Integration Framework (ABIF). The Objective of ABIF is to achieve a more integrated banking market, by allowing any two ASEAN countries to enter into reciprocal agreements to provide Qualified ASEAN Banks (QABs) with greater market access, and operational flexibilities consistent with those of domestic banks in the respective host countries.

20. **In automobile and life insurance, Lao PDR, Malaysia, Myanmar, and Thailand have restrictive policies.** Myanmar is still drafting its regulations on the insurance and reinsurance sector, and it is not possible to enter at this stage. In Thailand, the licensing regime is discretionary; if more than 49 percent of foreign equity is desired, the approval of the Minister is required upon the recommendation of the Commission; the Minister of Finance has the power to grant a license with the approval of the Cabinet. In Lao PDR, there is a 49 percent limit on foreign ownership, and the licensing regime seems burdensome, since approval from the Ministry of Planning and Investment, Ministry of Finance, and Ministry of Industry and Commerce is required. Malaysia does not allow entry via a branch. Prior to the liberalization in 2013 (see paragraph 18 above), foreign ownership in a subsidiary can be 100 percent; however, no new licenses were being issued, but were announced from time to time on an ad-hoc basis. The foreign ownership limit on acquiring a share of an existing insurance company was 70 percent. In cross-border reinsurance and retakaful (Islamic reinsurance) relating to non-life insurance and non-family retakaful respectively, Malaysian companies in Malaysia need to demonstrate domestic unavailability in the respective sectors in Malaysia before obtaining services abroad. However, Malaysia does not impose similar policies for reinsurance and retakaful relating to life insurance and family retakaful. The Philippines requires 10 percent of reinsurance to be ceded to the National Reinsurance Corporation of the Philippines.

21. **Telecommunications.** Most ASEAN countries limit foreign investment in fixed and mobile telecommunications services. The limit on foreign ownership is 49 percent in Indonesia and Malaysia, and 40 percent in the Philippines. The limit is a more relaxed 70 percent in Vietnam, but foreign majority control requires government approval, and in Thailand foreign-majority-owned or -controlled providers may offer services only on a resale basis. A number of ASEAN countries allow full foreign ownership in private companies, but restrict foreign ownership in state-owned telecom operators. Thus, the Philippines does not allow acquisition of a state-owned entity, whereas Cambodia and Lao PDR allow only a minority foreign share in state entities. In Vietnam, the state holds a dominant share in telecommunications service providers with network infrastructure. In terms of the legal form of entry, all countries allow entry through greenfield and acquisition, except in Malaysia, where entry at this stage is possible only through acquisition, because no new greenfield licenses are being issued. Singapore and Myanmar are the two relatively open countries in the region in that they do not limit entry and foreign equity participation. However, Cambodia (like Vietnam) does not allow foreign operators to establish their own international gateway, and Singapore requires that at least one director be ordinarily resident in Singapore.

22. **Policy in mobile telecommunications is similar to that in fixed telecommunications.** For most ASEAN Member States, the foreign equity limits in both areas are the same. The exception is Indonesia, where the foreign equity limit for mobile telecommunications operators is a more relaxed 65 percent compared to the 49 percent limit in fixed telecom.

23. **Retail.** Most countries in the region allow FDI in retail, except Indonesia and Lao PDR. Indonesia's FDI policies have become more restrictive since 2008, when foreign investment in retail was still allowed. Other countries surveyed allow investment as long as the foreign retailers meet the minimum capital requirements. In Thailand, the minimum capital requirement for opening the first five shops is B 100 million (about US$3.2 million). For each additional shop, capitalization of no less than B 20 million (US$640,000) is required. In the Philippines, a foreign retailer needs to bring in paid-up capital of US$2.5 million or more, provided that investments for each store must be not less than US$830,000. In Vietnam, establishing an

outlet beyond the first one is considered on a case-by-case basis, and approval depends on the number of outlets, market stability, population density, and consistency of the investment project with the master plan of the city where the shop is planned to be set up. Malaysia also has a minimum capital requirement that foreign retailers need to meet. In these cases, domestic retailers do not have the same requirement.

24. **Transportation.** Transportation services are relatively restricted in ASEAN countries, as they are in other parts of the world. In cross-border (Mode 1) maritime shipping, the chapter examines restrictions on both private and government cargo. Malaysia, the Philippines, Thailand, and Vietnam have restrictions on foreign ships carrying government cargo, but no limitations on private cargo. On commercial presence (Mode 3), for the types of transport covered by the survey (maritime, air, road, and rail), the majority of Member States mention that the control (for example, in terms of the power to name a majority of its directors or otherwise to legally direct its actions) must be held by local companies. In air transport, the Member States signed the ASEAN air transport liberalization agreements covering freight and passenger services. It is difficult to assess how much more openness the regional air services agreements offer beyond the existing Bilateral Air Services Agreements, which are discussed in more detail below.

25. **Education and medical services.** These services are covered most comprehensively, since all modes of supply were included in the survey: cross-border (Mode 1), consumption abroad (Mode 2), commercial presence (Mode 3), and presence of natural persons (Mode 4). Not surprisingly, most countries are fairly open in Mode 1 and Mode 2 types of trade in education and medical services. In Mode 3, Indonesia, Myanmar, the Philippines, and Thailand have restrictive policies. In these countries, the control of such institutions must be held by nationals, and in the case of Myanmar, the medical and higher education services are run by state-owned institutions. In the Philippines, medical services are run by the state, and the educational institutions must be owned and operated by Philippine nationals only. In Mode 4, Lao PDR and the Philippine require medical and educational services to be provided by the nationals. Other countries are open in the supply of services through Mode 4.

26. **Professional Services.** The supply of accounting, auditing, legal advisory services on foreign and domestic laws, architectural, engineering, and management consulting services are covered through Mode 1, Mode 3, and Mode 4. Although countries differ in their policies, it appears that most countries have fewer restrictions on management consulting, accounting, legal advice on foreign law, architecture, and engineering services than on auditing and legal advice on domestic law. In many of the countries, the cross-border supply of services (Mode 1) is unregulated and open. In Mode 3, the countries have restrictions on ownership, organization, and practices. Indonesia does not allow investment in most of its professional service sectors. In Mode 4, Thailand and the Philippines are quite restrictive; Thailand does not allow entry via Mode 4 in any of the professional service sectors covered, and the Philippines allows entry subject to restrictive conditions, including reciprocity and labor market tests.

D. Policy Measures Used by ASEAN Countries

27. **Besides the overall policy pattern by sector, a few of the key policy measures that the survey covers are looked at in each sector: legal form of entry and ownership, licensing regime, and regulatory environment.** The central features that emerge are the restrictiveness of policy and the degree of discretion in the policy environment relating to the entry and operation of foreign firms.

Legal form of entry and foreign ownership

28. **As was seen in the previous section, the restrictiveness of the legal form of entry and ownership varies by sector and country, but certain broad trends emerge.** In general, higher foreign ownership is allowed in a greenfield subsidiary than in entry through acquisition (tables 2.1, 2.2, and 2.3). Many countries allow full foreign ownership in a subsidiary, but full foreign ownership does not actually

mean liberal conditions of entry, since licensing can still be a limiting factor. For example, even though Malaysia allows 100 percent foreign ownership in banking and life insurance, new licenses are not being issued. In Thailand, insurance sector licenses are subject to review by several authorities, including the Office of Insurance Commission, on a case-by-case basis. If more than 49 percent of foreign equity is desired, the approval of the Minister of Finance is required upon the recommendation of the commission; the minister has the power to grant a license, with the approval of the Cabinet.

Table 2.1 Foreign Ownership Allowed in a Subsidiary (in percentage)

Selected Sectors	IDN	KHM	LAO	MMR	MYS	PHL	SGP	THA	VNM
Banking	99	100	100	100	100	60[a]	100	100	100
Insurance auto.	80	100	49	0	100	100	100	NL	100
Insurance life	80	100	49	0	100	100	100	NL	100
Fixed telecom	49	100	100	100	49	40	100	100	70
Mobile telecom	65	100	100	100	49	40	100	100	70
Retailing	0	100	0	100	100	100	100	100	100
Air transport	49	49	49	0	49	40	100	49	49
Maritime ship.	49	49	n.a.	100	100	40	100	49	49
Maritime aux.	49	100	n.a.	100	—	40	100	49	51
Road freight	49	100	49	100	49	40	100	49	51
Rail freight	0	100	n.a.	0	0	0	n.a.	49	49

Note: a. During the period in review, under Republic Act (R.A.) No. 7721, investment by foreign banks of up to 60 percent of the voting stock of a new banking subsidiary was allowed. However, a moratorium on the establishment of new commercial banks was imposed, except for microfinance-oriented thrift banks and rural banks, which were the means for a foreign bank to enter the Philippines. After the policy survey was conducted, foreign banks can apply to operate in the Philippines either as a branch or as a wholly owned subsidiary under the Republic Act (R.A.) No. 10641 enacted in 2014. In addition, the new law allows foreign banks to acquire up to 100 percent of the voting stock of an existing domestic bank. Zero means foreign ownership is not allowed; n.a. means not applicable for various reasons, such as the country is landlocked or has no railway system. — = not available. NL means no licenses are issued for subsidiaries in Thailand.

Table 2.2 Foreign Ownership Allowed in Acquisition of a Local Company

Selected Sectors	IDN	KHM	LAO	MMR	MYS	PHL	SGP	THA	VNM
Banking	99	100	100	100	30[b]	60[a]	100	49	30
Insurance auto.	80	100	49	0	70[b]	100	100	49	100
Insurance life	80	100	49	0	70b	100	100	49	100
Fixed telecom	49	100	100	100	49	40	100	100	70
Mobile telecom	65	100	100	100	49	40	100	100	70
Retailing	0	100	0	100	100	100	100	100	100
Air transport	49	49	49	49	49	40	100	49	49
Maritime ship.	49	49	NA	0	100	40	100	49	49
Maritime aux.	49	100	NA	0		40	100	49	51
Road freight	49	100	49	0	49	40	100	49	51
Rail freight	0	100	NA	0	0	0	NA	49	49

Note: a. In the Philippines, under the Republic Act (R.A.) No. 10641, enacted in 2014, after the policy survey was conducted, foreign banks can now apply to operate in the Philippines either as a branch or as a wholly owned subsidiary. In addition, the new law allows foreign banks to acquire up to 100 percent of the voting stock of an existing domestic bank.
b. Following the enactment of the Financial Services Act 2013 and Islamic Financial Services Act 2013 in June 2013, the acquisition of a significant foreign equity interest in Malaysian banks and insurance companies in both the conventional and Islamic finance sectors could be up to 100 percent, subject to meeting the prudential and "best interest of Malaysia" criteria.

Table 2.3 Foreign Ownership Allowed in Acquisition of a Local State-Owned Company

Selected sectors	IDN	KHM	LAO	MMR	MYS	PHL	SGP	THA	VNM
Banking	99	NA	100	0	30[b]	0*	100	9	30
Insurance auto.	80	49	49	0	70[b]	0	100	NL	
Insurance life	80	49	49	0	70[b]	0	100	NL	
Fixed telecom	49	49	100	100	49	0	100	100	70
Mobile telecom	65	49	100	100	49	0	100	100	70
Retailing	0	49	0	0	100	0	100	0	0
Air transport	49	49	49	0	49	0	100	49	49
Maritime ship.	49	49	NA	0	100	0	100	49	49
Maritime aux.	49	49	NA	0		0	100	49	51
Road freight	49	49	49	0	49	0	100	49	51
Rail freight	0	49	NA	0	0	0	NA	49	49

Note: A "Local State-Owned Company" is a company in which the government has majority ownership. NL means no licenses are issued for the acquisition of local state-owned insurance companies in Thailand.
b. Following the enactment of the Financial Services Act 2013 and Islamic Financial Services Act 2013 in June 2013, the acquisition of a significant foreign equity interest in Malaysian banks and insurance companies in both the conventional and Islamic finance sectors could be up to 100 percent, subject to meeting the prudential and "best interest of Malaysia" criteria.

29. **Compared to greenfield entry, there are stricter limits on foreign ownership via acquisition of an existing entity, especially if the entity is state owned.** Myanmar and the Philippines do not allow foreign acquisition of state-owned entities in most of the sectors covered. However, because acquisition is not subject to new licensing requirements, conditions of entry through this legal form may in fact be more liberal than greenfield entry. Across countries, the foreign equity limit is lower in transportation sectors. The only country that allows full foreign ownership of a state-owned entity is Singapore.

Licensing regime

30. **The licensing regime is vital, but it is difficult to assess whether licensing measures are applied for prudential or protectionist reasons.** In most countries, licensing and market entry criteria are publicly available, but fulfilling publicly available criteria does not ensure that a license is granted. All countries except Vietnam indicate licensing is not automatic in at least several sectors (table 2.4), and licenses tend to be issued on a case-by-case basis.

31. **In only a few countries can an explicit licensing limit or a hard-quota-type of restriction be observed, although the discretion of the licensing authority may be used to implement implicit limits.** Many countries also maintain different licensing criteria for foreign and domestic firms, but most such differences are relatively minor, such as an additional document or minimum capital requirement.

Table 2.4 Licensing Limits and Discrimination

	IDN	KHM	LAO	MMR	MYS	PHL	SGP	THA	VNM
Sectors for which Entry is Allowed	**14**	**15**	**11**	**10**	**14**	**13**	**14**	**15**	**15**
Licensing: explicit limit	0	1	0	0	8	2	0	0	0
Licensing criteria **not** publicly available	0	2	0	1	5	0	0	0	0
License **not** automatic if publicly available criteria are fulfilled	15	4	12	6	14	5	11	11	1
Different licensing criteria for foreign and domestic firms	4	3	1	4	1	10	3	12	12

Note: Discrimination refers to a difference in licensing requirements for foreign firms and domestic firms.

Regulatory environment

32. **The survey also covered several aspects of the regulatory environment, of which three are described here: whether the regulator is required to provide reasons for license rejection; whether there is a right to appeal the decisions of the regulatory authority; and whether regulators provide prior notice of regulatory and policy changes.** Countries in which the regulators are required to provide reasons for rejecting licenses would presumably have less room for discretion. Having a right to appeal is also connected to the licensing regime and indicates whether the private sector has recourse to a remedial process. The survey results show Malaysia, Myanmar, the Philippines, Singapore, and Thailand do not require regulators to provide reasons for license rejection. Appeals are not allowed in Cambodia, Malaysia, and Myanmar. Prior notice helps the private sector prepare for policy changes, and may even allow for

private sector input into policy. Inserdonesia, Lao PDR, Myanmar, the Philippines (except in banking services), and Thailand do not have processes for prior notice to the private sector (table 2.5).

Table 2.5 Regulatory Measures

	IDN	KHM	LAO	MMR	MYS	PHL	SGP	THA	VNM
Sectors for which entry is allowed	**14**	**15**	**11**	**10**	**14**	**13**	**14**	**15**	**15**
Regulator is not required to inform reasons for license rejection	3	0	0	8	12	6	11	7	0
Appeals not allowed	0	14	2	14	8	2	0	0	2
Prior notice of regulatory changes not allowed	15	0	12	15	10	11	0	13	2

33. **In low-income countries, where institutional capacity is limited, the absence of a formal policy or regulation is not uncommon.** The most number of subsector modes that are not covered by any specific regulation or policy appear in Lao PDR, followed by Cambodia, Myanmar, and the Philippines, and it is a phenomenon mostly observed in Modes 1 and 2 (table 2.6). The absence could have a restrictive impact, since it reduces transparency and predictability of the policy regime and increases the potential for discretion. But in many of these cases, in practice the supply of a service is allowed, with Vietnam a notable exception in this respect. Some other dimensions of the regulatory environment that the survey covered are described below.

Table 2.6 Is there a Regulation or Policy that Governs the Subsector Mode?

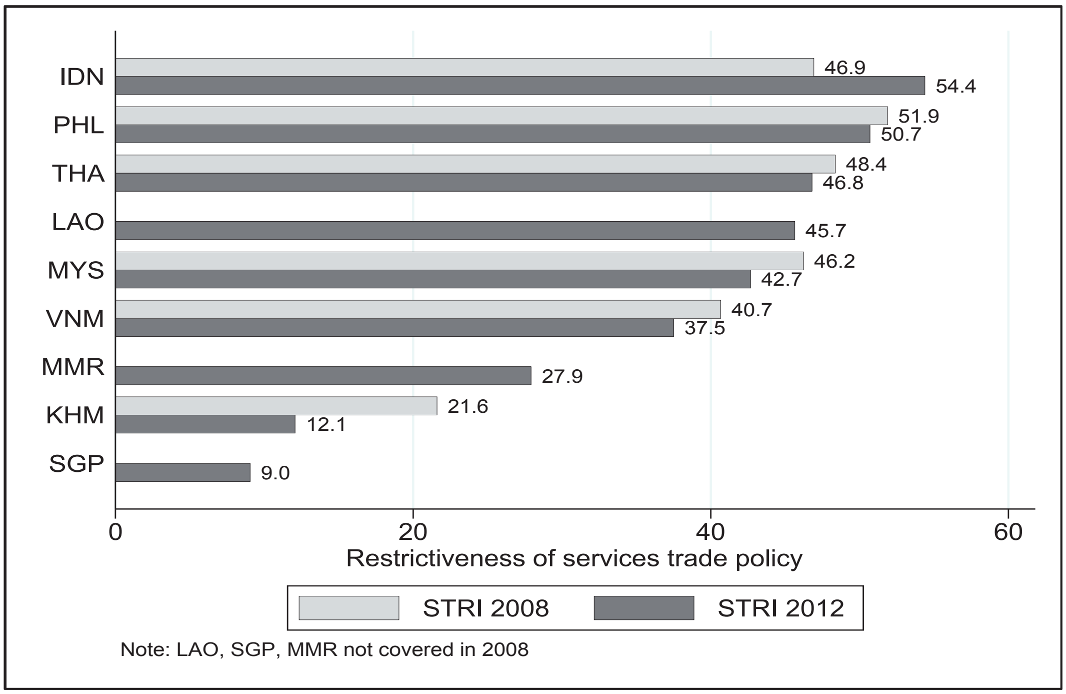
Measures	VNM	SGP	IDN	KHM	MYS	PHL	THA	MMR	LAO
No regulation	11	10	12	16	5	16	6	19	26
In practice, not prohibited	3	10	7	16	5	16	6	17	26
In practice, prohibited	8	0	5	0	0	0	0	2	0
No regulation cases by mode									
Mode 1	10	4	1	2	1	14	4	8	9
Mode 2	0	2	2	2	2	2	2	2	2
Mode 3	1	2	6	5	1	0	0	2	8
Mode 4	0	2	3	7	1	0	0	7	7

Note: Total subsector mode for the table is 46.

E. Have ASEAN Member States become More Open since 2008?

34. **As noted above, the surveys were conducted in both 2008 and 2012 for six ASEAN countries: Cambodia, Indonesia, Malaysia, the Philippines, Thailand, and Vietnam.** The data show that over this period, the policies of the six countries on average became more liberal, but the change is modest (figure 2.3). To identify the policy change, there is a need to look at the subsector mode level, because the country-level score is a weighted aggregation of subsector mode scores. For example, Indonesia's overall STRI increased by 7 points between 2008 and 2012. Even though the STRI went down in five subsector modes, it went up in three subsector modes, including in the retail sector.

Figure 2.3 ASEAN Member States Country Level STRI, 2008 and 2012



35. **The depth of liberalization of policies differs significantly across ASEAN countries.** In the Philippines, automobile and life insurance via Mode 1 were not allowed in 2008, but these services are now allowed (figure 2.4). In Thailand, cross-border bank loans, deposits, and automobile insurance were not allowed in 2008, but are now allowed without restrictions. In Cambodia, cross-border accounting and auditing services have been opened up since 2008. In Indonesia, FDI in road freight services was closed in 2008, but is now allowed subject to limitations; in contrast, FDI in retailing was open in 2008, but is now not allowed. In Vietnam, there was no restriction on cross-border maritime international shipping in 2008, but now there is a quota on bulk and liner cargo.

Figure 2.4 Changes in STRI, by Country and Subsector Mode, 2008–12

Note: "Acc1, acc3, and acc4" = accounting services via Modes 1, 3, and 4; "aud3" = auditing services via Mode 3; "auto1 and auto 3" = automobile insurance Mode 1 and 3; "aux3" = maritime auxiliary services Mode 3; "dep1" = bank deposit services Mode 1; "dom3 and dom4" = domestic legal advice via Modes 3 and 4; "fixed3" = fixed telecom via Mode 3; "int1 and int4" = international legal advice Modes 1 and 4; "life1" = life insurance via Mode 1; "loan1 and loan3" = bank loan services via Modes 1 and 3; "mob3" = mobile telecom via Mode 3; reins1 and reins3" = reinsurance services via Modes 1 and 3; "ret3" = retailing via Mode 3; "ship1 and ship3" = maritime shipping via Modes 1 and 3.

F. Is ASEAN Integrating Faster Internally?

36. **One of the goals of the survey, as described in section 2, was to identify instances where ASEAN countries treat services and services providers from their regional partners differently from those whose provenance is outside the region.** In fact, neither the law firms that collected the policy data nor the governments that verified the data could identify any meaningful instances of differential treatment. For the seven broad sectors (and relevant modes) covered by the questionnaire, for the most part the preferential policies vis-à-vis other ASEAN countries are virtually the same as nonpreferential (or most-favored-nation) policies vis-à-vis non-ASEAN countries.

37. **In professional and transport services, liberalization initiatives naturally tend to be among two or a few countries, because the regulatory framework favors reciprocal arrangements, such as recognition of qualifications and negotiation of traffic rights.** ASEAN countries have taken initiatives in both these areas, and to illustrate their impact, the intra-ASEAN openness in architectural and engineering services via Mode 4 and air transport services via Mode 1 is assessed below.

Architectural and Engineering Services via Mode 4

38. **ASEAN Mutual Recognition Arrangements (MRAs) have been developed to facilitate the movement of services professionals within the region.** Currently, there are seven MRAs in professional services: in engineering services (2005), nursing (2006), architectural (2007) surveying qualifications (2007), medical practitioners (2009), dental practitioners (2009), and a framework agreement on accountancy (2009). The Framework Agreement on Accountancy has been succeeded by the MRA on Accountancy, which was signed by the ASEAN Economic Ministers in 2014. The provisions of ASEAN MRAs for Architecture and Engineering services are compared with the MFN provisions in these sectors (table 2.7). Even though these professional services exemplify progress in regional integration, there is room to deepen integration. There are two problems: in some states, the restrictive domestic regime is still in the process of reform to align it with the relatively liberal MRAs; in other states, the liberal domestic regime is already more liberal than the MRAs.

39. **The first challenge is domestic regulatory reform to support the specific MRAs.** Passing new laws or reforming the existing domestic laws (labor law, immigration law, and professional regulation) is difficult due to the Constitutional and other legislative restrictions. For example, the Philippine Constitution (Article 17, Sec. 14) states that the practice of all professional services in the Philippines shall be limited to Filipino citizens, although there is another regulation (Philippines' Republic Act 8981) that provides exceptions when reciprocity requirements are met. Similarly, in Thailand, professional services are reserved for nationals. While Singapore has an approved list of recognized universities, it does accept architectural graduates who are not from these recognized universities, provided such graduates satisfy the relevant board that they are otherwise qualified and pass the examinations prescribed by the Board.

40. **The survey reveals that in some other respects, Member States already have quite liberal regimes for foreign licensed architects and engineers** (table 2.8). In these respects, it appears that being an ASEAN licensed professional confers no additional advantage, since the policy regime vis-à-vis all countries is already liberal. To illustrate this aspect, comparison is made of one condition of the MFN regime with the comparable condition in the MRA: work experience (table 2.9). The ASEAN MRA on architectural services requires at least 10 years of experience; but the MFN regime shows that four countries (Indonesia, Lao PDR, Myanmar, and Vietnam) do not require any work experience, and two countries (the Philippines and Malaysia) require two and five years of experience, respectively, and one country (Singapore) requires two to 10 years of experience. In engineering services, the same pattern can be observed, where the MFN regime is more relaxed than the ASEAN regime. Hence, although the MRAs are potentially an important step in the regional integration in professional services, there still appear to be

limited benefits of being registered as an ASEAN professional—a conclusion that accords with the findings of Aldaba (2013) and Hirawan and Triwidodo (2012).

Table 2.7 ASEAN Mutual Recognition Arrangement (MRA) on Architectural and Engineering Services

MRA on Architecture	MRA on Engineering
The ASEAN professional architects are eligible to apply to the ASEAN Architect Council to be registered as an ASEAN Architect when they meet the following conditions:	The ASEAN engineering professionals are eligible to apply to the ASEAN Chartered Professional Engineers Register as an ASEAN Chartered Professional Engineer when they meet the following conditions:
• **Education:** Completed an accredited architectural degree recognized by the professional architectural accreditation body whether in the Country of Origin or Host Country or assessed and recognized as having the equivalent of such a degree. The education for architects should be no less than five (5) years' duration delivered on a full-time basis in an accredited program in an accredited/validated university in the Country of Origin while allowing flexibility for equivalency.	• **Education:** Completed an accredited engineering degree/program recognized by the professional engineering accreditation body whether in the Country of Origin or Host Country or assessed and recognized as having the equivalent of such a degree.
• **Registration/License:** Obtained a current and valid professional registration or licensing certificate to practice architecture in the Country of Origin issued either by the Professional Regulatory Authority of the ASEAN Member Countries and in accordance with its policy on registration/licensing/certification of the practice of architecture or the Monitoring Committee.	• **Registration/License:** Professionals should have been assessed within their own jurisdiction as eligible for independent practice. The assessment may be undertaken by the Monitoring Committee or by the Professional Regulatory Authority within the country of origin.
• **Work Experience:** Acquired practical and diversified experience of not less than ten (10) years of continuous practice of architecture after graduation, of which at least five (5) years shall be after licensure/registration and at least two (2) years of which shall be in responsible charge of significant architectural works.	• **Work Experience:** Gained a minimum of 7 years of experience (since graduation), of which at least two (2) years shall be in responsible charge of significant engineering works.
• **Training:** Complied with the Continuing Professional Development policy of the country of Origin at a satisfactory level.	• **Training:** Complied with the Continuing Professional Development policy of the Country of Origin at a satisfactory level.
• **Ethical standard:** Obtained certification from the Professional Regulatory Authority of the Country of Origin with no record of serious violation on technical, professional, or ethical standards, local and international, for the practice of architecture.	• **Code of conduct and accountability:** Must agree to be bound by local and international codes of professional conduct.
• **Other requirements:** Complied with any other requirements agreed upon by the ASEAN Architect Council.	• **Other requirements:** Complied with any other requirements agreed upon by the ASEAN Chartered Professional Engineers.

Sources: MRA on Architecture services (2007); MRA on Engineering services (2005).

Table 2.8 Policy Summaries for Architectural Services and Engineering via Mode 4 – MFN Regime

Countries	Architectural Services via Mode 4	Engineering Services via Mode 4
Cambodia	Entry is allowed subject to meeting certain conditions: Educational and work experience requirements must be met. Foreign degrees and work experience recognized; the number of years of work experience is not available. There is a restriction on the employment of foreign employees, which is applicable to all firms. The maximum percentage of foreign employees in any firm is 10%. Exceptions may be granted. Initial stay allowed is 1 month; can be extended to 12 months.	No restrictions except 90 percent of firm employees need to be nationals.
Thailand	Not allowed.	Not allowed.
Vietnam	Must meet educational requirement; degrees from foreign countries recognized. Work experience or training not required. Professional exam in local language is required. Labor market test is required.	No restrictions except for labor market test required.
Indonesia	No sector-specific regulation governing this subsector mode. There is no additional qualification requirement. Work experience or training not required.	No sector-specific regulations governing this subsector mode. There is no additional qualification requirement. Work experience or training not required.
Philippines	Foreign citizens may be allowed to take licensure exam if he or she can meet reciprocity requirement and obtained education from universities recognized by the Government of the Philippines. Foreign nationals need a special/temporary permit from the Board of Architecture and the Professional Regulatory Committee. Must be qualified to practice architecture in his or her own country. Foreign nationals required to work with a Filipino counterpart. Work experience of 2 years is required. Labor market test (LMT) is required.	Foreign licensed professionals may be allowed to take the engineering license exams, practice, or be given a certificate of registration or be entitled to any privileges under the pertinent professional regulatory laws, provided that the country of which he or she is a citizen permits citizens of the Philippines to practice within its territorial limits under the same rules and regulations governing citizens thereof. This provision pertains to agriculture, geodetic, mechanical, metallurgical, chemical, civil, electrical, mining, naval architecture and marine, sanitary and electronic and communication engineering. LMT is required.

Table 2.8 Policy Summaries for Architectural Services and Engineering via Mode 4 – MFN Regime (continued)

Countries	Architectural Services via Mode 4	Engineering Services via Mode 4
Myanmar	No regulation or policy exists, but in practice entry is allowed. Domestic regulations are being drafted. Foreign licensed professionals can provide services automatically without additional requirement for qualification.	No regulation or policy exists, but in practice entry is allowed. Domestic regulations are being drafted. Foreign licensed professionals can provide services automatically without additional requirement for qualification.
Lao PDR	Foreign licensed professionals are qualified automatically without additional requirement. No educational, work experience and training requirement. Entry as a service supplying employees (SSE) is not allowed. The limit on the length of stay initially allowed is 4 years. Extension of stay is allowed.	Foreign licensed professionals are qualified automatically without additional requirement. No educational, work experience, or training requirement. Entry as an SSE is not allowed. The limit on the length of stay initially allowed is 4 years. Extension of stay is allowed.
Malaysia	Must reside in Malaysia not less than 180 days in a calendar year. Must be qualified in the country where he or she normally practices. Need to meet labor market test. The length of stay initially allowed is 5 years. Extensions of stay are allowed. Work experience of 5 years is required, foreign experience is recognized. Entry through (intracorporate transferees) ICT is not allowed.	Must reside in Malaysia not less than 180 days in a calendar year. Must be qualified in the country where he or she normally practices. Need to meet labor market test. The length of stay initially allowed is 5 years. Extensions of stay are allowed. Work experience of 5 years is required, foreign experience is recognized. Entry through ICT is not allowed.
Singapore	Foreign licensed professionals can provide services subject to certain conditions, (regulated by the Architects Act). Must meet educational requirement, degrees from certain countries are recognized: universities from Australia; Canada; China; England; Scotland; Wales; Ireland; Northern Ireland; France; Germany; Hong Kong SAR, China; Japan; New Zealand; the United States. Must be qualified to practice in any foreign country. Work experience (can be in any country) requirement varies from 2 to 10 years. The length of stay initially allowed is 2 years. Extension of stay is allowed.	For professional engineering services in civil, mechanical, and electrical engineering, all persons (including foreign licensed professionals) can provide services subject to certain conditions: Must be qualified and licensed to practice in Singapore as professional engineers in the above branches. Foreign degrees from certain countries are recognized (Australia; Belgium; Canada; China; France; Germany; Hong Kong SAR, China; India; Ireland; Japan; Republic of Korea; Malaysia; the Netherlands; New Zealand; South Africa; Sweden; Switzerland; Taiwan, China; the United Kingdom; the United States). Work experience of not less than 4 years (in any country) required. The length of stay initially allowed is 2 years. Extension of stay is allowed.

Source: World Bank surveys on Services Trade Integration for ASEAN countries, December 2012. Information was confirmed/reviewed by the respective government officials in May 2013.

Table 2.9 Work Experience Requirement for Architectural and Engineering via Mode 4

<table>
<tr><th>Member States</th><th>Architecture – MFN Regime</th><th>Engineering – MFN Regime</th><th>ASEAN – MRA</th></tr>
<tr><td colspan="4">If work experience is required, how many years?</td></tr>
<tr><td>Cambodia</td><td>—</td><td>—</td><td rowspan="9">Architecture
10 years of experience required, of which 5 years shall be after licensure and 2 years of which shall be in responsible charge of significant architectural work (Prov. 3.1.3, page 6, ASEAN MRA on Architectural Services).

Engineering
7 years of practical and diversified work experience (after graduation) required, of which at least 2 years is spent in responsible charge of significant engineering work (Provision 3.1.3 page 5, ASEAN MRA on Engineering Services).</td></tr>
<tr><td>Thailand</td><td>Not applicable
(entry via Mode 4 is not allowed for foreign nationals)</td><td>Not applicable
(entry via Mode 4 is not allowed for foreign nationals)</td></tr>
<tr><td>Vietnam</td><td>Not required</td><td>Not required</td></tr>
<tr><td>Indonesia</td><td>Not required</td><td>Not required</td></tr>
<tr><td>Philippines</td><td>2 years (upon having met reciprocity and labor market test (LMT) requirement)</td><td>4 years (upon having met the reciprocity and LMT requirement)</td></tr>
<tr><td>Myanmar</td><td>Not required</td><td>Not required</td></tr>
<tr><td>Lao PDR</td><td>Not required</td><td>Not required</td></tr>
<tr><td>Malaysia</td><td>5 years</td><td>5 years (experience obtained in any country is recognized)</td></tr>
<tr><td>Singapore</td><td>2–10 years</td><td>4 years is required (experience obtained in any country is recognized)</td></tr>
</table>

Sources: WB surveys on ASEAN integration (2012); ASEAN the Mutual Recognition Agreement on Architectural and Engineering Services.
Note: — = not available.

Cross-border air transport

41. **Compared to other sectors, ASEAN Member States appear to have made progress in the regional integration of their air transport markets.**[17] They have signed "multilateral" air transport agreements that are more liberal than their previous bilateral air service agreements. However, regional integration is still ongoing, since there are a number of areas that need to be further liberalized to achieve a more integrated regional air market. In fact, some Member States have moved ahead and individually concluded bilateral agreements with certain OECD countries.

42. **Most bilateral routes within ASEAN have now been liberalized by the ASEAN multilateral agreements.** The only exceptions are routes into and out of those Member States that have not fully accepted the air transport agreements, and these remain governed by Bilateral Air Services Agreements. The formal ASEAN agreements on air transport liberalization are the Multilateral Agreement on Air Services, the Multilateral Agreement for Full Liberalization of Passenger Air Services, and the Multilateral Agreement for Full Liberalization of Air Freight Services and their respective Implementing Protocols. These multilateral agreements go beyond the Bilateral Air Services Agreements in two important aspects: the agreements allow third, fourth, and fifth freedom rights for air carriers between designated secondary

[17] This Section and Annex Section 2 are based on the insightful study by Tan (2013).

cities and all capital cities of ASEAN Member States;[18] instead of substantial ownership and control by the nationals, the “community carrier” concept is in principle allowed. This means an airline can be substantially owned and effectively controlled by ASEAN interests taken cumulatively or in the aggregate (Tan 2009). This provision allows airlines to attract capital infusions and management expertise from multiple sources within ASEAN.

43. **However, there is still room for deepening regional integration in certain key respects.** To achieve a more integrated aviation market, ASEAN Member States need to consider further liberalization, such as the seventh freedom (the right to fly between two ASEAN countries while not offering flights to one’s own country), the eighth freedom (the right to fly between two or more airports within an ASEAN country while continuing service to one’s own country), and the ninth freedom (the right to fly inside an ASEAN country without continuing service to one’s own country) for the ASEAN Member States to consider. A single aviation market such as that which exists in the European Union liberalizes such operations fully and allows market competition throughout the region. It seems, however, that domestic carriage remains sensitive for large ASEAN countries with a large domestic population where, as elsewhere, such operations are reserved exclusively for local players.

44. **As far as ownership and control is concerned, although in theory a “community carrier” is allowed to operate, in practice, there is still room for progress.** It is not obvious whether the “community carrier” can fly into all Member States in the region, since the Member States still need to provide approval before the carrier can operate. However, if a specific number of Member States declare their unequivocal approval for such a model, it can encourage investors to establish such an airline. For now, investors comply with the traditional “substantial ownership and effective control of nationals” rule.

45. **Finally, even though the agreements are in force among most ASEAN Member States, there are states where there remains room to improve the scope of the agreements.** Indonesia’s position on the ASEAN agreements can be traced to its leading carriers’ lobbying of their government to continue protecting their international operations against those of rival airlines from neighbouring ASEAN states. Through their industry group, the Indonesian National Air Carriers Association, the major carriers have traditionally opposed efforts to open up the ASEAN air travel market. The Philippines’ reluctance is related to the limited airport slots and infrastructural constraints.

46. **However, there are several factors that may provide the momentum to achieve more beyond 2015.** First is the growing confidence of Indonesian carriers such as Garuda and Lion Air. As these airlines expand their services and increase their competitiveness and appeal to passengers, there may come a time when they feel more secure and see less of a need to resist greater liberalization. Second, there is the pressure created by the provincial governments, tourism authorities, and business community to allow greater direct access into secondary cities. Third, there are the obligations created by the agreements with larger countries such as China. The Member States recognize that the consolidation as a single market agreement internally could help in negotiations with large countries like China. Fourth, innovative airlines have sought to get around the restrictions, including those that are cast in the bilateral and multilateral agreements. One example is how AirAsia pioneered the cross-border joint venture model—while still imperfect, it allows

[18] The freedoms of the air are described in ICAO (2004) as the following: *first* is the right to fly over a foreign country, without landing there; *second* is the right to refuel or carry out maintenance in a foreign country on the way to another country; *third* is the right to fly from one’s own country to another; *fourth* is the right to fly from another country to one’s own; *fifth* is the right to fly between two foreign countries during flights while the flight originates or ends in one’s own country; *sixth* is the right to fly from a foreign country to another one while stopping in one’s own country for nontechnical reasons; *seventh* is the right to fly between two foreign countries while not offering flights to one’s own country; *eighth* is the right to fly between two or more airports in a foreign country while continuing service to one’s own country; ninth is the right to fly inside a foreign country without continuing service to one’s own country.

AirAsia to get around the "seventh freedom" prohibition and to operate region-wide from multiple hubs using a common, well-recognized brand.

47. **Recent research by Tan (2013) suggests that some ASEAN Member States have more liberal air services agreements with third parties than among themselves.** With the United States, Brunei Darussalam, Indonesia, Lao PDR, Malaysia, Singapore, and Thailand have "open skies" agreements that allow, at a minimum, unlimited third and fourth freedom capacity. Moreover, Singapore and Brunei Darussalam have gone further with the United States in that they are state parties to the APEC-sponsored Multilateral Agreement on the Liberalization of International Air Transportation (MALIAT) and the Protocol of the agreement.[19] The MALIAT Agreement provides for unlimited third, fourth, *and* fifth freedom rights among the state parties and replaces the traditional "substantial ownership and effective control" requirement with a more progressive "principal place of business and incorporation and effective control" clause. Brunei Darussalam and Singapore are also parties of the MALIAT Protocol, which goes further in providing for the exchange of seventh freedom and cabotage rights.

48. **In addition, several ASEAN Member States have entered into "horizontal" agreements with the European Community that recognize the right of all EU carriers to operate between any EU point and the state concerned.**[20] As of October 2013, four ASEAN Member States—Indonesia Malaysia, Singapore, and Vietnam—have entered into horizontal agreements with the European Community, and their individual bilateral agreements with the EU members do go much further. For instance, Singapore has had an agreement with the United Kingdom since 2007 that provides for unlimited third, fourth, and fifth freedom capacity *and* even seventh freedom and domestic carriage rights for both carriers on both sides. In June 2013, Malaysia adopted a new agreement with the United Kingdom containing similar rights. Annex 2.2 discusses in greater detail the ASEAN multilateral air transport agreements and reasons why some Member States have remained reluctant to liberalize the domestic air market.

G. Regional and Multilateral Commitments and Goals

49. **Having examined applied policies, three sets of comparisons can now be made—**between regional commitments and goals, and actual policy; between multilateral commitments and offers, and actual policy; and between the regional and multilateral dimensions.

The regional dimension

50. **The ASEAN Framework Agreement on Services (AFAS), signed in 1995, is one of the first regional trade agreements in services.** AFAS is closely related to the General Agreement on Trade in Services (GATS) and follows its main principles, disciplines, and approach to liberalization. It contains liberalization commitments that aim to reduce restrictions to services trade between ASEAN Member States, and calls for liberalization of services trade through successive rounds of negotiations of sector-specific commitments. Since 1995, numerous packages of AFAS commitments have been concluded and signed by ASEAN Member States. Most recently the Protocol to Implement the Sixth Package of Financial Services Commitments was signed in March 2015 by the ASEAN Finance Ministers while the signing of the Protocol to Implement the Eight Package of Commitments on Air Transport Services was completed in November 2014. These negotiations have thus resulted in eight packages of commitments in a wide range of service sectors under the purview of ASEAN Economic Ministers, six packages of commitments in financial services, and eight packages of commitments in air transport.

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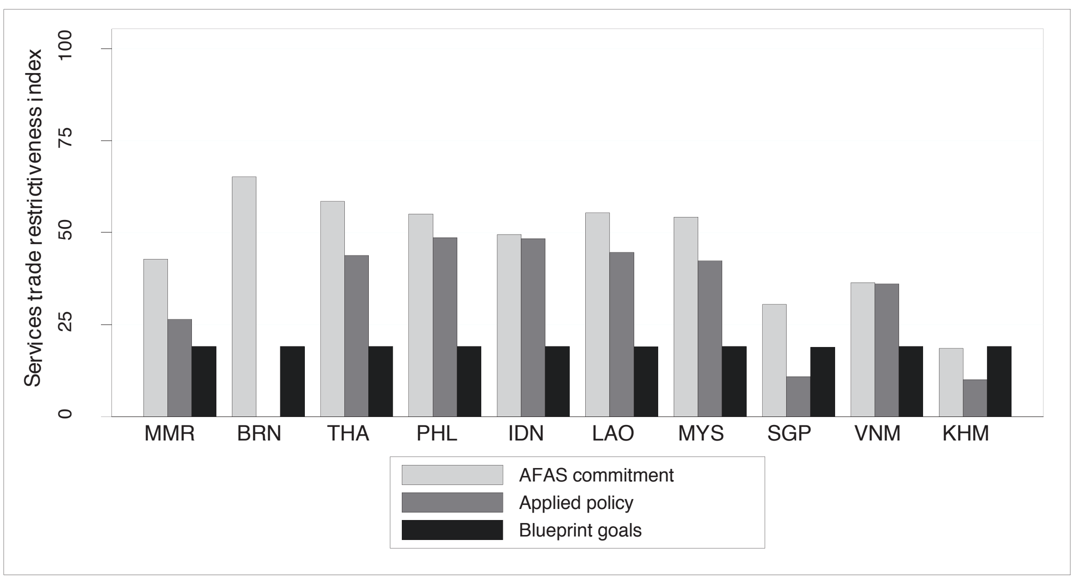
[19] The other parties to MALIAT are Chile, the Cook Islands, New Zealand, Samoa, and Tonga.
[20] These horizontal agreements do not alter the capacity provided for in the existing bilateral agreements.

51. **The ASEAN Economic Community (AEC) Blueprint was adopted in 2007 to further liberalize services trade among ASEAN Member States and create a free trade area in services trade by 2015.** The Blueprint aims to remove substantially all restrictions on trade in services for the four priority service sectors—air transport, e-ASEAN, health care, and tourism—by 2010, and the fifth priority service sector, logistics services, by 2013; remove substantially all restrictions on trade in services for all other service sectors by 2015; and undertake liberalization through consecutive rounds every two years until 2015, that is, 2008, 2010, 2012, 2014, and 2015.

52. **In addition, the Blueprint goals establish specific liberalization parameters for the sectors.** In all sectors, there would be no restrictions for Modes 1 and 2, with exceptions for bona fide regulatory reasons (such as public safety), which are subject to agreement by all Member States on a case-by-case basis. For the four priority service sectors, foreign (ASEAN) equity participation would be allowed of not less than 51 percent by 2008 and 70 percent by 2010, and for logistics services not less than 49 percent by 2008, 51 percent by 2010, and 70 percent by 2013. For the other service sectors, the equity participation thresholds were not less than 49 percent by 2008, 51 percent by 2010, and 70 percent by 2015. ASEAN also agreed to progressively remove other Mode 3 market access limitations by 2015.

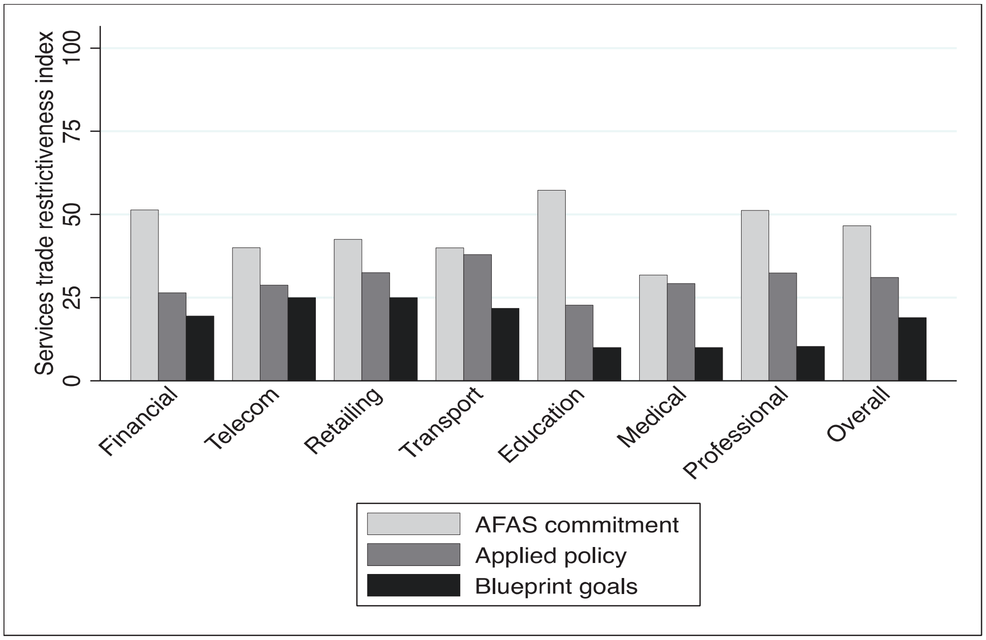
53. **It is evident from table 2.10 (and figure 2.5) that all ASEAN member countries' applied policies are more liberal than their AFAS commitments (through the Eighth Package), though the size of the gap varies across countries and sectors.** Indonesia and Vietnam are examples of countries where the gap is modest, whereas Cambodia, Myanmar, and Singapore have policies that are more open than their commitments. In terms of sectors, table 2.11 (and figure 2.6) shows that gaps in financial (especially banking) and education services with the STRI of commitments are more than twice the level of applied policy, and negligible in transport and medical services.

Figure 2.5 AFAS Commitments through the Eighth Package, Applied Policy, and Blueprint Goals, by Country



Note: Applied policy information for Brunei is missing.

Figure 2.6 AFAS Commitments, Applied Policy, and Blueprint Goals by Industry



Note: More disaggregated scores are provided in Annex figure 2.A.1

54. **Table 2.12 provides a more textured comparison, drawing upon the restrictions on entry and ownership in fixed-line telecommunications services.** Myanmar and Singapore already apply no restrictions on entry and ownership, and are ahead of the Blueprint goals for 2015 (which allows foreign equity limits greater than 70 percent). In contrast, Indonesia, Malaysia, and the Philippines are examples of countries in which the foreign equity limit is below that of the Blueprint goals.

55. **On the whole, evidence shows that in most ASEAN countries there is still room to narrow the gap between applied policy and Blueprint 2015 (the average gap is about 20 STRI points).** The two notable exceptions are Singapore and Cambodia; STRIs of their applied policies are on average lower than those of the Blueprint goals. In terms of sectors, applied policies are close to goals in financial, telecommunication, and retail services, but there is still room to achieve the goals in other sectors.

The multilateral dimension

56. **Two things are immediately evident from tables 2.10 and 2.11 (and figure 2.7 and 2.8).** First, the differences in the offers submitted during the course of the WTO's unfinished Doha negotiations by most ASEAN countries and the Uruguay Round commitments remain modest (the offers improve on commitments on only two STRI points). To be fair, more far-reaching offers would probably have been put forward if services negotiations had reached a more conclusive stage. Second, in most cases, both WTO commitments and offers bear no relationship to applied policies, which are significantly more liberal, with the starkest gaps in the case of Myanmar and Singapore. In fixed-line telecommunications, for example, table 2.3 shows that Singapore, which has an open market, limits direct and indirect foreign investment to 73.99 percent in both its GATS commitments and Doha offer, whereas Myanmar, with a similarly open market, has made neither commitments nor an offer. There are, however, two exceptions: Cambodia and Vietnam, both of which made far-reaching commitments during their WTO accession negotiations. Lao PDR's accession negotiations do not seem to have led to bindings that are as close to applied policies.

Figure 2.7 GATS Commitments Up To the Eighth Package, Doha Offers, and Applied Policy, by Country

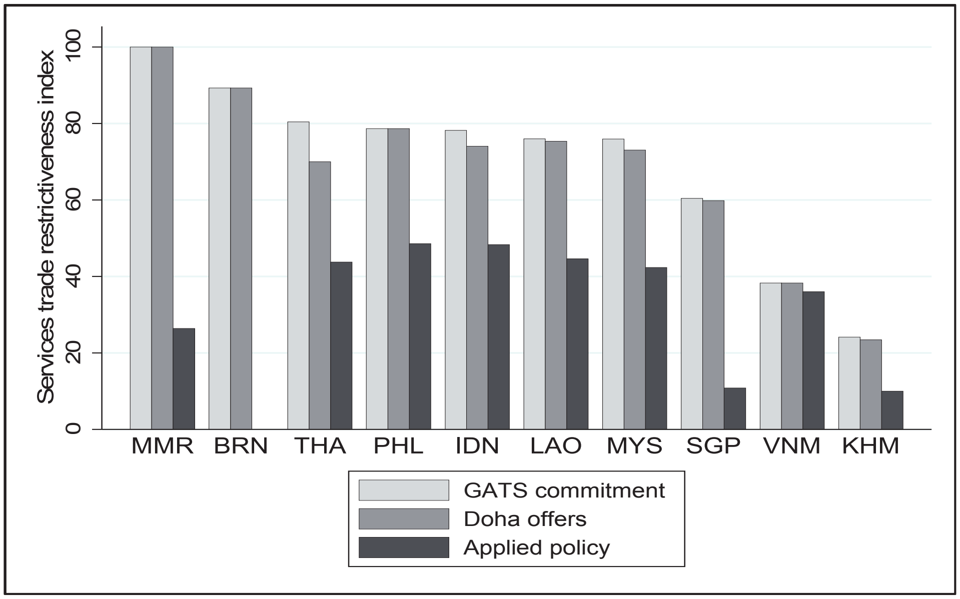
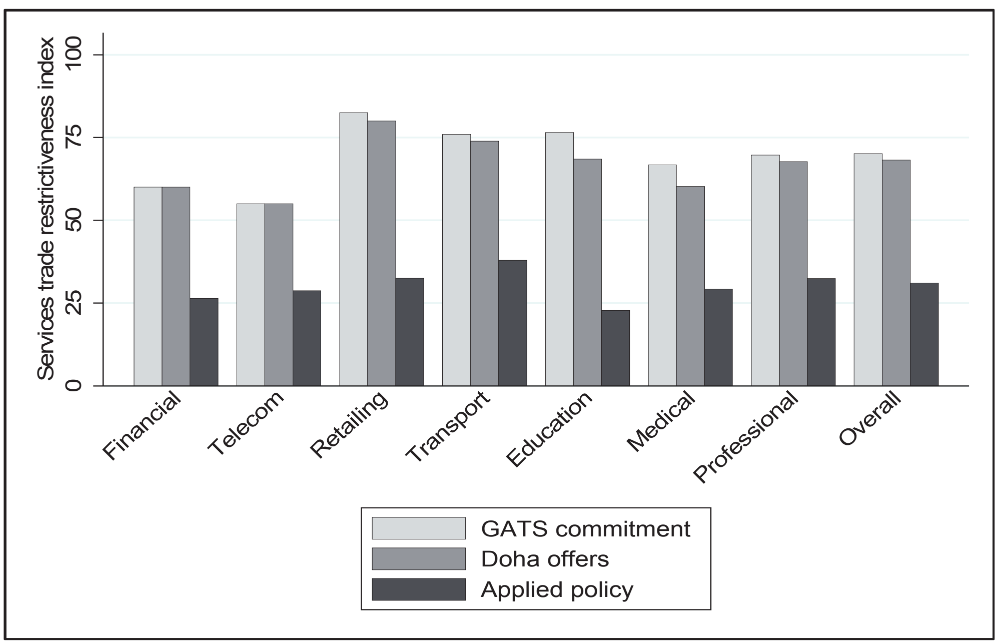


Figure 2.8 GATS Commitments, Doha Offers, and Applied Policy, by Industry



Note: More disaggregated scores are provided in Annex figure A.2.3.

Comparing regional and multilateral dimensions

57. **To summarize, the GATS commitments and Doha offers of ASEAN countries are far more restrictive than their AFAS commitments (with a gap of about 23 STRI points).** Thus, there is no doubt that the countries—especially Myanmar—have displayed a far greater willingness to widen and deepen their legal bindings in the regional than in the multilateral context. The two exceptions are again the recently acceding countries, Cambodia and Vietnam, whose WTO and AFAS commitments share some similarities. But the STRI of the ASEAN countries' AFAS commitments remains higher than that of applied policies, as seen above. And the gap between applied policy and Blueprint 2015 is about 20 STRI points.

Table 2.10 Restrictiveness of GATS Commitments, Doha Offers, AFAS Commitments, Applied Policy, and Blueprint Goals, by Country

Country	Restrictiveness of GATS Commitments	Restrictiveness of Doha Offers	Restrictiveness of AFAS Commitments	Restrictiveness of Applied Policy	Restrictiveness of Blueprint Goals
Brunei Darussalam	89.3	89.3	65.2	No data	19.1
Indonesia	78.2	74.0	49.5	48.3	19.1
Cambodia	24.1	23.4	18.5	10.0	19.1
Lao PDR	76.0	75.3	55.3	44.6	19.1
Myanmar	100.0	100.0	42.8	26.4	19.1
Malaysia	76.0	73.1	54.2	42.3	19.1
Philippines	78.7	78.7	55.0	48.6	19.1
Singapore	60.4	59.8	30.5	10.8	19.1
Thailand	80.4	70.0	58.5	43.8	19.1
Vietnam	38.3	38.3	36.4	36.0	19.1

Table 2.11 Restrictiveness of GATS Commitments, Doha Offers, AFAS Commitments Up To the Eighth Package, Applied Policies, and Blueprint Goals, by Sector

STRI, by Sector	Restrictiveness of GATS Commitments	Restrictiveness of Doha Offers	Restrictiveness of AFAS Commitments	Restrictiveness of Applied Policy	Restrictiveness of Blueprint 2015 Goals
Overall	**70.1**	**68.2**	**46.6**	**31.1**	**19.0**
Financial	**60.0**	**60.0**	**51.3**	**26.4**	**19.5**
Banking	64.6	64.6	59.0	24.6	21.3
Insurance	52.8	52.8	39.3	29.3	16.7
Telecom	**55.0**	**55.0**	**40.0**	**28.8**	**25.0**
Retailing	**82.5**	**80.0**	**42.5**	**32.5**	**25.0**
Transport	**75.9**	**73.9**	**40.0**	**37.9**	**21.8**
Maritime shipping	59.7	55.8	18.3	25.6	7.5
Maritime auxiliary	72.2	66.7	35.0	33.3	25.0
Road	77.5	77.5	45.0	37.5	25.0
Rail	92.5	92.5	70.0	59.4	25.0
Education	**76.5**	**68.5**	**57.3**	**22.8**	**10.0**
Medical	**66.8**	**60.3**	**31.8**	**29.3**	**10.0**
Professional	**69.7**	**67.7**	**51.2**	**32.4**	**10.4**
Accounting	73.0	73.0	49.0	27.0	10.0
Auditing	68.0	68.0	44.0	37.0	10.0
Legal advice domestic	91.3	91.3	90.0	53.8	12.5
Legal advice foreign	73.0	69.0	76.0	33.0	10.0
Engineering	60.0	57.0	32.5	28.0	10.0
Architecture	61.5	58.5	40.0	30.0	10.0
Management consulting	61.0	57.0	27.0	18.0	10.0

Table 2.12 Comparing Multilateral and Regional Commitments with Applied Policies: Restrictions on Entry and Ownership (Mode 3) in the Fixed Telecommunications Sectors

Country	GATS Commitments	Doha Offers	ASEAN Framework Agreement on Services (AFAS Eighth Package)	Blueprint 2015	Applied Policy (as of 2012), Reviewed by Government
Brunei	Subject to licensing by the appropriate regulatory authority and Companies Act. Local public switched voice telephone services are provided exclusively by Jabatan Telekom Brunei (JTB), a government department. International services: Exclusive monopoly until 2010, then, the government will review policy and decide whether to permit additional suppliers.	Offer is similar to GATS commitment.	Subject to licensing by the appropriate regulatory authority and Companies Act.	By 2015, allow for foreign (ASEAN) equity participation of not less than 70%. Progressively remove other Mode 3 market access limitations by 2015.	Data not available.
Cambodia	Provided exclusively by Telecom Cambodia until January 2009. Thereafter, no restrictions except a requirement that local shareholding of up to 49% is applicable.	Did not submit an offer.	No restrictions, except subject to requirement for local shareholding of up to 49%.	By 2015, allow for foreign (ASEAN) equity participation of not less than 70%.	No restrictions, except when acquiring a state-owned entity, the foreign equity limit is 49%.
Indonesia	Local services: Provided exclusively by PT Telecom until 2011. International: Provided exclusively by duopoly, expires 2005. Foreign equity limit is 35% and must be in form of a joint venture. At the end of each period, government decides whether to permit additional suppliers.	Offer is similar to GATS commitment.	Only through joint venture with local private sector. Foreign equity limit is 49%.	By 2015, allow for foreign (ASEAN) equity participation of not less than 70%.	There are no restrictions except foreign ownership limit is 49%.
Lao PDR	Only through acquisition of existing operators, and foreign equity participation limit is 49% for 5 years after the date of accession. Thereafter, commercial presence is allowed, with foreign equity limit of 60%.	Did not submit an offer.	Local and national long-distance services can be supplied only on a facilities basis for public use. 100% foreign owned or joint venture enterprise is allowed.	By 2015, allow for foreign (ASEAN) equity participation of not less than 70%.	Foreign ownership limit in a state-owned entity is 49.9%.

Table 2.12 Comparing Multilateral and Regional Commitments with Applied Policies: Restrictions on Entry and Ownership (Mode 3) in the Fixed Telecommunications Sectors (continued)

Country	GATS Commitments	Doha Offers	ASEAN Framework Agreement on Services (AFAS Eighth Package)	Blueprint 2015	Applied Policy (as of 2012), Reviewed by Government
Malaysia	Entry allowed only through acquisition. Foreign equity limit is 30%.	With respect to network facilities and services provider: only through acquisition and foreign equity limit is 30%. The management must be controlled by Malaysians. For Telekom Malaysia, the foreign equity limit is 30% in aggregate with no single country holding more than 5% of the equity at any one time.	Only through acquisition of shares of existing licensed public telecommunications operators, foreign equity participation limited to 51% in such providers.	By 2015, allow for foreign (ASEAN) equity participation of not less than 70%.	Entry is possible only through acquisition (no new license is allowed). The foreign equity limit is 49%.
Myanmar	No commitment.	Did not submit an offer.	No commitment.	By 2015, allow for foreign (ASEAN) equity participation of not less than 70%. Progressively remove other Mode 3 market access limitations by 2015.	Foreign Investment Law (2012) allows commercial presence of foreign service suppliers. No restrictions on the foreign equity participation.
Philippines	Franchise from the Congress and Certificate of Public Convenience and Necessity from the National Telecommunications Commission required. Foreign equity limit is 40%. All executives and managers must be citizens and limit on the share of foreigners in BOD is 40%.	Offer is similar to GATS commitment.	Entry is subject to the following requirements and conditions: 1. Franchise from Congress of the Philippines, 2. Certificate of Public Convenience and Necessity from National Telecommunications Commission, and 3. Foreign equity permitted up to 40%. 4. Resale of private leased line is not allowed.	By 2015, allow for foreign (ASEAN) equity participation of not less than 70%.	Entry as a branch or acquisition of state-owned entity is not allowed. Foreign ownership limit is 40%. Nationality requirement for board of directors is 60%.

Table 2.12 Comparing Multilateral and Regional Commitments with Applied Policies: Restrictions on Entry and Ownership (Mode 3) in the Fixed Telecommunications Sectors (continued)

Country	GATS Commitments	Doha Offers	ASEAN Framework Agreement on Services (AFAS Eighth Package)	Blueprint 2015	Applied Policy (as of 2012), Reviewed by Government
Singapore	Up to two additional operators will be licensed in 1998 for the provision of these services commencing April 1, 2000. Thereafter, additional licenses will be granted. A cumulative total 73.99% foreign shareholding, based on 49% direct investment and 24.99% indirect investment in these operators is allowed.	A cumulative total 73.99% foreign shareholding, based on 49% direct investment and 24.99% indirect investment is allowed.	A cumulative total of 73.99% foreign shareholding, based on 49% direct investment and 24.99% indirect investment is allowed.	By 2015, allow for foreign (ASEAN) equity participation of not less than 70%.	No restriction on foreign ownership, there shall be at least except that at least one member of the Board of Director shall be Resident in Singapore.
Thailand	Must be locally incorporated. Foreign equity limit is 20% of the registered capital. Due to scarce resources, the number of licenses may be limited. Since 2006, new commitments will be introduced, conditional on new communications acts.	Offers reflect commitment, except: Starting in 2006, new commitments will be made, as the Thai Communications Acts are being revised.	Facilities-based: Foreign equity limit is 25%. Number of licenses may be limited. Head office and management must be in Thai territory.	By 2015, allow for foreign (ASEAN) equity participation of not less than 70%.	Foreign-majority-owned or controlled providers may only offer services on a resale basis, and such offerings are limited to certain defined services. No other restrictions.
Vietnam	Facilities-based: Upon accession, joint ventures with telecom service suppliers duly licensed in Vietnam will be allowed. Foreign equity limit is 49%. Non-facilities based: Upon accession, joint venture with telecom service suppliers duly licensed in Vietnam with foreign equity limit of 51% is allowed.	Did not submit an offer.	None; services must be offered through commercial arrangements with an entity established in Vietnam and licensed to provide international telecommunication services.	By 2015, allow for foreign (ASEAN) equity participation of not less than 70%.	Foreign equity limit is 70% (including facilities-based services). Approval required for majority control. The State of Vietnam holds dominant shares in telecommunications service providers with network infrastructure.

Sources: Uruguay round commitments, accession schedules, and Doha round offers are from the WTO website. ASEAN Framework Agreement on Services (AFAS): Eighth Package of Schedules; Financial Services, 5th Package of Schedules; and ASEAN Economic Community Blueprint, January 2008.

H. Conclusion

58. **This chapter presented and analyzed a rich body of applied policy information on ASEAN Member States.** Four gaps in data limit the scope of the present analysis and should be the focus of future data collection and research. First, there are inadequate data on the existing market structure—for example, the number of firms, their market share, and ownership—across sectors and countries, which means that policy measures analyzed capture the restrictions on entry into markets but do not capture the prevailing extent of competition between domestic and/or foreign firms. Second, good data are unavailable on outcome variables such as prices, quality, or diversity of services, which makes it hard to infer the restrictiveness of policies by econometrically analyzing their impact on outcome variables of interest. Third, thus only limited information can be captured on the state of prudential and procompetitive regulation, which makes it difficult to assess how nondiscriminatory measures offer de facto protection to domestic service providers. More important, this gap makes it difficult to assess how the gains from market opening depend on the state of complementary regulation, and it is worth emphasizing in this context that a mechanical elimination of trade barriers with inadequate complementary reform of regulation is not necessarily desirable. Finally, limited information on the implementation of policies can be captured. For instance, while an effort is made to identify certain aspects of the processes involved in licensing services providers, such as transparency and accountability, the process remains opaque, and it is difficult to determine the extent to which the processes in themselves offer protection to domestic providers. In some cases, the absence of laws and regulations makes it a challenge to assess actual practice, and thus to determine whether a de jure vacuum signifies de facto openness or prohibition.

59. **Despite these limitations, some clear conclusions can be reached.** First, the ASEAN Member States have an average STRI higher than that of the most other regions, and the pace of recent reform has been gradual. Furthermore, with regard to the explicit restrictions, there is little sign of preferential treatment of any ASEAN Member State of other Member States. While the absence of preferences is not a problem, the absence of reform is. Member States will need to reduce the remaining explicit barriers to foreign entry and ownership—ideally on an MFN basis—to achieve the Blueprint Goals by 2015.

60. **Second, regionalism offers a potentially valuable avenue for liberalization in areas where multilateral cooperation is difficult, such as in professional services and transportation.** ASEAN Member States made some progress in deepening regional integration in these areas, and the efforts continue. There remains room for ASEAN Member States to reform domestic regulations in professional services to better align them with the MRA provisions. In air transport, there is opportunity to further liberalize the freedom of rights by allowing seventh freedom and eventually even cabotage, and making the community ownership of designated airlines automatic.

61. **Third, successful liberalization requires supporting reform of domestic regulation, ranging from prudential regulation in financial and professional services to procompetitive regulation in telecommunication and transport services.** In these areas, too, there is scope for regional coordination and cooperation, to reap economies of scale in regulation and to prevent the fragmentation of the regional market because of divergent national regulation (Mattoo and Sauvé 2011).

62. **Finally, the reform process needs to be monitored, transparent, and informed by sound analysis.** For all these reasons, ASEAN Member States may consider how to remedy the shortcomings in the current state of data identified above. In particular, it will require effort to collect better data on the implementation of reform in all dimensions—ranging from liberalization to improvement in regulation—as well as the consequences of reform for market structures and market outcomes—relating to the prices, quality, diversity, and access to services. Such data would facilitate analysis of both the gains from reform and design of reform, which could make future reform socially desirable and politically feasible.

Annex 2.A Measuring Services Trade Policy, STRI

1. **The policy information in this study was obtained through two surveys in 2008 and 2012.** The 2008 survey covered six ASEAN countries and the 2012 survey covered 9 ASEAN countries. The three new ones were Myanmar, Singapore and Lao PDR. Table 2.A.1 describes the sectors and modes covered by the two surveys.[21]

Table 2.A.1 Sector and Modal Weighting Schemes Used for Constructing STRIs

Aggregate Sectors	Subsectors, by Mode of Supply	Modal Weights $w_m^{(j)}$	Sector Weights w_j
Banking	Mode 1: (1) Deposit acceptance (2) Bank lending	 0.15 0.15	0.149
	Mode 3: (3) Deposit acceptance (4) Bank lending	 0.85 0.85	
Insurance	Mode 1: (5) Life (6) Automobile (7) Reinsurance	 0.10 0.10 0.80	0.095
	Mode 3: (8) Life (9) Automobile (10) Reinsurance	 0.90 0.90 0.20	
Telecommunications	Mode 3: (11) Fixed-line (12) Mobile	 1.00 1.00	0.095
Retailing	Mode 3: (13) Retail distribution	 1.00	0.239
Transportation	Mode 1: (14) Air passenger international (15) International shipping	 0.70 0.70	0.223 (0.037) (0.037)

[21] The Brunei survey was delayed because there is inadequate information on its policies.

Table 2.A.1 Sector and Modal Weighting Schemes Used for Constructing STRIs (continued)

	Mode 3: (16) Air passenger international (17) Air passenger domestic (18) International shipping	0.30 0.30 0.30	
	(19) Maritime auxiliary (20) Road freight (21) Rail freight	1.00 1.00 1.00	(0.050) (0.062) (0.037)
Professional Services	Mode 1: (22) Accounting (23) Auditing (24) International law (25) Architecture (26) Engineering (27) Management consulting	 0.20 0.20 0.20 0.20 0.20 0.20	0.199
	Mode 3: (28) Accounting (29) Auditing (30) Domestic law (31) International law (32) Architecture (33) Engineering	 0.40 0.40 0.50 0.40 0.40 0.40	
	(34) Management consulting Mode 4: (35) Accounting (36) Auditing (37) Domestic law (38) International law (39) Architecture (40) Engineering (cc) Management consulting	0.40 0.40 0.40 0.50 0.40 0.40 0.40 0.40	
Education	Mode 1: Higher education Mode 2: Higher education Mode 3: Higher education Mode 4: Higher education	 0.15 0.15 0.40 0.30	

Table 2.A.1 Sector and Modal Weighting Schemes Used for Constructing STRIs (continued)

Health	Mode 1: Medical and dental services Mode 2: Medical and dental services Mode 3: Medical and dental services Mode 4: Medical and dental services	 0.15 0.15 0.40 0.30	

Note: The sector weights are used for constructing country STRIs. There are no sector weights reported for education and health services, because these sectors were not covered in 2008 surveys, and for comparison with 2008 country-level STRIs, the 2012 country-level STRIs do not aggregate STRIs for education and health. The STRIs for midwife and physical therapist services via Mode 4 were aggregated with medical dental services via Mode 4, with equal weights.

2. **It is notoriously difficult to measure policies affecting services trade because of their variety and complexity** (see, for example, the overview by Deardoff and Stern [2008]). Here, a measure of the restrictiveness of a country's policy regime, the Services Trade Restrictions Index (STRI) is developed, which has the weakness of being subjective but the virtue of being simple, transparent, and robust. This measure is most convenient to depict overall patterns in policy, across countries, modes, and sectors. It builds on a relatively long tradition of restrictiveness indexes, ranging from simple counts of policy barriers (Hoekman 1996) to more complex weighted averages, where weights reflect prior (usually subjective) assessments of the relative restrictiveness of specific policy barriers; work currently being undertaken at the OECD[22] uses an elaborate version of this method, which is described in OECD (2009a).

3. **A single measure of overall openness for any subsector mode combination is constructed; for example, one for the cross-border supply of bank loans and another for accepting bank deposits by establishing a commercial presence abroad.** This measure avoids the pitfalls of the approaches that assign fixed weights to all types of restrictions (entry, operational, regulatory) and that treat the restrictions as additive. For instance, if foreign suppliers are not allowed to enter in the first place, then that restriction is binding and other restrictions on operations and regulatory environment simply do not matter. Similarly, a foreign equity limit of 49 percent already precludes foreign corporate control, and so adding to it a further (frequently encountered) requirement that the majority of boards of directors be nationals would amount to double counting.

4. **Essentially, policy regimes are assessed in their entirety and assigned into five broad categories:** completely open, that is, no restrictions at all[23]; completely closed, that is, no entry allowed at all; virtually open but with minor restrictions; virtually closed but with very limited opportunities to enter and operate; and a final residual "intermediate" category of regimes that allow entry and operations but impose restrictions that are neither trivial nor stringent. Table 2.A.2 presents the five principal categories and illustrates what portfolio of policies might underpin the restrictiveness scores.

[22] Further information about the OECD's work in this area, which focuses on member economies, can be found at http://www.oecd.org/trade/stri, and is described in OECD (2011). The ability of their index to capture trade costs in services is explored in OECD (2009b).
[23] "No restrictions at all" applies only to the measures covered for a subsector mode; it does not mean there are no other restrictions that are not covered.

Table 2.A.2 How STRI Scores Are Assigned

Overall Policy Description	**5-Point Scale**	**Policy Summary Examples for ASEAN Member States**
Open without restrictions	0	**Cambodia: Retail bank loan – Mode 1** "No restrictions."
Virtually open	0.25	**Vietnam: Life insurance – Mode 3** "Entry as a branch is not allowed. No restrictions on foreign ownership in greenfield subsidiary or acquisition of existing entity."
Existence of major/nontrivial restrictions	0.50	**Thailand: Air passenger domestic – Mode 3** "The limit on foreign ownership is 49 percent, with effective control by Thai nationals. At least 40% of Board of Directors must be national."
Virtually closed	0.75	**Malaysia: Reinsurance – Mode 1** "Reinsurance companies must demonstrate domestic unavailability in both Malaysia and Labuan before obtaining services abroad."
Completely closed	1	**Philippines: Architecture services – Mode 3** "Commercial presence is not allowed."

Note: As is apparent from the examples shown, most subsector mode combinations are characterized by multiple provisions, in which case the regime assignment reflects the overall restrictiveness of all applicable measures.

5. **Since the principal criterion for covering certain policy measures in the database is their potential to significantly affect services trade, most measures in the database are taken into account in determining the STRI.** There are, however, some exceptions. First, there is a de minimis threshold in the sense that while some variables clearly add to the rich texture of the database, their restrictive impact is either not clear or small relative to the impact of other variables already considered. For instance, the failure to give advance notice prior to introducing regulatory changes is not penalized; or, when there are already restrictions on greenfield investment and acquisitions, additional restrictions on forming joint ventures are also not penalized. A variable may be more important in one sector, but its impact may fall below the de minimis threshold in others. For instance, restrictions on entry as a branch matter in financial services, but do not in other sectors where local incorporation is the preferred mode of establishing commercial presence; similarly restrictions on acquiring state-owned firms matter in the transportation and telecommunications sectors, where there are likely to be state-owned incumbents, but not in professional and retail services. Finally, a few variables for which the response rate was low or inconsistent, for example, license length or license allocation mode, were not considered for scoring, as cross-country differences would reflect response rates or interpretation differences rather than differences in restrictiveness.

6. **It is convenient to assign a value to each of these five categories of regimes on an openness scale from 0 to 1 with intervals of 0.25.**[24] The resulting score is called a Services Trade Restrictions Index (STRI). As the examples in table 2.A.2 show, most policy regimes have more than one provision in place per subsector and mode of supply, in which case the assigned score (shown in the right-most column) reflects the overall restrictiveness of all measures evaluated simultaneously.[25] Since the STRI focuses

[24] At this level, basic STRI scores are no more than "labels" attached to the five ordered categories of restrictiveness. However, as soon as these scores are further processed, either by aggregation or by use in a quantitative model, the specific values assume a cardinal meaning that implies the five categories are "equidistant" in terms of restrictiveness. The working paper version of this article (Borchert, Gootiiz, and Mattoo 2012b) discusses an alternative approach of ranking policy bundles purely ordinally.

[25] The Database Guide (Borchert, Gootiiz and Mattoo, 2012a) contains in its Section 4 three examples—from Burundi, Thailand, and India—that illustrate how a portfolio of several measures is being assigned to one of the five basic

mainly on the set of measures which discriminate against foreign services and providers, the greatest level of openness is associated with a value of zero. However, since the STRI does not adequately cover complementary areas of nondiscriminatory prudential and procompetitive regulation, and since it is likely that the results of liberalization depend on the state of these types of complementary regulation, it cannot be said that a zero level of STRI is necessarily immediately desirable from a broader welfare or development perspective.

7. **Once a score has been attached to each regime, STRI values can be aggregated across sectors and modes of supply.** Let s_{jmc} denote the basic scores on a five-point scale per subsector and mode of supply, as described in table 2.A.1 In order to arrive at an aggregate STRI of country *c*, $STRI_c$, weighted averages across modes of supply $m \in M$ are taken, whereby the set of modal weights $w_m^{(j)}$ is specific to sector *j*. The sectors differ in the relative importance of alternative modes for delivering a specific service. For instance, in a "consumer service" such as life insurance, a higher modal weight is attached to commercial presence than in the reinsurance sector, in which cross-border provision among firms is the dominant mode of supply. Formally, the sectoral scores are given by

$$STRI_{cj} = \sum_m w_m^{(j)} s_{jmc} \ .$$

8. **Sectoral scores are then aggregated across all sectors $j \in J$ using weights w_j that reflect the relative importance of constituent service sectors in domestic value added.** Sector weights w_j are based on service sectors' standardized share in total services output for an "average" industrialized country.[26] Overall country-level scores are obtained as

$$STRI_c = \sum_j w_j STRI_{cj} \ .$$

9. **The complete weighting schemes used to aggregate modes, subsectors, and sectors, respectively, can be found in table 2.A.2, including further details regarding the sectoral weights.** All scores at any level of aggregation are available from the STRI section of the database; in particular, the full set of baseline values s_{jmc} is accessible so that users are free to devise alternative aggregation schemes if they wish.

10. **The subjectivity of this approach is clear, but given data constraints and the wide range of sectors covered, there is no obviously superior method of quantification.** A demonstration that the STRI assessments are broadly corroborated by alternative methods of quantification can be found in Borchert, Gootiiz, and Mattoo (2012b). The subjectivity of the STRI is somewhat mitigated by the extensive consultations that have been done with the private sector and regulators in making the assignments of

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scores. In principle, policy measures can be divided into two tiers. The first-tier measures include those that affect market entry decisions most significantly, such as a limit on foreign ownership and the number of licenses. The second-tier measures are those that affect operations of service providers, such as restrictions on the repatriation of earnings. The second-tier measures do not contribute to overall restrictiveness when first-tier measures are prohibitive. In contrast, if the first-tier measures are not prohibitive, then second-tier measures are also considered in determining the overall restrictiveness score.

[26] A sense of how sectors are overweighted or underweighted in low-income countries can be gleaned from the fact that the share of financial and business/professional services tends to rise with income, whereas the share of retail distribution and, to some extent, telecommunications services, tends to decline with income. However, for the STRI to be comparable across countries, it is necessary to use one uniform set of weights for all countries.

weights to specific categories, and developing a scoring rule sheet, which sets out how a specific restriction is scored. The adopted approach is at this stage perhaps more suitable than any fixed algorithm to turn the rich and difficult-to-quantify aspects of policy information into broadly plausible if somewhat imprecise restrictiveness scores. In Paul Krugman's words, it has the virtue of being "roughly right rather than precisely wrong."

Weighting schemes for the STRI

11. **Table 2.A.3 documents the sets of weights used to derive aggregate, country-level STRI scores, $STRI_c$, from basic scores per subsector and mode, s_{jmc}.** Modal weights sum up to unity within any given subsector, for example, "accounting" (all subsectors are listed in table 2.A.1). Subsectors are aggregated to the sectoral level, for example, "telecommunications," using simple averages. Sector scores are aggregated to the country level using standardized weights based on the constituent service sectors' share in total services output for an "average" industrialized country. The service sector output shares are taken from Hoekman (1996, 37, Appendix 1) and scaled so as to make the weights of all sectors covered in the Services Trade Restrictions Database add up to unity. It is recognized that service sectors command a different share in total services output in different countries, especially across developing and developed countries, and are at least in part influenced by policy restrictions. As an empirical regularity, the share of financial and business/professional services tends to rise with income, whereas retail distribution and, to a lesser extent, telecommunications services, occupy a larger share in poorer countries. However, comparability requires the use of one uniform set of weights for all countries. The shares for an "average" industrialized country have been chosen as this benchmark because industrial countries tend to be more open, so shares are less likely to be distorted by restrictions.

Table 2.A.3 Sectors and Modes Covered by the Surveys in 2008 and 2012

Aggregate Sectors	Subsectors	Modes	Year
Financial	**Retail Banking** (1) Acceptance of deposits (2) Lending	Modes 1 and 3	2008, 2012
	Insurance		
	(3) Life (4) Automobile (5) Reinsurance	Modes 1 and 3	2008, 2012
Telecommunications	(6) Fixed line (7) Mobile	Mode 3	2008, 2012
Retailing	(8) Retailing	Mode 3	2008, 2012
Transportation	(9) Air passenger international (10) Air passenger domestic (11) Air cargo international	Modes 1 and 3	2008, 2012
	(12) Air cargo domestic (13) International shipping		
	(14) Maritime shipping auxiliary (15) Road freight[a] (16) Rail freight		

Table 2.A.3 Sectors and Modes Covered by the Surveys in 2008 and 2012 (continued)

Aggregate Sectors	Subsectors	Modes	Year
Professional Services	(17) Accounting (18) Auditing Advice on domestic law Advice on foreign law	Modes 1, 3, and 4	2008, 2012
	Architecture		only 2012
	(22) Engineering (23) Management Consulting		
Education	Higher education	Modes 1, 2 3, and 4	only 2012
Health	Medical and dental services	Modes 1, 2 3, and 4	only 2012
	(26) Nurses and Paramedics	Modes 4	only 2012

Note: As an exception to the modal aggregation rule outlined above, air passenger transport subsectors are first aggregated within Mode 3, that is, air passenger domestic and air passenger international, then the resulting modal score is aggregated with Mode 1 using the modal weights as shown.
a. In road transport, only Mode 3 in 2008 and both Mode 1 and Mode 3 in 2012 were covered.

12. For most sectors, the deviations between the set of weights used and weights representative of low-income countries are not large; if anything, scores in the retailing sector are underweighted, whereas professional services scores are somewhat overweighted.

13. Figures 2.A.1 and 2.A.2 present Services liberalization commitments measured by the STRI methodology in different sectors by ASEAN countries under AFAS and WTO respectively. Figure 2.A.3 gives the score of applied policies by ASEAN countries in different sectors.

Figure 2.A.1 AFAS Commitments, Applied Policy, and Blueprint Goals by Sector

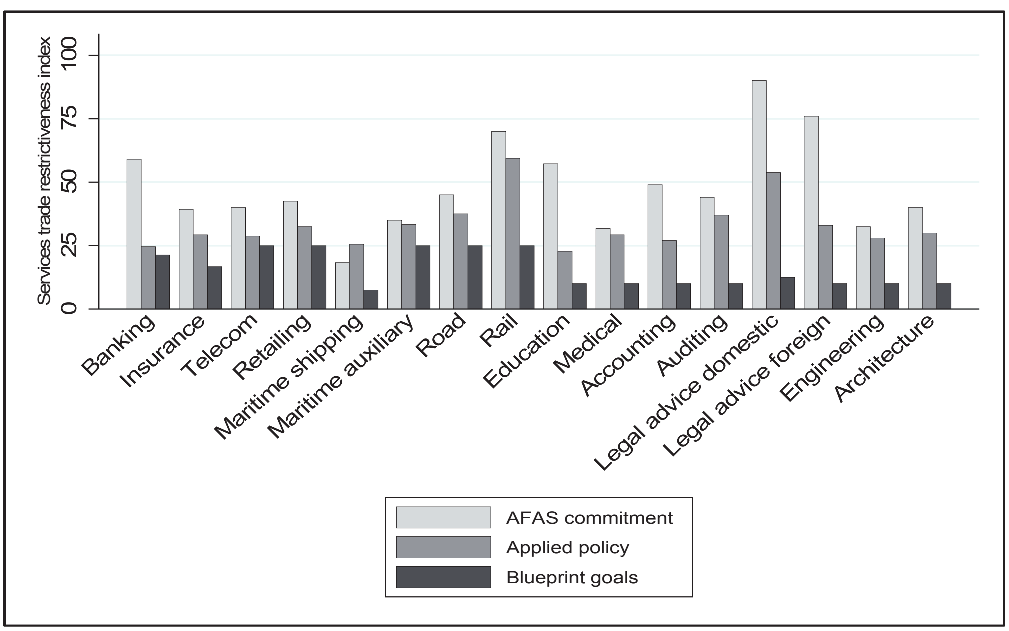


Figure 2.A.2 GATS Commitments, Doha Offers, and Applied Policy, by Sector

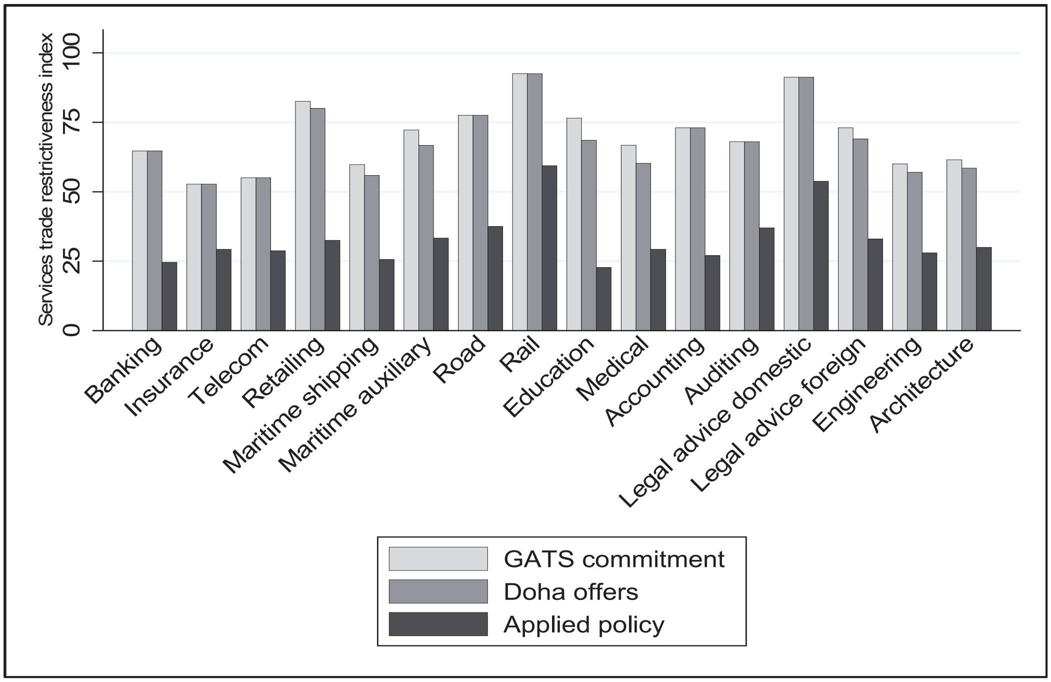
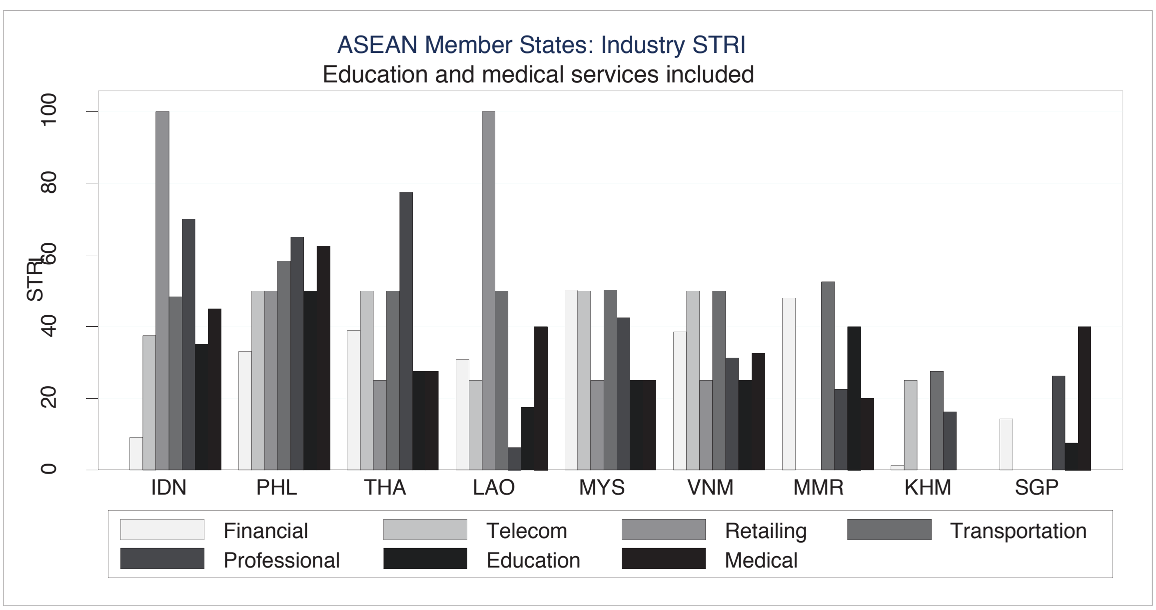


Figure 2.A.3 Applied Policies for ASEAN Member States, by Industry



Annex 2.B ASEAN Multilateral Agreements in Air Transport[27]

1. **The discussions on regional air services agreements started in November 2004, during the 10th ASEAN Transport Ministers' Meeting held in Cambodia, with adoption of a document called the Action Plan for ASEAN Air Transport Integration and Liberalization 2005–2015.** The Action Plan, together with an accompanying document known as the Roadmap for Integration of Air Travel Sector (RIATS), established the objective of achieving an effective "open skies" regime for the region by the target date of 2015. The RIATS aimed to fully liberalize air cargo services by 2008 and allow third, fourth, and fifth freedom flights to the regional air passenger service providers between designated points within ASEAN subregions by 2006, and between ASEAN capital cities by 2010.

2. **Subsequently, the RIATS commitments for passenger services were formalized as two legal agreements for ASEAN Member States' acceptance.** These are the Multilateral Agreement on Air Services (MAAS) and the Multilateral Agreement on the Full Liberalization of Passenger Air Services (MAFLPAS), adopted in 2009 and 2010, respectively. Concurrently, an agreement for cargo transport was also adopted—the 2009 Multilateral Agreement on the Full Liberalization of Air Freight Services (MAFLAS). Most recently the Protocol to Implement the Eight Package of Commitments on Air Transport Services has also been signed.

What is allowed under the agreement?

3. **Overall, the objectives of the agreements are found to be modest—market access relaxations are limited to the third, fourth, and fifth freedoms, and have not extended to the seventh, eighth, and ninth freedoms.**[28] More specifically, the MAAS Implementing Protocols specify the following "third," "fourth," and "fifth" freedom market access rights:

- Protocol 1 Unlimited Third and Fourth Freedom Traffic Rights Within ASEAN Sub-Region
- Protocol 2 Unlimited Fifth Freedom Traffic Rights Within ASEAN Sub-Region
- Protocol 3 Unlimited Third and Fourth Freedom Traffic Rights Between ASEAN Sub-Regions
- Protocol 4 Unlimited Fifth Freedom Traffic Rights Between ASEAN Sub-Regions
- Protocol 5 Unlimited Third and Fourth Freedom Traffic Rights Between ASEAN Capital Cities
- Protocol 6 Unlimited Fifth Freedom Traffic Rights Between ASEAN Capital Cities

4. **The first four Implementing Protocols of MAAS—Protocols 1 to 4—are limited in impact and relatively straightforward.** By virtue of their geographic scope, they only deal with market access relaxations designed to spur growth within subregions straddling the Member States' boundary regions, and the designated points are mainly secondary cities (Forsyth et al. 2006). Four such subregions have been identified (new subregions may be declared or existing ones expanded): the Brunei Darussalam, Indonesia,

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[27] This section is based on the insightful study by Tan (2013).

[28] *Third and fourth freedom:* If the Singapore carrier has rights to carry passengers from Singapore to Bangkok, it is utilizing the "third freedom" granted by Thailand to Singapore. The reverse journey back to Singapore with the same rights would constitute the "fourth freedom." *Fifth freedom:* In both directions, if the carrier has the right to stop over in Malaysia to drop off some passengers and fill up the vacated seats with new passengers picked up from there, this is the "fifth freedom" granted to Singapore by both Thailand and Malaysia that permits Singapore carriers to carry traffic between their respective points. *Seventh freedom:* The right of a carrier to connect two international points *outside of its home country*. *Eighth freedom:* If the flight originates in the carrier's home country (Malaysia), and operates between domestic points within the contracting party (Jakarta and Bali). *Ninth freedom:* The same carrier operates between domestic points (Jakarta and Bali) of contracting party without starting or ending in the home country.

Malaysia, and the Philippines East ASEAN Growth Area (BIMP-EAGA); the Sub-regional Cooperation in Air Transport among Cambodia, Lao PDR, Myanmar, and Vietnam (CLMV) (this corresponds with the CLMV Agreement); the Indonesia, Malaysia, Singapore Growth Triangle (IMS-GT); and the Indonesia, Malaysia, Thailand Growth Triangle (IMT-GT).

5. **In terms of air traffic volume and market potential, Protocols 5 and 6 have much greater economic significance, since these cover the 10 capital cities and are not limited by subregional proximity.** Specifically, Protocol 5 provides contracting states' designated carriers with unlimited third and fourth freedom opportunities between their own capital city and all the other ASEAN capital cities. Protocol 5 further provides that such rights shall be allowed by December 31, 2008 (although, as noted above, Protocol 5 was actually adopted only in May 2009). Protocol 6 lays down a deadline of December 31, 2010, for a contracting state's designated carriers to operate full third, fourth, and fifth freedom rights from their capital city to other contracting states' capital cities (for example, a Malaysian carrier from Kuala Lumpur to Hanoi with fifth freedom pickup rights in Phnom Penh).

6. The MAFLPAS Implementing Protocols address the following market access rights:

- Protocol 1 Unlimited Third and Fourth Freedom Traffic Rights Between Any ASEAN Cities
- Protocol 2 Unlimited Fifth Freedom Traffic Rights Between Any ASEAN Cities.

7. **The MAFLPAS agreement was designed to supplement MAAS and to cover the rest of the ASEAN cities.** Hence, MAFLPAS Protocol 1 allows for unlimited third and fourth freedom operations for state parties' carriers between two noncapital cities, or between a noncapital and a capital city (capital-to-capital operations remain governed by MAAS Protocol 5). MAFLPAS Protocol 2 provides for unlimited fifth freedom operations involving the noncapital cities. Under its terms, Protocol 2 can also cover flights involving capital cities, except when *all three points* are capitals, in which case MAAS Protocol 6 governs.

Ownership and control

8. **How have the ASEAN multilateral agreements sought to deal with these ownership and control restrictions?** In essence, when both market access and ownership and control are freed up, the Member States can achieve a single air market. On top of prohibiting seventh freedom and domestic operations by foreign carriers, the current ASEAN regime allows limits to be placed on carriers like AirAsia from going into, say, Indonesia, either to establish a wholly owned subsidiary or to buy an existing local airline fully. In comparison, the EU permits any EU national to move into another EU country and establish a fully owned airline there, *and* fly it between any two points within the EU (including domestic points).

9. **Interestingly, both MAAS and MAFLPAS provide *alternatives* to the traditional "substantial ownership and effective control" rule.** They allow an "ASEAN community carrier," which means an airline can be substantially owned and effectively controlled by ASEAN interests *taken cumulatively or in the aggregate* (Tan 2009). This means that airlines can now attract capital infusions and management expertise from more sources across ASEAN. However, it is not clear that the "community carrier" can fly into all Member States in the region, because the Member States receiving an application from such a carrier must provide an approval before the carrier can operate. To encourage investors to establish airlines in the region, it would help if a specific number of Member States declared their unequivocal approval for such a model. For now, investors comply with the traditional "substantial ownership and effective control of nationals" rule. No community carrier has thus far been set up in ASEAN, and new airlines like Malindo and Thai Vietjet Air continue to employ the traditional joint venture model that requires majority ownership and effective national control. A regime that allows carriers bearing a community ownership structure to be recognized automatically in ASEAN will be a way forward. One solution is to allow Member States to

retain the traditional *national* ownership and control restrictions for *their own* designated carriers if they wish to, without affecting other carriers' ability to be set up as community carriers.

How far have the Member States implemented these agreements and the relevant commitments?

10. **The agreements are in force among most ASEAN Member States. However, some states need to be brought more fully within the scope of the agreements.** Both MAAS and MAFLPAS are in force after having received the acceptance of the minimum number of three ASEAN Member States for each agreement. At the same time, the respective Protocols' separate requirements for entry into force have been satisfied. All the Protocols are thus in force for those Member States that have ratified them. As shown in table 2.B.1, all Member States have accepted MAAS Protocols 1 to 4, but Protocols 5 and 6 have not yet been ratified by the Philippines. In the case of MAFLPAS and its Protocols 1 and 2, Indonesia and Lao PDR are not yet state parties (table 2.B.2).

11. **The following tables summarize the Member States' ratification status as of October 2013.**

Table 2.B.1 Ratification Status of 2009 Multilateral Agreement on Air Services (MAAS)

	MAAS (Parent Agree-ment)	Protocol 1: Third and Fourth Freedom within Subregion	Protocol 2: Fifth Freedom within Subregion	Protocol 3: Third and Fourth Freedom between Subregions	Protocol 4: Fifth Freedom between Subregions	Protocol 5: Third and Fourth Freedom between Capitals	Protocol 6: Fifth Freedom between Capitals
Brunei Darussalam	✓	✓	✓	✓	✓	✓	✓
Cambodia	✓	✓	✓	✓	✓	✓	✓
Indonesia	✓	✓	✓	✓	✓	✓	✓
Lao PDR	✓	✓	✓	✓	✓	✓	✓
Malaysia	✓	✓	✓	✓	✓	✓	✓
Myanmar	✓	✓	✓	✓	✓	✓	✓
Philippines	✓	✓	✓	✓	✓	[X]	[X]
Singapore	✓	✓	✓	✓	✓	✓	✓
Thailand	✓	✓	✓	✓	✓	✓	✓
Vietnam	✓	✓	✓	✓	✓	✓	✓

Source: ASEAN Secretariat.
Note: ✓ denotes state party; [X] denotes nonstate party.

Table 2.B.2 Ratification Status of 2010 Multilateral Agreement for Full Liberalization of Passenger Air Services (MAFLPAS)

	MAFLPAS (Parent Agreement)	Protocol 1: Third and Fourth Freedom between all Cities	Protocol 2: Fifth Freedom between all Cities
Brunei Darussalam	✓	✓	✓
Cambodia	✓	✓	✓
Indonesia	[X]	[X]	[X]
Lao PDR	[X]	[X]	[X]
Malaysia	✓	✓	✓
Myanmar	✓	✓	✓
Philippines	✓	✓	✓
Singapore	✓	✓	✓
Thailand	✓	✓	✓
Vietnam	✓	✓	✓

Source: ASEAN Secretariat.
Note: ✓ denotes state party; [X] denotes nonstate part

12. **Indonesia is, of course, the one Member State whose acceptance of the ASEAN agreements is critical for the entire ASEAN Single Aviation Market (ASAM) project.** Spanning 17,000 islands and home to 270 million people (effectively half the entire ASEAN population), Indonesia has the region's largest land area, economy, population, and air travel market. Its capital, Jakarta, is ASEAN's biggest city by population.

13. **Indonesia's position on the ASEAN agreements can be traced to its leading carriers' lobbying of their government to continue protecting their international operations against those of rival airlines from neighboring ASEAN states.** Through their industry group, the Indonesian National Air Carriers Association (INACA), the major carriers are traditionally not in favor of efforts to open up the ASEAN air travel market (although see below for recent changes in attitude). Their concern lies with the stronger airlines from the other ASEAN states, principally Malaysia, Singapore, and Thailand, which may dominate the international market between Indonesia and these countries. INACA's position is that as a huge archipelago, Indonesia has hundreds of points to offer international aviation, whereas the other states have far fewer points to offer (indeed, Singapore has all of one!). For some Indonesian carriers, this represents a systemic imbalance for exchanging air traffic rights.

14. **Overall, despite Indonesia's traditional stance toward liberalization, the recent capacity revision with Singapore is a positive development.** It shows that the Indonesian carriers are likely to support (or at least not object to) capacity increases for foreign carriers when they themselves come close to exhausting their own limits to fly to other states.

15. **Indeed, the Indonesian carriers are expanding rapidly across the region, showing a capability and willingness to compete with their regional rivals.** Lion Air has even established a subsidiary, Malindo, in Malaysia, taking the challenge right into the turf of its Low Cost Carrier (LCC) rival, AirAsia. In essence, Lion Air is seeking to penetrate AirAsia's home market in the same manner that the latter has entered Indonesia. Another subsidiary, Thai Lion Air, is scheduled to commence operations in Thailand in

late 2013. Yet another subsidiary in Myanmar is reportedly being launched. In short, Lion Air is seeking to replicate AirAsia's experience with its joint venture subsidiaries across the region.

16. **In this backdrop, there have been encouraging changes in Indonesia's policy on the ASEAN agreements.** The Indonesian Government has ratified MAAS Protocols 5 and 6. This will be a huge boost for the ASEAN Single Aviation Market integration project and the entire region.

17. **In comparison, the Philippine government's position is slightly different.** The Philippines has actually embraced MAFLPAS Protocols 1 and 2 to open up access to its secondary cities in a bid to spur regional development. Yet, it has kept its capital, Manila, restricted and has not ratified MAAS Protocols 5 and 6. The government justifies its decision based on the shortage of landing and takeoff slots and overall runway congestion at central Manila's Ninoy Aquino International Airport.

18. **While the concern over congestion at Ninoy Aquino International is understandable, the attempt to link traffic rights and airport slots is problematic.** Indeed, these are separate matters that should be kept distinct. In particular, the lack of airport slots should not prevent Member States from ratifying the ASEAN agreements to liberalize market access rights and to signal their support for the ASEAN's market integration efforts. Linking slots to access rights may encourage air rights negotiators to use congestion and lack of slots (which may be within the competence of other government agencies) as pretexts to delay their acceptance of regional agreements.

19. **For its part, it is unclear why Lao PDR has not ratified MAFLPAS Protocols 1 and 2.** It is likely that internal consultations are ongoing within Lao government agencies and that ratification will happen soon. It should also be noted that Cambodia, in 2013, submitted instruments of ratification for MAFLPAS and Protocols 1 and 2, becoming the latest Member State to ratify these agreements.

Chapter 3. Services Liberalization in ASEAN Countries: Impacts, Experiences, and Lessons

Findings from case study analyses highlight the complementarity of private sector initiative and government support for success in services exports. For example, the strong trade performance of higher education services in Malaysia, medical tourism in Thailand, and back-office processing in the Philippines have been based on private investments that were accompanied by an enabling business and regulatory environment and an active role of the government in establishing and monitoring quality standards. Also, public authorities often have a crucial role in mitigating adverse distributional effects and social hardship that might result from trade-induced structural adjustment in social sectors.

A. Introduction

1. **This chapter summarizes sectoral reform experiences undertaken in a unilateral, plurilateral, and multilateral context and their implications in ASEAN Member States.** Five examples are analyzed: higher education services in Malaysia, financial services in Singapore, health services in Thailand, telecommunication-based services in the Philippines, and transport services in the Greater Mekong region. These case studies highlight important elements of the process to reform domestic service sectors and attract investment, and could contains lessons for other ASEAN Member States that are envisaging similar services trade policy reforms.

2. **One recurrent theme that emerges across the case studies is cooperation between the government and the private sector in conceiving and implementing service sector reforms.** Private firms are often the driving force and key client of change and trade success; therefore, government support to facilitate and encourage investment is critical. At the same time, governments have an important role to play in accommodating private initiatives and developing a regulatory and operational framework, such as through standards, accreditation, and quality control measures, which enable the development and internationalization of services, while protecting domestic consumers. Hence, the process of fostering services trade is not only a question of liberalization and the opening of markets, but also a process of careful regulatory reform that encourages competition, efficiency, and service quality.

B. Malaysia: Higher Education Services

3. **Education plays a crucial role in fostering personal and social development, and is a driver for economic growth and development.** Because of its central importance for society, government involvement in the sector has traditionally been very prominent. Most schools, technical colleges, universities, and adult education centers have typically been owned, financed, and operated as public facilities. Yet demographic changes, technological developments, and the evolution of national development goals have over time prompted governments toward reforms that have opened the sector to new operating models and the involvement of private service providers. In parallel, international trade in education services, particularly at the tertiary level, has been growing in importance (WTO 2010).

4. **Malaysia has been one of the pioneers in Southeast Asia in developing a private higher education sector and fostering cross-border trade in education services.** In particular, the Government of Malaysia has introduced major educational reforms since the mid-1990s in order to turn the country into a regional education hub. Private institutions were allowed to offer tertiary degrees, and foreign universities received permission to establish branch campuses. As a result, the number of privately and foreign-

controlled educational service providers, and the number of foreign students studying in Malaysia, have increased markedly.

Higher education policy reforms

5. **Two of the priorities during the two decades following Malaysia's independence in 1957 was fostering national unity and pursuing policies that would equalize opportunities among people of different ethnic backgrounds.** Broadening access to publicly funded higher education was a means to advance this social equity objective, and the government expanded the supply of educational services accordingly. The University of Malaysia, the first in the country, was founded in 1961, and by the 1980s, strong demand for college and university education had led to the establishment of several other institutions of higher education. Yet, the resulting investment and operating costs started to put growing strains on the government's budget. Government expenditure on tertiary education increased from 9 percent in 1970 to 13 percent of GDP in 1990 (Ziguras 2001).

6. **Despite the government's investments in higher education, the available university places remained insufficient to meet the demands for tertiary education, and those who were unable to secure admission to the local universities had to turn to overseas institutions.** In 1995, about 20 percent of Malaysian students were pursuing degrees abroad (Ziguras 2001). In order to stem the outflow of currency for overseas education and to satisfy the growing demand for university education, the government decided to liberalize its educational system, allowing the private sector to engage in higher education (Abidin et al. 2012). These reforms paved the way for the subsequent growth and export success of Malaysian educational service providers.

7. **Several laws and regulations have been instrumental in fostering the development of an internationalized system of higher education in Malaysia since the mid-1990s** (table 3.1). This body of legislation notably established a framework for the operation of private colleges and universities, as well as foreign branch campuses. In parallel, it created the necessary institutional infrastructure of accreditation and quality assurance in order to ensure that the newly emerging educational offerings were satisfying the government's minimum standards and were in line with international standards. Also, in 2004, the government shifted responsibilities for tertiary education from the Ministry of Education to a new, dedicated Ministry of Higher Education, which oversees the sector and guides its development.

Table 3.1: Main Legislation Concerning the Internationalization of Higher Education in Malaysia

Law/Regulation	Description
Private Higher Educational Institutions Act, 1996	The act opened the doors for Malaysian private higher education institutions to award certificates either at the subdegree level or through degree programs offered as a result of collaborative or twinning arrangements with local or foreign universities.
National Accreditation Board Act, 1996	The law led to the creation of the National Accreditation Board (renamed the Malaysian Qualifications Agency), with responsibilities for accreditation and quality control with respect to private higher educational institutions.
Private Higher Educational Institutions Act, amended 2003	The amendment paved the way for the establishment and upgrading of private universities, university colleges, and branch campuses of foreign universities in Malaysia.
Malaysian Qualifications Act, 2007	The law created a single quality assurance body through the merger of two respective government bodies.

Source: Nga 2009.

8. **In order for private sector service suppliers to conduct courses and degree programs in Malaysia, four administrative stages are required.** First, prospective tertiary education providers must secure approval from the Ministry of Higher Education to establish a private higher educational institution. This process is based on an invitation the ministry extends to private universities and branch campuses of foreign universities, or on an application put forward by a particular educational institution. All applicants must be incorporated as local companies. Second, the institution has to secure registration from the Private Higher Education Management Sector within the ministry. Third, the private higher educational institution needs to apply to the Ministry of Higher Education to get permission to conduct its particular course or training program. And fourth, the Malaysian Qualification Agency must give its green light concerning the extent to which the courses meet Malaysia's minimum standards. This assessment then forms the basis for the recommendation to the Minister of High Education on whether to grant overall approval for the launch of the private higher educational institution's course and degree programs (Yean and Yi 2007). Only accredited programs are allowed to recruit international students.

9. **In 2007, the Government of Malaysia launched the National Higher Education Strategic Plan to further advance the privatization of higher education, while emphasizing standardization and quality assurance.** It thereby aims to establish world class higher education institutions by 2020 that can produce highly qualified graduates for modern jobs in industry and services. The Strategic Plan also established ambitious targets of more than doubling the number of foreign students pursuing degrees in Malaysia to 200,000 by 2020 and increasing export earnings from higher education correspondingly.

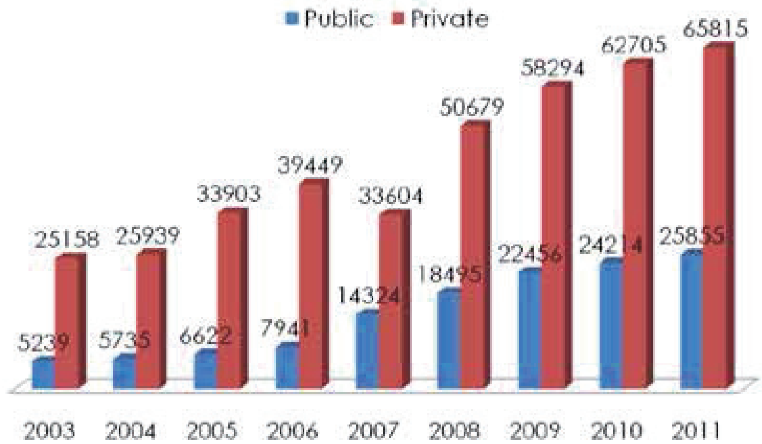
10. **As part of the drive toward the internationalization of higher education, the government has been promoting the development of EduCity Iskandar in Southern Malaysia.** This integrated education hub is to bring eight foreign universities together on a single campus by 2015, so that they can share common facilities, such as student accommodations and sports and recreation centers. EduCity is located within a 15-minute driving distance from Singapore, and is part of a larger cluster of tourism, wellness, and creative services activities.

Trade in higher education services

11. **While the liberalization of the higher education sector in Malaysia was initially driven by the objective of providing opportunities for university study for Malaysians, that is, to meet domestic demand, it quickly became evident that the sector also offered substantial potential for international services trade.** Indeed, Malaysia turned out to have several significant strengths as an exporter of higher education services: English is widely spoken and used as the language of instruction; the country represents a welcoming melting pot of cultures, traditions and ethnicities; and living costs and course fees are relatively low. Completing a degree in an Australian branch campus in Malaysia has been estimated to cost about US$32,000 compared with US$87,000 on the Australian mother campus (Yean and Yi 2007). Meanwhile, the government's efforts with respect to accreditation of educational establishments and recognition of programs nationally and internationally have helped to make the study options attractive for foreigners.

12. **Indeed, the number of international students hosted in Malaysia expanded quickly over the last decade and more than tripled between 2003 and 2011 to more than 91,000** (figure 3.1). Most students hail from Southeast Asia or the Middle East, with Indonesia, China, and Iran being the most prominent countries of origin. Each foreign student is estimated to contribute on average about 30,000 ringgit (US$9,600) to Malaysia's gross national income per year (Abd Aziz 2012).

Figure 3.1 Foreign Students Hosted in Malaysia



Source: Ministry of Higher Education.

13. **In addition to foreigners consuming education services in Malaysia—that is, services trade under Mode 2—there is also trade under the other three modes: cross-border trade, commercial presence, and temporary movement of persons.** Malaysia has several universities that provide for distance or online learning services, two of which also serve foreign students through cross-border trade. In particular, the Asia e-University had 1,033 local and 217 foreign students in 2012, and the Open University Malaysia had 64,253 local and 128 foreign students (Abd Aziz 2012).

14. **Concerning commercial presence, Malaysia had attracted seven branch campuses of Australian, British, Dutch, and Indian universities by 2011.** These branch campuses offer the same courses and degrees as the home universities to students based in Malaysia, thus making it possible for students to realize substantial savings in living expenses while pursuing an internationally renowned degree. In 2011, three-quarters of the 15,300 students at Malaysia's foreign branch campuses were from the host country, while the remaining quarter was foreigners.

15. **Partly related to the need to staff foreign branch campuses, Malaysia is also a significant importer of higher education services through the temporary movement of natural persons.** According to the Ministry of Higher Education, there were 6,684 international academic staff working at higher education institutions in Malaysia in 2010.

16. **Moreover, a number of private higher education institutions have made transnational arrangements with foreign partners to facilitate the movement of Malaysian students, and, hence, services trade.** Under these twinning or advanced credit transfer arrangements, students who have successfully completed certain parts of their studies at Malaysian private higher educational institutions are enabled to enter the degree programs at the partner university abroad at an advanced stage and receive their degree from the foreign university in an accelerated manner.

17. **Despite notable success in the internationalization of higher education, Malaysia is encountering a number of challenges in the sector.** In particular, international rankings of universities do not place Malaysian institutions very highly. Decades of affirmative action in the public sector have eroded the quality of the faculty pool, as measured, for example, by the percentage of faculty with PhDs, coupled with an overly centralized administration and lack of research funding. There is evidence that graduate unemployment has been rising, while midlevel skills are in short supply and technical education and vocational training need to be better

coordinated (Boston Consulting Group 2011). In short, while Malaysia has succeeded in promoting private and international provision in higher education, there is a need to accelerate reforms of the overall domestic higher education framework.

Lessons for Higher Education Reform in ASEAN

18. **The impetus of the reform process of higher education in Malaysia was to improve the availability of high-quality tertiary education opportunities for domestic students.** The government realized that increasing demand for university study could be better served by harnessing private sector capital and initiative, while making sure that new, private service providers adhere to a set of minimum quality standards. Yet fairly soon, the new universities realized that they could not only offer an attractive education program to local students so that more of them did not need to study abroad, but that the private higher educational institutions themselves could profitably attract foreign students to pursue degrees in Malaysia.

19. **Several factors seem to have been instrumental for the export success of Malaysia in the higher education sector.** The government's willingness to liberalize higher education and cede some control over the sector's development to private service providers laid the foundation for the subsequent dynamism in the sector. At the same time, the government established a regulatory framework for new private universities and set up the quality assurance infrastructure that made it possible to avoid a slide toward educational establishments that merely serve as "degree mills." Further, the outward orientation and international benchmarking when setting standards for courses and degrees anchored the credibility of the new educational offerings, and facilitated the recognition of graduate qualifications from these private higher educational institutions, which would in turn attract more demand. Finally, the active pursuit of partnerships with foreign universities through branch campus establishment or twinning programs brought foreign expertise and competition to the country that have helped lift the prestige of receiving a university education in Malaysia. This favorable reputation in combination with the cost advantages of study and student life triggered the education services export boom that Malaysia experienced over the last decade.

20. **All of these aspects of higher education reform could also be gainfully pursued in other ASEAN countries.** They represent good policy practice that will help establish a well-performing domestic education sector. Whether such a tertiary education system then goes on to yield export success will also depend on other factors, such as language considerations, cost competitiveness, the sociopolitical environment, and immigration policies. Within Southeast Asia, Singapore and Thailand already have ambitious targets to increase their intake of foreign students over the coming years, as have Australia, China, and Japan in the wider Asia-Pacific sphere (Abd Aziz 2012). Nevertheless, the global market for tertiary education is expanding, so that other countries in the region might well want to pursue strategies for developing education hubs that serve the worldwide increasing number of international students or the region's own students who are currently looking at overseas education. As ASEAN economies become more dynamic and appealing to international businesses and organizations, there is additional value in pursing higher education in the region, since it gives students an edge in understanding the local context and dynamics that would facilitate their professional aspirations.

C. Singapore: Financial Services

21. **Financial institutions play a critical role in managing risks and closing information gaps within society.** They diversify the risks faced by depositors by pooling their savings and distributing them among many creditors. They also collect and evaluate the information necessary to make prudent and productive investment decisions. Moreover, they contribute to better corporate governance by evaluating the performance of borrowers and, when necessary, compelling them to act in the best interests of the firm—and therefore of its providers of funds (Dobson 2008). Yet, to perform this critical role properly, financial

institutions need a regulatory framework that ensures the stability of the overall system in the interest of all participants.

22. **Given the crucial role of financial services in modern economies, having a well-performing financial system is a central element of any growth and development strategy.** In this context, fostering competition in the sector to entice financial institutions to provide high-quality services at reasonable prices is key. Opening financial markets to foreign service providers is one important means of generating such a procompetitive business environment. In particular, financial services liberalization calls for the removal of discriminatory quantitative or qualitative regulation that used to keep foreign financial service providers out of the domestic market. These regulatory measures can notably concern cross-border trade and the commercial presence of banking and insurance companies.

23. **Since the late 1960s, Singapore has actively promoted the development of its financial sector, with the aim of becoming a financial center in the region.** At that time, Singapore was dominated by foreign banks. From the early 1970s, the Monetary Authority of Singapore (MAS) adopted policies to protect the local banks, especially in retail banking, so that they could grow and assume a larger share of the domestic market. MAS decided in the late 1990s that there was a need to proactively manage the inevitable increase in competition to further strengthen the local banks. MAS undertook a comprehensive review of Singapore's financial system against the backdrop of the Asian Financial Crisis. This eventually led to significant liberalization of the financial sector, and a more risk-based supervisory approach. Further liberalization measures were extended in bilateral and plurilateral Free Trade Agreements that Singapore signed with a number of international partners, including ASEAN, Australia, Japan, New Zealand, and the United States. This liberalization effort was accompanied by strengthening the regulatory framework through more demanding disclosure standards, liquidity support, deposit guarantees, and foreign exchange arrangements.

Policy reforms concerning financial services

24. **The liberalization in Singapore's retail banking sector was undertaken in a gradual manner and involved several phases (AIMO 2014), which were managed and supervised by the MAS.** The first reforms were launched in March 1999 and involved new banking privileges and licenses for foreign banks. A new category of banking license, the "Qualifying Full Bank" (QFB), was created, which grants holders enhanced privileges in establishing additional branches, offsite Automated Teller Machines (ATMs), and sharing of ATMs. The 40 percent limit on foreign shareholding of local banks was also removed. Over the following six years, QFBs were given additional privileges to reduce the differentiation between foreign and local banks. These included operating up to 25 locations participating in government schemes,[29] and providing Electronic Funds Transfer at Point of Sale services (Yue 2003). The first four QFB licenses were issued to ABN Amro Bank, Banque Nationale de Paris, Citibank, and Standard Chartered Bank by the end of 2000, and further two QFB licenses were allocated to Malaysia's Maybank and HSBC in December 2001. Subsequent QFBs were awarded under Free Trade Agreements.

25. **By 2005, the only substantive restriction on foreign banks, compared to local banks, was the number of service locations they could operate. Singapore took further steps to reduce this gap.** In June 2012, MAS announced its intention to grant significantly rooted QFBs an additional 25 places of business, of which up to 10 may be branches (MAS 2013). In determining whether a QFB is significantly rooted, MAS would consider a range of quantitative and qualitative attributes, such as whether the bank is locally incorporated with majority Singaporean representation, what types of businesses are conducted by

[29] Specifically, the provision of Supplementary Retirement Scheme and CPF Investment Scheme accounts, and the acceptance of CPF fixed deposits. These are schemes under the Central Provident Fund, Singapore's social security system.

the locally incorporated entity, and whether Singapore is one of the bank's major markets in terms of group profits and assets. This would allow Singapore to achieve greater foreign bank participation in its domestic financial system in a way that strengthens financial stability, while encouraging foreign banks to deepen their roots in Singapore.

26. **Singapore also restructured the nonretail banking sector, with the aim of encouraging greater participation by foreign banks in its domestic wholesale market.** Prior to 2001, there were two categories of nonretail banks—Restricted Banks and Offshore Banks. In 2001, a new license category of Wholesale Banks was created, and all Restricted Banks were converted to Wholesale Banks. Many Offshore Banks also applied and were upgraded to Wholesale Banks. Wholesale Banks can engage in the whole range of banking operations, except that they can have only one operating office in Singapore, are only allowed to accept fixed deposits of at least S$250,000 per deposit, and are not allowed to operate savings accounts in Singapore dollars. The same framework applies to both local and foreign Wholesale Banks. In 2002, the first Wholesale Bank licenses were granted to 20 foreign banks, including financial service providers from Australia, France, Japan, and Switzerland. Today, any bank may apply for a Wholesale Bank license in Singapore, subject to its meeting MAS's prudential requirements.

27. **To strengthen the domestic banking industry in the context of increased foreign competition, the Singaporean authorities encouraged consolidation among the local banks.** The first merger occurred in 1998 between Development Bank of Singapore (DBS) and Post Office Saving Bank (POSB). Other mergers soon followed, including United Overseas Bank's (UOB's) US$10 billion acquisition of Overseas Union Bank (OUB), and Overseas-Chinese Banking Corporation's (OCBC)'s US$5 billion acquisition of Keppel-Tat Lee Bank. These mergers entailed the rationalization of operations and the upgrading of risk management systems. With greater economies of scale, the banks were able to lower costs, which in turn facilitated the introduction of new products and services.

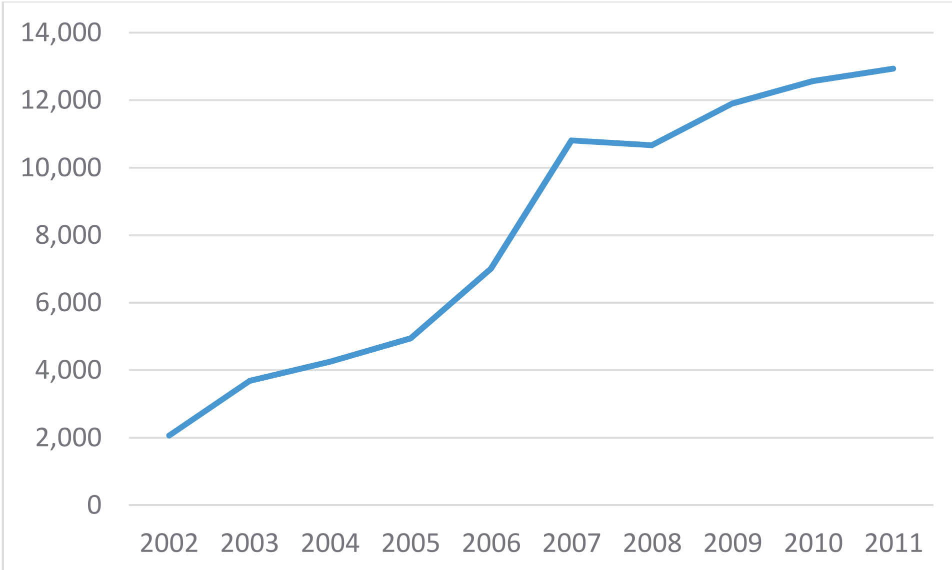
28. **Capital markets also underwent reform.** In December 1999, the Stock Exchange of Singapore (SES) merged with the Singapore International Monetary Exchange (SIMEX) to form the Singapore Exchange (SGX). In 2000, the stockbroking industry was liberalized to free the level of fees charged and to open up market entry. As a result, brokerages consolidated, upgraded their capabilities, and widened the services and products they provide. New foreign brokerages were permitted to reach out to foreign investors. Since SGX was listed in November 2000, MAS issued statutory laws regulating the capital market, and is overseeing SGX's regulatory role with respect to market participants.

29. **Singapore also opened up completely the direct life and general insurance market.** In March 2000, the closed door policy on direct insurers and the 49 percent foreign shareholding limit in locally owned direct insurers were lifted to foster an open and competitive environment for the industry. In 2003, the Insurance Act was amended to allow for the establishment of a risk-based capital framework, which was subsequently introduced in 2004. Since risk-based supervision reduced the need to rely on high minimum paid-up capital, MAS lowered the minimum paid-up capital requirements from S$25 million, to S$10 million for direct insurers, and S$5 million for monoline insurers under the framework. This would also help develop the market and attract niche insurance players to Singapore.

Trade in financial services

30. **The liberalization in Singapore's financial sector has made it possible for the country to substantially increase its exports of insurance and financial services.** Between 2002 and 2011, exports almost quadrupled from S$5.9 billion to S$22.4 billion. Imports also increased, but net exports show a strong upward trend (see figure 3.2) and, indeed, are the main contributor to Singapore's now positive services trade balance.

Figure 3.2 Net Exports of Insurance and Financial Services in Singapore (S$ million)



Source: Singstat.

31. **Indeed, Singapore has a trade surplus in financial services with all of its major trading partners** (see table 3.2). Trade with partners in Asia is particularly strong, underlining the role of Singapore as a regional financial center, but commercial transactions with partners in America and Europe are also substantial. Trade in financial services with other ASEAN countries accounts for 13 percent of total financial services exports and 9 percent of imports.

Table 3.2 Singapore's Trade in Insurance and Financial Services with Major Partners, 2011 (S$ million)

	Exports	Imports	Net Exports
Asia	**6,085**	**3,744**	**2,341**
China	582	434	149
Hong Kong SAR, China	1,213	765	448
India	509	347	162
Japan	880	794	86
Korea, Republic of	403	160	243
America	**3,234**	**1,413**	**1,821**
United States	1,461	801	660
Europe	**3,367**	**1,669**	**1,698**
Oceania	**1,344**	**592**	**752**
Australia	1,197	520	677
ASEAN	1,807	676	1,131
European Union	2,855	1,162	1,693

Source: Singstat.

Lessons for financial services reform in ASEAN

32. **Singapore's liberalization of the financial sector was characterized by gradual reforms that affected all major elements of the financial system.** Also, the process did not just involve opening the market to foreign banks and insurance companies, but extended to the active preparation of the domestic financial sector for the coming increased competition. Moreover, MAS imposed strict licensing conditions so that only foreign service providers that met its high prudential standards could set up in Singapore. This ensured continued stability of the financial system.

33. **Singapore's remarkable success in growing its financial sector could usefully inspire other ASEAN Member States to pursue similar reform policies.** Not every country in the region might be in a position to become a financial center, but opening the domestic market to foreign financial services providers can have a number of benefits that go beyond trade enhancement and positively affect the entire domestic economy. Foreign banks can often provide high-quality banking services at lower cost; spur quality improvements; trigger cost-cutting in the domestic banking industry; promote better accounting, auditing, and rating institutions; and increase the pressure on governments for greater transparency in prudential regulation (Levine 2004). Enhanced market access for foreign insurers will also allow local markets to diversify risk more effectively and benefit from the foreign companies' know-how and resources (Dobson 2008). Such changes will increase the efficiency with which capital is allocated, and spur economic growth over what would otherwise have been the case. But as the Singaporean reforms have shown, the market opening should go hand-in-hand with a review of the regulatory regime and the possible adoption of new measures to guard against systemic risk.

D. Thailand Health Services Exports

34. **The well-being of a country's citizens depends critically on the performance of its health sector. Quality health services are a key ingredient to human development and a prerequisite for sustained economic growth.** In particular, effective preventive and restorative care preserves a country's stock of human capital and keeps the working population in a physical condition that makes it possible for it to be highly productive.

35. **While the health sector in most countries remains predominantly oriented toward the domestic market, international trade has been gaining in importance in recent years.** This trend is driven by rising health care costs in high-income countries and rising health care demand as a result of modern life styles, combined with limited insurance coverage and long waiting lines. Emerging and developing countries that have well-qualified medical and nursing staffs can often provide health services of similar quality at lower prices, and have been attracting foreign patients for treatment abroad.

36. **Thailand has been one of the frontrunners with respect to patient insourcing in Southeast Asia.** The country initially focused on tourism-related activities such as spas, traditional massages, and herbal treatments. In recent years, however, private hospitals have discovered that they can profitably attract and treat foreign patients for elective medical procedures, such as plastic surgery.

Policy reforms concerning health services

37. **While Thailand has been a well-known tourist destination for many decades, it was not until the 2000s that medical tourism started to surge** (Supakankunti and Herberholz 2012). In the wake of the 1997 Asian economic crisis, bed occupancy in many private hospitals declined significantly, prompting high-end private medical institutions, which had invested substantially during the economic boom, to seek out medical tourists from abroad.

38. **Subsequently, the Thai government adopted a series of measures to promote medical tourism, which culminated into the development of a vision for Thailand to become a world-class medical hub.** This vision has been explicitly spelled out and pursued by the Ministry of Public Health (MoPH 2009). Yet, since the policy equally affects the wellness sector and herbal treatments, several other ministries (Commerce, Labor, Education, and Foreign Affairs) and the Tourism Authority of Thailand have also been directly implicated. A major step toward becoming a prime destination for medical tourists has been the adoption of standards for hospital accreditation in Thailand that were in line with international standards (Supakankunti and Herberholz 2012).

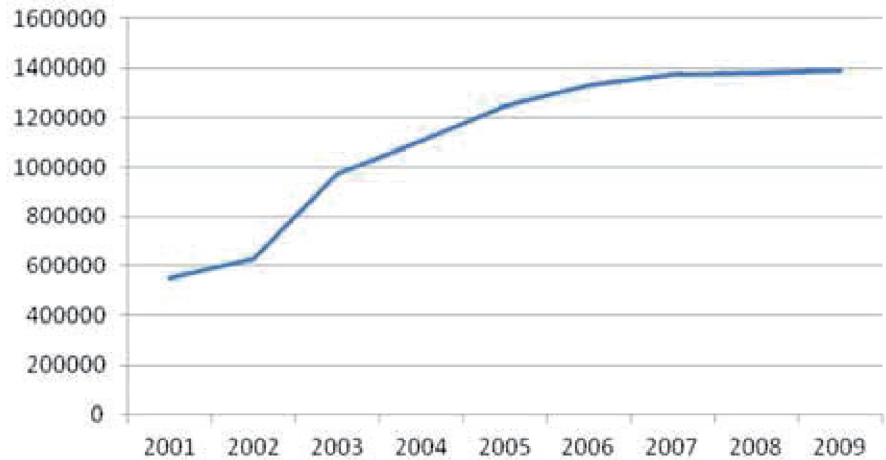
39. **One major challenge for the development of a health services export sector in Thailand has been the emergence of a dual market structure and internal brain drain.** Doctors and nurses in the private, export-oriented sector can earn three to five times as much as their colleagues in the public sector. This income gap has enticed the best medical professionals to seek employment in private hospitals in urban areas, while shortages of trained medical staff occur in rural areas. The problem is due to the fact that private hospitals that treat foreign patients do not participate in Thailand's social health insurance schemes. Foreigners and upper-income Thai citizens pay out of pocket or are covered by private health insurance. This practice diverts resources, including medical personnel, away from public hospitals, which participate in the social health insurance schemes and serve only Thai patients (Cattaneo 2012). A related concern is that tertiary medical education is provided almost exclusively by the public sector. Hence, all the talent that private, export-oriented hospitals hire has been formed with taxpayers' money.

40. **As a result, the Thai government had to devise a set of complementary policies in order to contain political and social discontent about the uneven distribution and quality of medical services.** One principal element of this flanking policy has been the imposition of three years' compulsory public service for medical graduates, with two-thirds of whom are sent to work in rural areas (Cattaneo 2012). Moreover, financial incentives were introduced for doctors in rural areas, such as allowances for hardship, not engaging in private practice, overtime work, and special service. Additional financial incentives were announced in 2004–05, as a result of which a new medical graduate in the most remote rural district can earn a salary equal to that of a senior medical practitioner in the central department with 25 years of experience. In 2004, the government approved the "One District, One Doctor Project," under which new medical students are recruited from high schools in rural districts, educated at a local university and local hospital, and retained to work in their own districts. In mid-2004, the government also approved a project to rapidly increase the acceptance of medical graduates as a proactive approach to human resources planning in the health sector, where the duration of education is long.

Trade in health services

41. **The number of international patients in Thailand increased markedly during the 2000s to 1.4 million in 2009** (see figure 3.3). This total includes general tourists and foreigners who work or live in Thailand and receive medical treatment during their stay. Pure medical tourists accounted for an estimated 30 percent of all international patients, or 420,000 individuals (NaRanong and NaRanong 2011). This number exceeds the corresponding figure for Singapore, which used to be considered the leading medical tourist destination in the region and the "medical hub of Asia." Recently, the growth rate of international patients in Thailand has slowed, however, as a result of political instability and the global financial crisis.

Figure 3.3 Number of Foreign Patients Treated in Thailand



Source: Supakankunti and Herberholz 2012.

42. **Thailand's main strengths as a medical tourism destination are its high-quality medical professionals and a hospitable and service-minded culture.** In addition, the cost of medical treatments is competitive relative to other providers in the region (see table 3.3). Moreover, since Thailand has traditionally been a major tourism destination, the country is particularly well placed to supply tourism-related medical treatment and wellness packages. In this context, the general tourism infrastructure like hotels, shopping malls, and restaurants is also an important component of the medical tourism experience of international patients, and is supporting Thailand's quest to become a leading medical services supplier (Supakankunti and Herberholz 2012).

Table 3.3 Competitive Position of International Health Service Locations in Asia

Competitive Advantage	Thai	Singapore	India	Malaysia
Service & Hospitality	*****	**	*	*
Hi-technological Hardware	**	****	**	*
HR Quality	****	****	**	**
International Accredited Hospital	**	**		*
Pre-emptive Move	**	***		**
Synergy/Strategic Partner	*	**		**
Accessibility/Market Channel	**	***	*	**
Reasonable Cost	****	*	****	***

Source: Thailand MoPH 2009.
Note: A higher number of stars suggests a stronger competitive position of a country in that sector.

Lessons for health services reform in ASEAN

43. **Many developing-country governments see medical tourism as an opportunity to generate additional export revenues and jobs.** Yet, the public health system will rarely be in a position to attract and accommodate international patients, so that the extent to which the private sector does, or is able to, participate in the provision of health services is a crucial factor for the development of medical tourism.

44. **In Thailand, the growth of private hospitals has given rise to a brain drain of health professionals from the public sector toward the private sector.** Increasing numbers of foreign patients and related export revenues have channeled more health care resources in the private sector toward servicing foreign and high-income local patients, to the detriment of low- and middle-income patients. This type of issue should ideally be addressed before actively promoting medical tourism in order to reduce supply bottlenecks and minimize social and political discontent. There are basically three means by which supply shortages in the public sector could be alleviated (Arunanondchai and Fink 2007): (a) investment in the education of more health care professionals by both the public and private health sectors, (b) incentives to stem the brain drain from the public sector and from rural areas, and (c) imports of foreign health care professionals. All of these choices involve important commitments of public resources or politically sensitive trade-offs, but pursuing such policies early on is bound to make the process of liberalizing the domestic health sector and enhancing health services exports smoother and more broadly beneficial for the entire population.

E. The Philippines: Telecommunications-Based Services

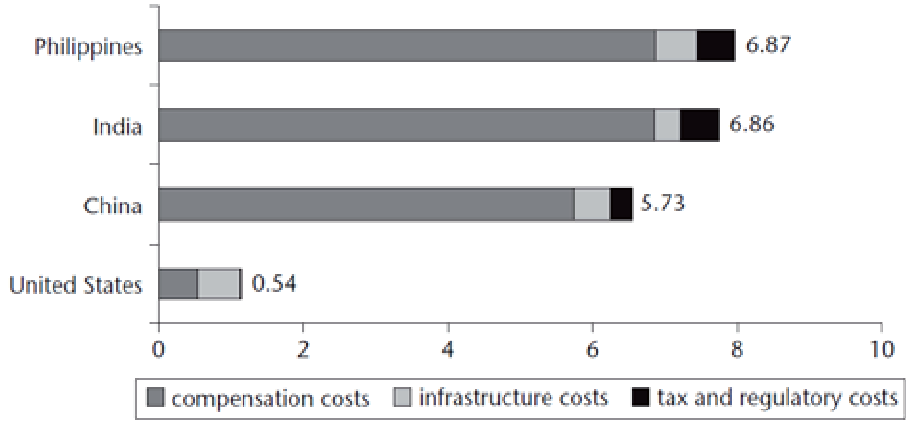
45. **Following the path of India, many developing economies have recently emerged as outsourcing destinations, and their exports of information-technology-based services have grown rapidly.** This expansion of services trade has been driven by considerable reductions in communications, transport, and transactions costs. Rapid advances in information and communication technologies and the ongoing liberalization of trade and investment in services have increased the tradability of many service activities and created new kinds of tradable services. Many service sector activities are thus becoming increasingly internationalized, especially since advanced information and communications technology enables the production of services to be location-independent. This development has led to the globalization of services activities, with associated changes in trade, cross-border investment, and employment patterns.

46. **The Philippines has been very successful in trying to benefit from the growing trend in high-income countries for firms to outsource back-office and information technology functions in order to take advantage of advanced skills and lower labor costs of specialized service providers.** This success has been possible thanks to several favorable structural factors, notably modest labor compensation costs, a large pool of suitably qualified talent, and low telecommunications and real estate costs.

47. **Business process outsourcing (BPO) is labor-intensive, and wage expenses account for about half of total costs.** The Philippines has been very competitive with respect to labor costs due to monthly wage rates of about US$400 that place the labor compensation costs in the country at the same level as those of India (A.T. Kearney 2011). This is reflected in the high financial attractiveness score of the Philippines compared to some of its competitors (figure 3.4).

48. **The Philippines has a well-performing tertiary education system that makes it possible for the country to graduate about 500,000 college graduates every year, many of whom have a science, engineering, or business specialization.** Moreover, young Filipinos are familiar with the cultural, legal, and accounting systems in the United States; speak idiomatic American English better than many other Asians and with more neutral accents; and are known for their warm, customer-oriented attitude that is important for BPO and call center activity. Overall, the share of college graduates deemed fit to work in international operations is estimated to be at least twice as high as, for example, in China (Yi 2012).

Figure 3.4 Financial Attractiveness Score, Selected Countries, 2011



Source: A.T. Kearney 2011.

49. **While there are notable weaknesses in the telecommunications and general infrastructure in the Philippines, the broadband telecommunications system in urban centers and industrial parks, which are of critical importance for BPO, performs well.** Communications costs are low and the quality and reliability of services are good. Moreover, the development of BPO activities has benefited from the ready availability of reasonably priced office space in Makati City, Manila's main business district, after the Asian financial crisis.

Policy reforms concerning ICT services

50. **The government has facilitated the success of the BPO industry in the country by trying to provide an enabling, supportive business environment.** One key policy reform was the liberalization of the telecommunications industry in the mid-1990s. In particular, competition in local long-distance services and the authorization of international simple resale led to a sharp drop in telecommunication rates. Indeed, the price reduction for phone calls in the Philippines was more pronounced than in most other countries in the region (Fink, Mattoo, and Rathindran 2001). Moreover, a large number of Voice over Internet Protocol (VoIP) providers was subsequently allowed to emerge in the Philippines, which further contributed to lowering communications costs.

51. **Several public institutions and government programs have been instrumental in establishing the skill and knowledge foundations for the BPO boom.** In particular, the Commission on Higher Education, which is attached to the Office of the President, has been in charge of establishing standards for all degree-granting programs at postsecondary educational institutions. Moreover, the Technical Education and Skills Development Authority, which is responsible for managing and supervising technical education and skills development, provided voucher-based funding for private sector training initiatives.

52. **The rapid expansion of the BPO sector in the Philippines has also benefited from governmental investment support and financial incentives.** Foreigners were allowed to own up to 100 percent of BPO firms. This full foreign ownership possibility has been helpful in assuaging investor concerns about employee integrity, leakage of technological know-how, and data protection.

53. **The Philippine government has encouraged FDI through several forms of investment incentives.** If firms engage in one of the activities contained in the government's Investment Priorities Plan, which includes BPO activities, they are eligible for fiscal incentives from the Board of Investments. Such incentives include income tax holidays of up to eight years, tax deductions equivalent to 50 percent of

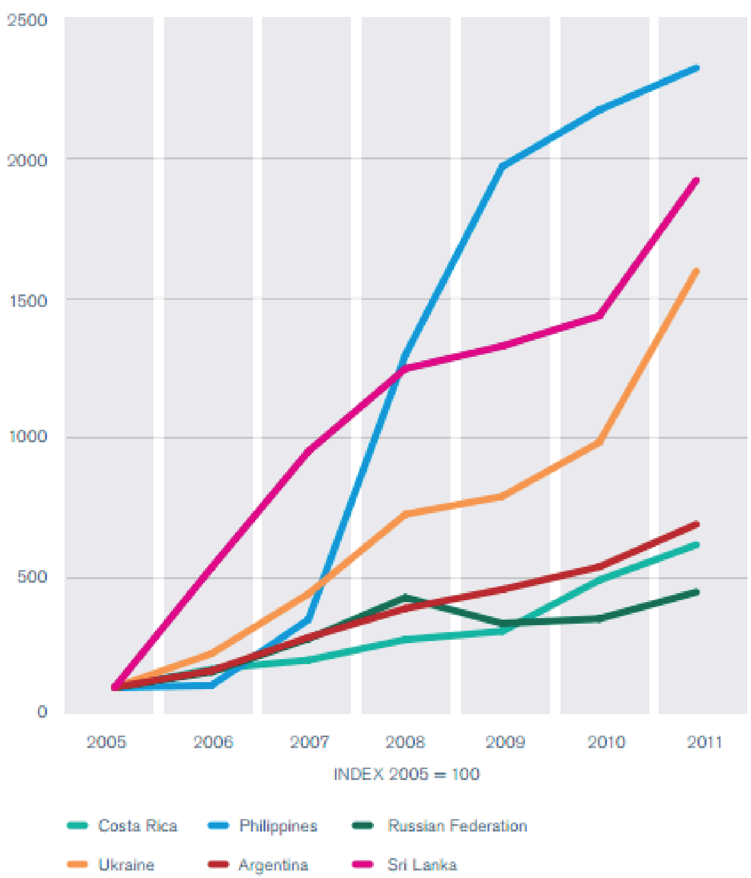
wages of direct-hire workers, and duty exemptions for imports of raw materials. Moreover, firms that export at least 70 percent of their output and have established themselves with the Philippines Export Zone Authority (PEZA) enjoy additional incentives, such as a low 5 percent gross income tax rate, exemption from all local government fees or taxes, and exemption from expanded withholding tax (Yi 2012).

54. **Further, for companies registering under PEZA, the authority offers one-stop-shop services for business registration, and extends an exemption from local government business permits, licenses, and fees.** PEZA issues permits related to building and occupancy, import and export, and environment compliance (Yi 2012). Such services have helped reduce business start-up time and costs.

Trade in ICT services

55. **Between 2005 and 2011, Philippine exports of computer services rose by an annual average of 69 percent, outgrowing many other emerging services providers (see figure 3.5), and since 2010 the Philippines has become the world's biggest voice-BPO provider.** In 2011, BPO exports accounted for 16 percent of total Philippine exports (Mitra 2013). BPO is estimated to have generated more than US$15 billion in revenues in 2013, with BPO firms employing more than 900,000 staff. The IT-BPO Road Map 2011–2016 of the Business Processing Association of the Philippines foresees further growth in the industry, and estimates that by 2016, BPO-firms could earn up to US$25 billion in revenues and provide employment for 1.3 million office workers. The sector would then contribute 9 percent to the country's GDP.

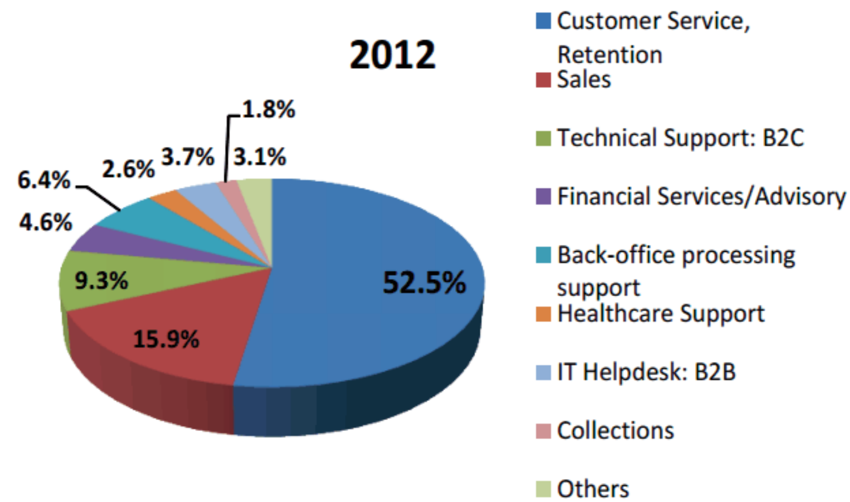
Figure 3.5 Exports of Computer Services in Selected Developing Economies



Source: WTO 2012.

56. **About 80 percent of the total BPO industry has been centered on call center activities, of which about three-quarters are provided for the U.S. market.** Within call center operations, two-thirds of all activities concern customer service and sales (see figure 3.6). There have been efforts, however, to diversify revenue and employment into a broader range of nonvoice, complex services, including legal, financial, and other analytical work.

Figure 3.6 Distribution of Call Center Activities



Source: Call Center Association of the Philippines.

Lessons for ICT-related reforms in ASEAN

57. **Over just one decade, BPO activities have grown from virtual nonexistence to a significant part of the Philippine economy.** This export success has been made possible through private sector initiative that took advantage of some key strengths of the Philippines, notably low labor costs; an abundant supply of well-qualified, Anglophone graduates; and a good telecommunications infrastructure. In addition, the government supported the development of the sector by making BPO firms eligible for investment support and export zone benefits, and fostering tertiary education.

58. **Despite the continuing growth in BPO activities in the Philippines, a number of challenges are emerging that also warrant the attention of policy makers in other emerging services exporters.** One fragile point in the Philippine success is the strong concentration of BPO activity in call centers and the heavy reliance on one client market, the United States. This strong exposure to a narrow market segment and one geographic client location makes the sector's revenues and employment vulnerable to cost pressures. Indeed, the appreciation of the Philippine peso vis-à-vis the U.S. dollar up to mid-2013 significantly reduced the attractiveness of the country for voice service offshoring. Hence, efforts to diversify the activity spectrum of BPO services and to broaden the geographic client base are important medium- to long-term objectives for public and private decision makers. One critical element in this context concerns further improvements in the quality of tertiary education and on-the-job training in order to develop the skills base for the shift toward higher-value knowledge process outsourcing.

59. **Moreover, policy makers should be mindful of the income distribution effects of BPO development.** Most jobs in call centers and other outsourcing activities have been created in or near major urban centers, notably Manila, and provided income for young, college-trained graduates, while rural, less educated workers have not benefited from the BPO boom. More generally, recent research on services liberalization in the Philippines points to increasing wage disparities, to the detriment of more vulnerable

populations (Amoranto, Brooks, and Chun 2010), so that complementary, broad-based policies to support training and education that makes it possible for broad segments of the population to upgrade their earning potential are called for.

F. The Greater Mekong Subregion: Transportation Services

60. **The Greater Mekong Subregion (GMS), which comprises the six countries of Cambodia, China (Guangxi Zhuang Autonomous Region and Yunnan Province), Lao PDR, Myanmar, Thailand, and Vietnam, has experienced strong economic growth over the last decade, largely driven by expanding trade and investment links.** The physical connectivity in the region has improved, and policy barriers to intraregional trade and investment have come down. Yet, there is untapped potential to make additional improvements in trade and transport facilitation, and the poorest GMS countries—Cambodia, Lao PDR, and Myanmar—are seen as the biggest beneficiaries of further reductions in trade transactions costs (Stone and Strutt 2009).

61. **At the national level, internal and external connectivity has been expanded substantially over the last 15 years.** National road networks have been developed and up-scaled, and modern communication technology has spread rapidly throughout GMS countries (CIE 2010). Also, tariff and nontariff barriers have come down. Yet, there remains considerable scope to realize further gains from regional integration by reducing avoidable transaction costs and delays in cross-border trade.

Policy reforms concerning logistics services

62. **Policy makers in GMS countries are aware of the benefits of trade and transport facilitation and have pursued two initiatives within the broader GMS Economic Cooperation Program aimed at reducing trade transactions costs: the Strategic Framework for Action on Trade Facilitation (SFA-TFI) and the Cross-Border Transport Agreement (CBTA).** These programs complement other national and regional efforts to remove impediments to regional integration, and present a collaborative way to realize substantial gains that benefit the entire region.

63. **The SFA-TFI is focused on institution building, training, and research activities at the regional level.** It addresses policy and institutional issues related to the treatment of border and behind-border issues, and the development of policy positions and negotiation capacities in relation to bilateral, plurilateral, and multilateral trade agreements (ADB 2008).

64. **The CBTA promotes transport and trade facilitation in the GMS region** (Nyunt 2013). It was initially signed in November 1999 by Lao PDR, Thailand, and Vietnam. Cambodia, China, and Myanmar acceded to the Agreement in November 2001, November 2002, and September 2003, respectively. The central features of the CBTA focus on (a) enabling vehicles, drivers, and goods to cross national borders through the GMS road transport permit system; (b) avoiding costly transshipment through a customs transit and temporary importation system and a guarantee system for goods, vehicles, and containers; (c) reducing processing time at borders, through single-window inspection, single-stop inspection, information and communication equipment and systems for information exchange, risk management, and advance information for clearance; and (c) encouraging network effects and economies of scale by promoting the number of border checkpoints implementing CBTA.

65. **The GMS countries have been successful in mobilizing funds and loans for developing national and regional road and rail infrastructure, but progress within CBTA and the implementation of related soft infrastructure reforms (for example, regulations, procedures, and expertise) have been lagging.** Trade facilitation issues go well beyond customs administration, and notably involve improved coordination with and among other border agencies. The prevalence of informal

payments and lack of transparency with respect to the applicable procedures and regulations continue to be a problem in the GMS region. Also, differences in logistics regulations across countries, for example, concerning axel load limits in main transport corridors, and a lack of common standards, for example, with respect to the use of containers or trucks in transborder shipments, continue to complicate the movement of goods within GMS (World Bank 2012b).

66. **Almost every country in the region is working on building its National Single Window as an anchor for trade facilitation reform.** The National Single Window forces agencies to work together toward a shared vision. The major challenges reformers face in this context are not typically ICT related, but relate to the very high degree of active collaboration required from both public and private stakeholders (World Bank 2012b).

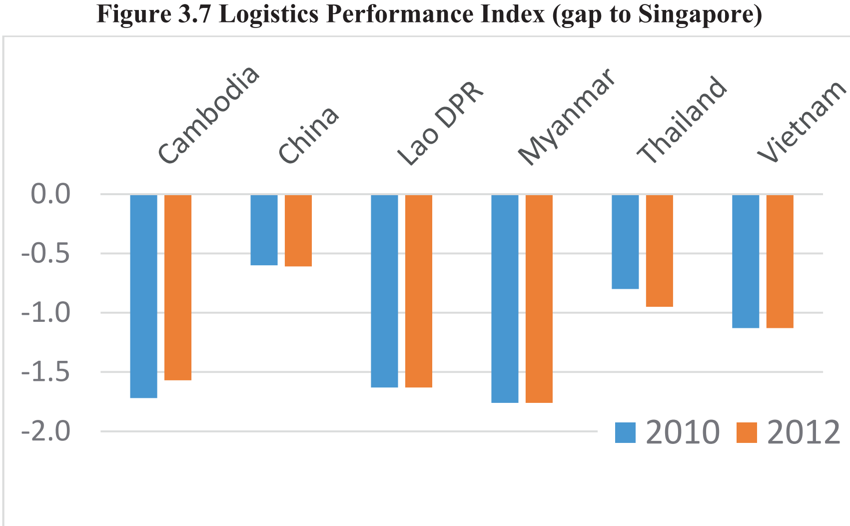
67. **Moreover, national logistics plans are under development by many GMS governments to identify key short- and long-term priorities for action.** Such blueprints have proven to be most useful and effective if they benefit from high-level political commitment to lead and monitor implementation, and if they are developed as multimodal, integrated plans, rather than on a sectoral (air, land, water) basis. Also, a clear definition and delimitation of responsibilities of different stakeholders is instrumental for implementation success.

Logistics performance

68. **The performance of the logistics sector plays a critical role in shaping countries' international competitiveness.** With trade policy barriers falling, the integration of logistics systems across countries is becoming a crucial factor for enabling the participation of countries and regions in international production sharing networks that have been driving global trade growth.

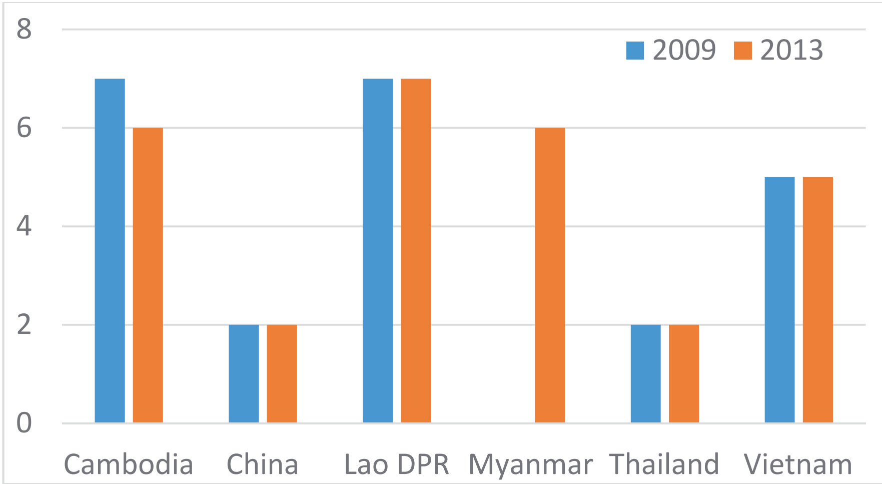
69. **The trade and transport facilitation efforts in GMS countries have been bearing fruit in the sense that their logistics performance is improving.** For all countries in the region, except Thailand, the World Bank's Logistics Performance Index showed a higher value in 2012 than in 2010. However, the progress of logistics in the GMS region seems modest. The gap between the GMS countries and the best performer in ASEAN, that is Singapore, remains largely unchanged, except for Cambodia, whose gap has narrowed (figure 3.7). A similar picture emerges when assessing the complexity of documentary requirements over time, as measured by the number of documents required for imports (figure 3.8).

Figure 3.7 Logistics Performance Index (gap to Singapore)



Source: World Bank 2012a.

Figure 3.8 Number of Documents to Import (difference to Singapore)



Source: World Bank Doing Business Database.

Lessons for logistics reforms in ASEAN

70. **Trade and transport facilitation promise substantial gains for the GMS region.** The CBTA contains a number of pertinent provisions to facilitate cross-border movement and customs transit. These measures aim to reduce the time and administrative procedures when moving goods across the region. In particular, customs and border clearance formalities are to be harmonized or facilitated, and greater use of risk management techniques and information and communications technology are envisaged. However, putting the agreed measures into practice has proven time-consuming, and the resulting delay in implementation might have limited trade and transport operators from reaping the full benefits of regional integration. Hence, considerations for policy makers include identifying potential implementation bottlenecks on the ground, more resources to support their administrations, and adequate timelines and political guidance to reduce trade transaction costs.

71. **Some elements of the CBTA have, over time, been overtaken by broader regional initiatives, as is the case with the ASEAN Single Window.** To achieve the objectives more effectively, ASEAN needs to continue to ensure minimal overlap among initiatives at the unilateral, plurilateral, and multilateral level, and to coordinate the interventions of different development partners. In this context, institutional capacity building is called for in order to equip national administration with the skills and tools to deal with the multitude of customs and border clearance reforms and projects.

Chapter 4. Strengthening the ASEAN Framework Agreement on Services and the Services Integration Process

This chapter reviews the ASEAN Framework Agreement on Services (AFAS) and assesses how it contributes to promoting integration of services trade within the region. In particular, the chapter assesses (a) the disciplines and architecture of AFAS, including its key rules and obligations, sectoral provisions, and institutional framework; and (b) the progress under AFAS, drawing on a database that captures the commitments made under it, and compares it with commitments under the General Agreement on Trade in Services (GATS) and other trade agreements. It also takes a look at mutual recognition arrangements as an important initiative to facilitate the flow of professional services. Based on this analysis, it finds that ASEAN Member States have taken important steps in the liberalization of trade and investment in services, but the "single market" still remains a distant goal. The ASEAN Economic Community (AEC)-AFAS framework has provided few opportunities to tackle regulatory barriers on services trade, which is ultimately leading to a shallow integration process that will not create a true single market. In addition, a number of issues regarding AFAS's obligations and scope remain, and need to be clarified to ensure its effectiveness in removing barriers to trade and investment in services.

A. Introduction and Background

1. **Economic integration in Southeast Asia is at a crossroad, especially on services integration.** ASEAN Member States have set ambitious goals, seeking to establish a single market for goods and services, to integrate the economies of the 10 countries. Further, in keeping with ASEAN's overarching goals of integrating with the world economy, ASEAN Member States, individually or as a group, are deepening their ties with the world through the negotiation of broad free trade agreements (FTAs) with all the major economies, including China, India, Japan, the Republic of Korea, the European Union, and the United States.

2. **This situation offers important challenges and opportunities on both the internal and external fronts for ASEAN, especially on trade and investment in services.** Advances in communication technology have supported services trade as the fastest-growing segment of international trade for the last three decades (Cattaneo et al. 2010), and great potential remains within ASEAN Member States to increase intraregional trade in services, particularly of high-value-added, modern services (see Chapter 6), offering valuable opportunities for the region. However, because services trade is governed mostly through domestic laws and regulations, service integration entails policy coordination challenges much deeper than trade in goods.

3. **This chapter assesses the ASEAN Framework Agreement on Services (AFAS) and its contribution to promoting integration on services within the region.** To provide a basis for further reform and liberalization of the service sector in ASEAN Member States, this chapter reviews the principles of the AFAS and its achievements to date. In particular, it assesses (a) the disciplines and architecture of the AFAS, including its key rules and obligations, sectoral provisions, and institutional framework; and (b) progress achieved by the AFAS, drawing on comparative institutional data (separate from that discussed in Chapter 2), which captures the commitments made under it and compares it with commitments under GATS and other trade agreements. The chapter also takes a look at mutual recognition arrangements as an important initiative to facilitate the flow of professional services, and services liberalization elements contained in ASEAN Member States' FTA with trading partners. Based on this analysis, the chapter offers

recommendations to strengthen the ASEAN services trade framework, including in the new services integration agreement that the ASEAN Member States are considering now.

4. **The findings of this analysis are twofold.** First, ASEAN Member States have made important progress in the liberalization of trade and investment in services, and the AFAS, reinforced by the negotiating goals set out in the ASEAN Economic Community Blueprint, has provided a solid platform for reducing market access and national treatment limitations to services trade. Second, despite this progress, the AEC-AFAS framework has provided few opportunities to tackle regulatory barriers on trade and investment in services, which is ultimately leading to a shallow integration process that is not leading to a true single market. In fact, if ASEAN fails to advance toward the elimination of regulatory restrictions to trade in services, the conclusion of FTAs with third parties may do away with the ASEAN services integration agenda altogether. A central message of this chapter, and running through this report, is that, to maintain the progress made in obtaining reciprocal preference on services under the AFAS and to advance toward an effective single market, ASEAN Member States need to strengthen the agenda for cooperation on the regulation of services.

5. **This chapter draws on the literature on ASEAN services trade treaties and regulations.** Trewin et al. (2008) offer a comprehensive review of East Asian FTAs and how they affect ASEAN services trade; they provide an analysis of commitments based on a literature review, explain the differences in the various agreements in political and economic terms, and offer recommendations for ASEAN agreements with third parties. Dee (2009, 2010) assesses in detail the AFAS commitments on services trade and the gaps between the commitments and actual policies in ASEAN Member States. Sectors reviewed included medical, health, and financial services (Dee 2009), and air transport, maritime, and telecommunications services (Dee 2010). Dee (2013) updates the findings on financial services and air transport and compares them with actual regulatory practices, which allows her to provide specific recommendations. ERIA (2012) offers a broad review of the implementation of AEC goals across all areas, including services trade, and provides an estimate of the impact of such measures on the ASEAN economies. The analysis here attempts to expand on these studies by focusing on the operation of, and dynamics generated by, the rules and institutional settings on services trade in ASEAN, and avoiding unnecessary repetition of the formal aspects of the system. In terms of progress, this chapter goes beyond the existing literature by reviewing the types of commitments in place and evaluating them in light of other services agreements in the region and abroad.

6. **The chapter is organized as follows.** The remainder of section A provides background on the ASEAN process and the restrictions that affect services trade. Section B offers a detailed analysis of the disciplines that apply to services trade in the region and how they affect the services integration process. Section C provides a comprehensive review of the ASEAN institutions and bodies involved in promoting services integration. It also analyzes the decision-making process that ASEAN Member States follow to that end, and evaluates the implications of these institutions and procedures for the advancement of services trade. Section D assesses ASEAN progress in services integration by comparing the existing AFAS liberalization commitments with those offered by ASEAN Member States under the multilateral and bilateral agreements, and to those hypothetically required by the ASEAN Economic Community Blueprint. Section E summarizes the main findings and makes specific recommendations to further promote services integration within ASEAN and realize a single services market.

Regional integration under the ASEAN Economic Community

7. **The ASEAN Economic Community encompasses four pillars:** (a) a single market and production base, (b) a highly competitive economic region, (c) a region of equitable economic development, and (d) a region fully integrated into the global economy. In 2007, ASEAN leaders adopted the ASEAN Economic Community (AEC) Blueprint with the commitment to accelerate their efforts toward regional

economic integration. The AEC Blueprint sets out a set of ambitious goals for 2015 and a strategic schedule for implementing a number of measures that lead toward closer regional integration.

8. **The liberalization of trade in services is one of the central elements in realizing the first pillar of the AEC, which includes the free flow of services.** The Blueprint aims to establish the "free flow of trade in services, where there will be substantially no restrictions to ASEAN services suppliers in providing services and in establishing companies across national borders within the region, subject to domestic regulations." The institutionalization of ASEAN services integration predated the AEC Blueprint with the signing of the ASEAN Framework Agreement on Services (AFAS) in 1995. AFAS has three main objectives: to enhance services cooperation among Member States to substantially eliminate restrictions to trade in services among Member States; to liberalize trade in services beyond those undertaken by Member States under the GATS, with the aim to realizing a free trade area in services; and to arrive at what are referred to as packages of commitments, to be accomplished through successive rounds of negotiations of sector-specific commitments. Specific targets for service sector liberalization and integration have been set under the AEC (box 4.1)

Box 4. 1 AEC Blueprint for Economic Integration in Services Trade

The AEC Blueprint contains the following action plan for the liberalization of trade in services:

1. Remove substantially all restrictions on trade in services for four priority service sectors—air transport, e-ASEAN, health care, and tourism—by 2010, and the fifth priority service sector, logistics services, by 2013.
2. Remove substantially all restrictions on trade in services for all other service sectors by 2015.
3. Undertake liberalization through consecutive rounds every two years until 2015, that is, 2008, 2010, 2012, 2014, and 2015.
4. Target to schedule minimum numbers of new subsectors for each round: 10 subsectors in 2008, 15 in 2010, 20 in 2012, 20 in 2014, and 7 in 2015, based on GATS W/120 Services Classification List.
5. Schedule packages of commitments for every round according to the following parameters:
    - No restrictions for Modes 1 and 2, with exceptions due to bona fide regulatory reasons (such as public safety), which are subject to agreement by all Member States on a case-by-case basis
    - Allow for foreign (ASEAN) equity participation of not less than 51 percent by 2008, and 70 percent by 2010 for the four priority service sectors; not less than 49 percent by 2008, 51 percent by 2010, and 70 percent by 2013 for logistics services; and not less than 49 percent by 2008, 51 percent by 2010, and 70 percent by 2015 for other service sectors
    - Progressively remove other Mode 3 market access limitations by 2015.
6. Set the parameters of liberalization for national treatment limitations, Mode 4, and limitations in the horizontal commitments for each round by 2009.
7. Schedule commitments according to agreed parameters for national treatment limitations, Mode 4, and limitations in the horizontal commitments set in 2009.
8. Complete the compilation of an inventory of barriers to services by August 2008.
9. Allow for overall flexibilities, which cover the subsectors totally excluded from liberalization and the subsectors in which not all the agreed parameters of liberalization of the modes of supply are met, in scheduling liberalization commitments. The scheduling of liberalization commitments in each round shall be accorded with the following flexibilities:
    - Possibility of catching up in the next round if a Member State is not able to meet the parameters of commitments set for the previous round

Box 4. 1 AEC Blueprint for Economic Integration in Services Trade (continued)

- Allowing for substitution of subsectors that have been agreed to be liberalized in a round but for which a Member State is not able to make commitments, with subsectors outside of the agreed subsectors
- Liberalization through the ASEAN minus X formula (See Note below). Complete mutual recognition arrangements (MRAs) currently under negotiation, that is, architectural services, accountancy services, surveying qualifications, medical practitioners by 2008, and dental practitioners by 2009.

10. Implement the MRAs expeditiously according to the provisions of each respective MRA.
11. Identify and develop MRAs for other professional services by 2012, to be completed by 2015.
12. Strengthen human resource development and capacity building in the area of services.

Source: ASEAN AEC Blueprint.

Note: ASEAN – X formula allows a sub-group of ASEAN Member States to make faster progress in regional integration without requiring the involvement of the other members.

9. Since 1995, numerous *packages* of AFAS commitments have been concluded and signed by ASEAN Member States. These negotiations have resulted in (a) eight packages of commitments in a wide range of service sectors under the purview of ASEAN Economic Ministers, (b) six packages of commitments in financial services, and (c) eight packages of commitments in air transport. The packages contain liberalization commitments that aim at reducing restrictions to services trade among the ASEAN Member States. Liberalization measures in the financial services sector have a more gradual timetable that aims to allow members to ensure orderly financial sector development and maintenance of financial and socioeconomic stability. Member countries are encouraged to follow prudent principles such as using ASEAN-X processes, and to take into account national policy objectives and the level of economic development when liberalizing financial services.

Restrictions on services trade

10. **Trade and investment in services can be limited through formal restrictions or through a wide range of domestic regulations.** Formal restrictions to services are those aimed at limiting access into the domestic services market by local and/or foreign firms, or at affording domestic services suppliers a competitive advantage through measures that discriminate against foreign service suppliers, referred to as market access restrictions and discriminatory measures, respectively. Measures that limit market access are typically quantitative in nature, but may also entail total prohibitions or limitations to the form of entry. Table 4.1 offers examples of formal restrictions to trade and investment in services that are at the core of services trade negotiations, including under the AFAS. In trade agreements, especially those inspired by the GATS, these types of restrictions to trade and investment fall under the scope of the provisions on "market access" and "national treatment," which are the main obligations toward services liberalization.

11. **Regulatory measures normally aim to correct market failures or pursue other noneconomic policy goals, which may not be directly related to trade.** Services are prone to market failures, in particular due to information asymmetries that affect sectors like professional services and financial services, and the existence of monopolies in networked services, including telecommunications and energy distribution. Also, a number of services play an important role in noneconomic policy goals; universal access to health and education services, for example, is a key element of distributional policies (Krajewski 2003; Stiglitz 2010). The objective of dealing with regulatory measures is not their removal, but to ensure that they are not more trade restrictive than necessary for their legitimate purposes.

Table 4.1 Formal Restrictions on Trade and Investment in Services

Market Access Restrictions	Discriminatory Measures

• Monopoly / exclusive service suppliers
• Quantitative limitations on
  o number of services providers
  o services transactions
  o operations / output
  o number of employees
• Geographic restrictions
• Limitations to foreign equity participation
• Economic needs tests
• Limitations on form of establishment
• Joint-venture requirements
• Prohibitions on participation
	• Discriminatory licensing requirements on
	  o Qualifications / education
	  o Technical capacity
	  o experience
	• Nationality / residency of service providers and managers, boards of directors
	• Discriminatory taxation
	• Sectors reserved to domestic investors
	• Landownership restrictions
	• Type of shares owned by foreigners
	• Other forms of discriminatory measures

12. **Regulatory measures govern the way service suppliers do business, but do not usually take the form of discriminatory measures or entail quantitative ceilings.** Regulatory measures, however, do entail conditions that affect services provision. For instance, the substantial conditions for the issuance of licenses or permits can determine whether a service sector is de facto open or closed to foreign participants. This is particularly the case in professional services, which require a demonstration of studies in accredited institutions. Other regulatory measures relevant to services trade include:

- zoning / geographic restrictions
- qualifications requirements
- knowledge transfer
- rules on anticompetitive behavior
- limitations on distribution channels
- limitations on pricing
- limitations on transfer of funds
- advertising limitations
- rules on competition policy
- requirement to subscribe to association
- approval of mergers and acquisitions
- performance requirements
- import permits
- duration of license / divestment
- hours of business operations.

13. **Some regulatory measures can impair services trade and investment and limit market integration, even when they are nondiscriminatory or feature no obvious quantitative restrictions** (WTO 2012). For example, a number of requirements for the issuance of licenses and permits are usually nondiscriminatory and justifiable on public policy grounds, and in fact they exist in all jurisdictions. To the extent that these requirements are different from country to country in terms of substance and procedures, however, even when they pursue similar policy objectives, they can increase costs and lead to market segmentation, limiting integration of the services markets. In this case, efforts to reduce such costs without sacrificing legitimate public policy objectives should be pursued, domestically and externally. Under the GATS and other trade agreements, these types of measures are commonly covered by the disciplines on "domestic regulation" (for example, GATS Article VI), which seek to provide a framework that ensures that these regulatory measures do not entail greater restrictions to trade than what is necessary to achieve their policy goals. If those requirements were discriminatory instead, they would fall under the regular liberalization obligations in trade agreements, including most-favored nation, market access, and/or national treatment.

14. **Consequently, integration of services markets requires two types of efforts: (a) liberalization in the form of removal of market entry and discriminatory restrictions, and (b) regulatory cooperation aimed at reducing barriers from divergent regulation.**[30] In addition, a third level of broader cooperation initiatives, including capacity building, regional coordination of infrastructure development, and promotion of private sector development, can complement liberalization and regulatory cooperation measures. The experience of the most advanced modern integration process, the European Union, demonstrates that services liberalization is usually the first step in economic integration, and focuses on the dismantling of domestic formal restrictions to foreign services. Trade liberalization is generally governed by a set of mandatory disciplines agreed between the partners, focused on removing formal barriers to access and discriminatory treatment. This is the focus, for example, of the GATS, and bilateral free trade agreements. The greater the desired economic integration, instead, the stronger the need to address regulatory barriers through cooperation mechanisms. Greater cooperation tends to require an active and continuous engagement, which is typically reflected in standing institutions and/or procedures that facilitate dialogue among the partners.

B. Disciplines and Negotiating Modalities on Services Trade

15. **The ASEAN Framework Agreement on Services is closely related to the GATS and follows its main principles, disciplines, and approach to liberalization.** The AFAS, signed in 1995, was the first regional agreement to be concluded after the entry into force of the WTO agreement on services, and was influenced by it. The AFAS was meant to:

- enhance cooperation in services among Member States in order to improve efficiency and competitiveness, diversify production capacity, and improve supply and distribution of services within and outside ASEAN
- substantially eliminate restrictions to trade in services among Member States
- liberalize trade in services by expanding the depth and scope of liberalization beyond those undertaken by Member States under the GATS, with the aim to realizing a free trade area in services.

16. **The goals of the AFAS were further strengthened with the signing of the Bali Concord II, which set out to establish the ASEAN Economic Community as a "single market and production base," with "free flow" of goods, services, and investment.** The completion of the AEC, originally scheduled for 2020, was ambitiously advanced to 2015 by the ASEAN Heads of State during the 12th ASEAN Summit in the Philippines in January 2007. The AEC goals and the AEC Blueprint adopted in 2007 thus further elaborated and gave meaning to the AFAS objective of eliminating restrictions to trade in services and realizing a free trade area in services. Ultimately, the AEC–AFAS seeks to go far beyond the progressive services liberalization envisaged in the GATS in order to establish a single market in services trade and investment.

[30] In fact, the removal of regulatory barriers, even those that are nondiscriminatory, can be considered a form of "liberalization" (see, for example, Krajewski 2003). For greater clarity, however, "liberalization" is associated with the removal of formal restrictions to services trade, in the format of market access or discriminatory measures. "Regulatory cooperation" is referred to as the process of reducing regulatory restrictions, through mutual recognition, harmonization of principles, regulatory unification, or otherwise.

Architecture

17. **While the AEC revamped the goals of services integration, the architecture, disciplines, and procedures in place remained those of the AFAS, which, in turn, is linked directly to the GATS in all its elements.** Created only a year after the GATS, the AFAS relies significantly on the GATS to complement its architecture and disciplines. The agreement features 14 provisions (box 2), none of which contains any major liberalization or regulatory obligation. The substantial element of AFAS, instead, is featured in Article XIV(1), entitled "Final Provisions," which provides that:

> *"1. The terms and definitions and other provisions of the GATS shall be referred to and applied to matters arising under this Framework Agreement for which no specific provision has been made under it."*

In this way, the AFAS effectively incorporates the main substantial disciplines of the GATS, including on the key liberalization obligations of market access and national treatment. The AFAS also adopts GATS's structure in the way it tackles the different modes of services trade, and the GATS architecture for negotiating and making commitments.

Box 4.2 AFAS Articles

I. Objectives
II. Areas of Cooperation
III. Liberalization
IV. Negotiation of Specific Commitments
V. Mutual Recognition
VI. Denial of Benefits
VII. Settlement of Disputes
VIII. Supplementary Agreements or Arrangements
IX. Other Agreements
X. Modification of Schedules of Specific Commitments
XI. Institutional Arrangements
XII. Amendments
XIII. Accession of New Members
XIV. Final Provisions

Modes of supply

18. **Following the GATS model, the AFAS covers fours modes of services supply, which reflect the various means through which services are traded internationally.** The four modes can be summarized as follows:

- Cross-border supply (Mode 1): similar to trade in goods, it occurs when a service is delivered from a supplier in one country to a consumer in another country.
- Consumption abroad (Mode 2): services supplied in the territory of one country to the consumers of another. The consumer moves to acquire services in the country of the services suppliers. This entails that the services are supplied outside the territory of the country making the commitment.
- Commercial presence (Mode 3): services are supplied through any type of business or professional establishment of one country in the territory of another. This mode captures foreign investments in the service sector.
- Movement of natural persons (Mode 4): services supplied by nationals of one country in the territory of another.

19. **The alternative to this modal structure is the model pioneered by the North American Free Trade Agreement (NAFTA), which provides for different disciplines for *trade* and *investment* in services.** These agreements feature a chapter on cross-border trade in services and a separate one on foreign investment, which covers investment in both goods and services. In the ASEAN region, only Singapore has so far adopted this model in its bilateral trade agreements. Other ASEAN Member States, namely Malaysia and Vietnam, are becoming familiar with this model in the ongoing negotiations on the Trans-Pacific Partnership agreement, which will likely adopt a NAFTA-like format.

20. **The ASEAN Agreement on the Movement of Natural Persons (AMNP), concluded in 2012, altered the AFAS modal structure.** Negotiations pertaining to Mode 4 will now be conducted under the AMNP, thus limiting the liberalization discussions under the AFAS to Modes 1, 2, and 3. The AMNP is a stand-alone agreement that contains its own provisions, including on transparency, recognition, and dispute settlement.

Liberalization Disciplines, Obligations, and Modalities

21. **Unlike the GATS, the AFAS is a framework agreement that features no substantial obligations of its own, but imports GATS's main disciplines through Article XIV of the AFAS.**[31] However, the exact disciplines, including their interpretation, that are in fact incorporated in the AFAS, how, and to what extent, could be further clarified. Although Article XIV of AFAS provides that "The terms and definitions and other provisions of the GATS shall be referred to and applied to matters arising under this Framework Agreement for which no specific provision has been made under it," the agreement is silent regarding what formalities, if any, such as a decision by the ASEAN Member States, are required to incorporate any new developments under the WTO.

22. **The main liberalization disciplines under AFAS pertain to market access and national treatment.** While the AFAS does not expressly refer to these provisions, the wording of the agreement, which refers to "eliminating substantially all existing discriminatory measures and market access limitations," and the use of GATS-like schedules that expressly refer to "market access" and "national treatment," confirms the adoption of these provisions into the AFAS.[32] Together these two provisions aim to reduce quantitative restrictions on services trade and provide a level playing field between domestic and foreign service suppliers. As described in the GATS, AFAS disciplines on "market access" cover the following six categories of restrictions:

- number of service suppliers
- value of service transactions or assets
- number of operations or quantity of output
- number of natural persons supplying a service
- type of legal entity or joint venture
- participation of foreign capital.

Of these, the first four categories are quantitative, since they deal with quota-type limits. These limits may be expressed either as an absolute number or in the form of an economic needs test, and cover both discriminatory and nondiscriminatory measures.

23. **Discriminatory measures are addressed by the national treatment obligation.** The provisions do not provide an exhaustive list of discriminatory measures, but simply require a member to accord to ASEAN services and service suppliers treatment "no less favorable than that it accords to its own like services and service suppliers" with respect to measures affecting trade in services.

24. **Following GATS wording, the national treatment obligation covers both de jure and de facto discrimination.** That is, a measure is discriminatory when it alters the conditions of competition in favor of domestic services and service suppliers, regardless of whether the measure is openly discriminatory in

[31] For a general review of GATS disciplines, see WTO Secretariat (2005, 2006). For a more comprehensive analysis of the agreements, see Wolfrum, Stoll, and Feinäugle (2008).
[32] Moreover, according to information provided during the drafting of the report, WTO Scheduling Guidelines are adhered to in full by ASEAN Member States.

its text. Typical examples of discriminatory measures include restrictions on tax benefits only for nationals, training requirements imposed only on foreign suppliers, or language requirements that are not directly relevant to the exercise of a profession.

25. **The full extent of the incorporation of GATS disciplines also remains generally untested.** For example, the terms of GATS provisions on market access and national treatment have been interpreted by the WTO panels and Appellate Body in a handful of dispute settlement cases.[33] These interpretations help clarify the meaning of these provisions in the WTO context. It is not clear what significance such interpretations have under the AFAS. One example of this is whether the WTO supporting documents, such as the "Scheduling Guidelines," can be used to clarify the scope of these provisions in the context of ASEAN.

26. **Currently, in line with GATS practices, the market access and national treatment obligations are not immediately mandatory across the board.** The reach of these obligations is limited to those services sectors and modes of supply on which the ASEAN Member States have undertaken specific commitments through the AFAS rounds of negotiation. Further, even if full commitments were undertaken in all services sectors, a number of limitations to trade in services could remain in place. While the elimination of quantitative and discriminatory limitations would go a long way in reducing formal barriers to trade within ASEAN, regulatory restrictions, which may constitute unnecessary barriers to trade, would fall beyond the main obligations of the agreement and could be maintained. The central importance of market access and national treatment obligations under the AFAS, especially compared to the status of rules on domestic regulation, which have not yet been developed at the GATS level and therefore are not subject to specific disciplines under the AFAS, confirms that the region has focused so far on the elimination of formal restrictions to trade and investment in services. ASEAN Member States, however, have done little to complement the reduction of formal barriers with positive actions, such as coordinated regulatory policies in services.

Scheduling modalities

27. **Scheduling" is the mechanism for linking specific service sectors and/or a certain type of measure to the disciplines of international trade agreements.** Different models of trade agreements refer to this technique in different ways. GATS-style agreements refer to it as "scheduling of specific commitments." NAFTA-style, negative-list agreements follow the more classical terms of international law, calling this process "listing" (for "list of reservations"), or "taking reservations." Regardless of the name, the purpose of the schedules of commitments / lists of reservations is to determine how the obligations of the agreement apply to each specific services sector and type of measure. Schedules tend to be country specific, and are typically the result of a mercantilist negotiating process. The choice of the scheduling modalities of liberalization obligations is generally regarded as a decision central to the negotiating process, since to some extent it defines the dynamics of the negotiations and is generally linked to the disciplines that the agreement is expected to include.

28. **There are two elements that determine the liberalization approach.** The first is the sectoral coverage of the commitments. Disciplines can apply to services sectors through either a positive list of sectors submitted by each of the parties, or by applying to all sectors except those included in each country-specific list (negative list). The second concerns how the liberalization obligations—that is, the national treatment and market access—apply to those sectors. There can be two approaches. Using a negative list approach, parties can assume that services are generally open and nondiscriminatory, and only exceptional

[33] See, for instance, the panel and Appellate Body reports on EU – Bananas III (WTO documents WT/DS27/R/ECU and WT/DS27/AB/R), United States – Gambling (WTO documents WT/DS285/R and WT/DS285/AB/R), and China – Publications and Audiovisual Products (WTO documents WT/DS363/R and WT/DS363/AB/R).

restrictions need to be listed. Or, on the contrary, each individual liberalization measure can be listed as being committed.

29. **Three types of agreements in services can be identified depending on the liberalization approach.** The "pure positive list" agreements are those that require both sector and specific measures to be explicitly listed in order to be committed. This approach is rare in international services negotiations, and so far has only been adopted by China in it agreements with the special administrative regions of Hong Kong and Macao. A second, much more popular approach is the positive or "hybrid" lists originally introduced by the GATS, whereby nonlisted sectors are excluded from the main liberalization disciplines—on a positive basis—but specific limitations must be recorded in listed sectors if they are to be maintained—on a negative list style. This is the liberalization modality of choice of most developing countries, and of some of the biggest trade hubs like the EU and Japan. Finally, agreements that require the negative listing of both sectors and measures are "negative lists" agreements. The NAFTA pioneered this approach on services trade, and many FTAs have followed its model, in particular those promoted by the United States and Canada, as well as some high-income countries such as Chile, Korea, and Singapore.

30. **Not surprisingly, the AFAS's schedules of commitments follow the hybrid list format featured by the GATS.** This modality has also been used in all services agreements concluded by ASEAN with external partners, namely Australia, China, India, Korea, and New Zealand. This scheduling modality features some advantages for the negotiating parties, not least of which is the familiarity of an approach used at the multilateral level. Furthermore, positive listing provides the additional reassurance for developing countries that only sectors expressly listed are subject to liberalization commitments, which offers greater control over the negotiated sectors.

31. **Even in a hybrid list format, positive listing, however, may not be the best modality for agreements seeking extensive services liberalization and the creation of a single market.** While in principle full liberalization can be reached through either negative or positive lists, negative lists tend to create incentives toward greater liberalization. In particular, empirical evidence suggests that negative lists are associated to greater sectoral coverage in services agreements, although they do not necessarily offer better results in regard to the depth of the commitments (Fink and Molinuevo 2008).

32. **Despite the consistent use of GATS-like schedules in services negotiations, ASEAN countries have experience with negative lists.** ASEAN Member States have experimented successfully with this modality under the framework of the third economic pillar of ASEAN, foreign investment. The ASEAN Comprehensive Investment Agreement (ACIA), which draws on the models of investment protection and liberalization treaties, provides for reservations lists, which list sectors subject to exceptions rather than committed sectors. The ACIA, which is meant to complement the liberalization of trade in goods, applies for the purpose of investment protection with respect to a commercial presence, to all measures affecting services sectors, whether included or not in AMS schedules of commitments, and also reaches some services sectors that are ancillary to the goods production. Some ASEAN Member States also have additional experience with negotiations under negative lists. Singapore regularly makes use of negatives lists in both the services and investment chapters of its trade agreements, following closely the structure and disciplines of agreements from Canada and the United States. Japan promotes the use of negative lists for the investment disciplines, including in its various agreements with ASEAN Member States Brunei Darussalam, Indonesia, Malaysia, the Philippines, Thailand, and Vietnam.

33. **This experience suggests ASEAN Member States, including the smaller economies, could meet the challenges of negative list negotiations**. While disciplines on services trade and investment may pose some additional challenges with regard to administrative and coordination efforts, and the impact on some sensitive sectors, the use of negative lists under the AFAS would increase transparency and reflect more clearly the liberalization achievements of the ASEAN Economic Community. This would also relate

to the ASEAN Economic Community principles of establishing a single market and production base, although some particular limitations between ASEAN Member States will remain.

Other general disciplines

34. **It is not evident whether the AFAS provides any disciplines beyond market access and national treatment.** In its Article XIV, the AFAS incorporates the GATS's "definitions and other provisions" "for which no specific provision has been made" under the agreement. This seems to suggest that all disciplines found in the GATS are incorporated into ASEAN when such issues are not explicitly covered in the AFAS. Following these terms, GATS disciplines on transparency, domestic regulation, subsidies, fair competition, and transfer of funds, and the exceptions to those obligations, would be included in the AFAS just like market access and national treatment. A strict interpretation of Article XIV also seems to imply that, unlike other regional trade agreements, the AFAS would be amended by any decision of WTO members regarding the GATS, unless ASEAN Member States explicitly provide otherwise on a case-by-case basis. That includes, for example, the Guidelines for Mutual Recognition Agreements or Arrangements in the Accountancy Sector adopted by the WTO Members following the GATS Article VI:4 mandate, and the Least Developed Country Services Waiver, which is a result of GATS Article IV:3 disciplines on special and differential treatment.

35. **Most-favored-nation (MFN) treatment.** The MFN provision is one of the cornerstones of the multilateral system, and requires that, with respect to any measure affecting trade in services, any treatment given by a member to any other country in the world, including non-WTO members, be extended immediately to all fellow WTO members. However, GATS Article V on Economic Integration allows members to deviate from the MFN principle and advance toward free trade and investment in services by concluding economic integration agreements (EIAs). In order to be a lawful exception to the MFN principles, such agreements must:[34]

- have substantial sectoral coverage, in terms of number of sectors, volume of trade affected, and modes of supply (understood as not providing for the a priori exclusion of any mode of supply)
- provide for the absence or elimination of substantially all discrimination that affects service suppliers from a party to an EIA
- not raise the overall level of barriers to trade in services for WTO members that are not party to an EIA.

36. **The AFAS disciplines on MFN treatment provide instead greater "flexibilities" in implementation of the MFN in services.** Originally, AFAS disciplines on MFN, through the AFAS's ubiquitous Article XIV, arguably incorporated those of Article V of the GATS on Economic Integration. An amendment signed in 2003 allowed two or more ASEAN Member States to conclude agreements, *among* themselves, to further liberalize trade in services for specific sectors, without extending such preferences to the rest of ASEAN—the so-called "ASEAN Minus X formula" (ASEAN Secretariat 2009).[35] Broad agreements concluded by ASEAN Member States as a bloc with *third* countries remain subject to the conditions for EIA, as provided by GATS Article V.

[34] Article V:7(a) of the GATS requires any parties to an Economic Integration agreement to "promptly notify any such agreement and any enlargement or any significant modification of that agreement to the Council for Trade in Services." The Council has not yet been notified about the AFAS.

[35] Arguably, this provision is contrary to Article V of the GATS, which explicitly requires that, for any deviations from the MFN obligation, an economic integration agreement has substantial sectoral coverage in terms of number of sectors, volume of trade affected, and modes of supply (understood as not providing for the a priori exclusion of any mode of supply).

37. **These flexibilities thus create lenient disciplines (or trade benefits) on MFN for Member States, both for agreements within ASEAN and with third countries, without extending them to other ASEAN Member States.** This has its advantages, since it allows those ASEAN Member States with more open regimes to advance reciprocal liberalization either in specific sectors (within ASEAN) or through broad free trade agreements in services (globally). However, these disciplines also suggest that greater liberalization and reciprocal preferences can be achieved with selected partners, even nonmembers of ASEAN, which may not fit squarely with the goal of establishing a "single market" in the region. The conclusion of an ASEAN single market in services should grant ASEAN Member States privileged access to each other's markets, thus beyond any preferences that they may grant to other countries through free trade agreements. A way forward on this issue is to look at the possibility of including a stronger MFN provision in the enhancement of the AFAS, particularly one that covers agreements concluded by individual ASEAN Member States with third countries (which in turn should remain subject to the conditions for EIA).

38. **Transparency and domestic regulation.** Beyond the liberalization provisions, the GATS features general obligations that aim to support and complement the liberalization achieved through the reduction of market access and national treatment restrictions. Key among these is to provide sufficient information about potentially relevant rules and regulations, an obligation critical to the effective implementation of an agreement. The GATS requires WTO members to promptly publish all measures pertaining to or affecting the operation of the GATS. Moreover, there is an obligation to notify the Council for Trade in Services at least annually of all legal or regulatory changes that significantly affect trade in sectors where specific commitments have been made. Members are also required to establish enquiry points that provide specific information to other members upon request.

39. **The GATS also seeks to ensure that domestic regulatory measures do not act as barriers to trade and investment in services.** Disciplines on "domestic regulation" cover those measures that neither set quantitative restrictions nor are discriminatory in nature, such as licensing and registration requirements, screening procedures, and so forth. WTO members are required to ensure, in sectors where commitments exist, that measures of general application are administered impartially and in a reasonable and objective manner. In addition, service suppliers in all sectors must be able to use national tribunals or procedures in order to challenge administrative decisions affecting services trade. The provision also includes a negotiating mandate to develop any necessary disciplines to prevent domestic regulations (qualification requirements and procedures, technical standards, and licensing requirements) from constituting unnecessary barriers to trade. The goals of the provision are to develop sectoral disciplines intended to ensure that domestic regulations are, are among other things:

- based on objective and transparent criteria, such as competence and the ability to supply the service
- not more burdensome than necessary to ensure the quality of the service
- in the case of licensing procedures, not in themselves a restriction on the supply of the service.

40. **Other GATS disciplines provide for additional rules on competition policies, subsidies, and transfer of funds.** On competition policy, the GATS requires WTO members to ensure that monopolies and other business do not act inconsistently with the countries' services commitments. Unlike for many regional agreements, subsidies on services trade are covered by the GATS, while calling for negotiations on the issue. Also, GATS rules require WTO members to allow international transfers and payments for current transactions relating to specific commitments, to the extent this does not impinge on the countries' rights under the WTO Charter.

41. **As noted earlier, these GATS disciplines also apply to the AFAS, under the Final Provision contained in Article XIV (1), but their precise scope needs to be clarified.** Some GATS obligations, including Article V:3 on notification of changes in laws and regulations, and Article VI:1 on reasonable

administrative of domestic regulations, only apply to services sectors where specific commitments have been undertaken under the GATS. It would help to clarify that these provisions would also apply to sectors where specific commitments have been undertaken under AFAS, but not in the GATS.

42. **The AFAS's focus on progressive liberalization through negotiating rounds has left regulatory measures out of the services integration agenda.** Focusing only on market access and national treatment fails to address the restrictive impact that regulatory barriers, including administrative practices, have on services trade and investment. Furthermore, the AFAS's lack of clarity on the disciplines on domestic regulation, and the fact that they do not come across as a priority in the agreement, provides an incentive to maintain the status quo, potentially keeping regulatory barriers as protectionist measures for domestic services providers.

Mutual Recognition Arrangements

43. **As set out in the AEC Blueprint, the conclusion and implementation of Mutual Recognition Arrangements (MRAs) by 2015 is one of the key priorities of economic integration in services.** The MRAs aim to facilitate trade in services by mutual recognition of authorization, licensing, or certification of professional services suppliers. The goal of the MRAs is to facilitate the flow of foreign professionals, taking into account relevant domestic regulations and market demand conditions (ASEAN Secretariat 2009). MRAs in seven occupations under the purview of the ASEAN Economic Ministers have been concluded to date (see table 4.2).

Table 4.2 MRAs Concluded under the Purview of ASEAN Economic Ministers

Mutual Recognition Arrangement	Signing Date	Implemented Through
Engineering services	December 9, 2005	ASEAN registration (ASEAN Chartered Professional Engineer Coordinating Committee)
Nursing services	December 8, 2006	Bilateral registration
Architectural services	November 19, 2007	ASEAN registration (ASEAN Architecture Council)
Framework Arrangement on Surveying Qualifications		MRA
MRA Framework on Accountancy Services	February 26, 2009	MRA
Medical practitioners		Bilateral registration
Dental practitioners		Bilateral registration
Accountancy	November 13, 2014	MRA

44. **The MRAs are currently in various stages of implementation, with bodies being established to administer them.** The different MRAs have different implementing mechanisms. At the outset, the arrangements on accountancy and surveying qualifications are "framework" agreements that provide no substantial obligations. These agreements provide the broad principles and framework for the further negotiations of bilateral or multilateral MRAs on those professions between interested ASEAN Member States.

45. **Progress has occurred in the MRA implementation mechanisms at the regional level.** This is especially the case for architectural and engineering services, which are to be implemented by the

registration of ASEAN chartered professionals with the relevant bodies—the ASEAN Architecture Council and the ASEAN Chartered Professional Engineer Coordinating Committee, respectively. National regulatory bodies in these professions have been established in order to address the domestic procedures, and to monitor the certification and accreditations offered within the country. A number of ASEAN Member States, especially the smaller economies, have yet to establish such domestic professional bodies.

46. **In general, the reporting of actual implementation of the MRAs can still be improved.** The dissemination of information, including through the internet, on the various aspects of the implementation of the MRAs could still be improved. Individual professionals would benefit from the availability of more precise and detailed information on what agreements countries are implementing, and how.

47. **The scope of the MRAs varies across sectors.** The MRA on engineering, for instance, is limited in scope because it provides for foreign professionals to practice only in collaboration with one or more engineers of a host country. While this type of restriction on professional services is applied by many countries, it seems to narrow the scope of the MRA in promoting mobility of engineers within the region.

48. **One issue regarding implementation of the MRAs is the extent to which ASEAN members' policies and regulations on the relevant procedures need to be, and have been brought, in accordance with the MRAs** (ERIA 2012). This issue arises because some of the arrangements do not immediately require ASEAN Member States to allow foreign professionals to access their markets, but rather provide that the recognition of the professional accreditations is to be done on the basis of the current laws and regulations of the recognizing country. For example, the MRA on medical professionals establishes that:

> "A Foreign Medical Practitioner may apply for registration in the Host Country to be recognised as qualified to practise medicine in the Host Country in accordance with its Domestic Regulations and subject to
>
> […]
>
> *any other assessment or requirement* as may be imposed on any such applicant for registration as deemed fit by the [relevant authorities] of the Host Country.]"[36]

Although less explicitly, the MRAs on engineering and architecture also include references to compliance with domestic laws and regulations that could be interpreted as providing the host countries' authorities a similar degree of discretion in the process of recognition.

49. **Partly because of the need to further clarify agreements and its operating procedures, there has been little practical impact of the MRAs to date.** Authorities from different ASEAN Member States maintain different interpretations and practices on various provisions of the arrangements, and many operational details of the MRAs need to be further discussed during the implementation stage. For instance, it is unclear whether retraining can be required by the host country's authorities, or whether certain accreditations by certain educational institutions of professional bodies from at least some of the ASEAN Member States obtain automatic recognition in other jurisdictions. As in other areas of services disciplines in ASEAN, more effort is needed to provide the information to make faster progress on the integration process.

[36] ASEAN Mutual Recognition Arrangements on Medical Practitioners, Article 3.1 (excerpt).

Dispute settlement

50. **Assessing the precise level of compliance with AFAS rules remains a challenge, not just in the case of MRAs, but across all service sectors and for all ASEAN Member States.** This is partly due to the lack of common understanding among ASEAN Member States of the exact scope and meaning of the terms of the relevant agreements. It may also stem from the lack of capacity or willingness of some Member States to amend the current rules and regulations where they contradict regional obligations and commitments. Both of these issues relate to the absence of an operational dispute settlement mechanism for disciplines on economic integration in ASEAN.

51. **An effective dispute settlement mechanism is an essential component of an integration process.** It fosters predictability and confidence in the system by promoting compliance with the agreed rules and commitments and increasing transparency and understanding of the common disciplines through binding interpretations. In 2004, the ASEAN Enhanced Dispute Settlement Mechanism (EDSM) was established, which applies to all economic integration matters, including the ASEAN Economic Community, the AFAS, and sectoral cooperation arrangements.[37,38] The EDSM superseded the 1996 Protocol on Dispute Settlement Mechanism, which had provided for a more politically oriented process.

52. **The EDSM procedures closely follow the WTO dispute settlement mechanism.** Several aspects of the WTO mechanism are replicated in ASEAN, including three procedural stages: consultations, decision, and the possibility of retaliation if the decision is not implemented. Also in line with the multilateral rules, individual countries cannot block the progress of the jurisdictional procedures. The EDSM provides for some specific improvements over the multilateral rules regarding the duration of the dispute, as well as small differences needed to adapt the WTO mechanism to the regional setting.

53. **Following the WTO model, the ASEAN procedures establish two jurisdictional bodies: an ad-hoc panel to issue a first decision, and a standing Appellate Body to review the case on appeal.** The decision taken by the panels or the appellate body is ratified by the Senior Economic Officials' Meetings, unless all 10 countries, including the parties to the dispute, vote against it. This mechanism, referred to as the "negative consensus" rule, ensures the automaticity of the dispute has been appraised as a key component the WTO dispute settlement system.[39]

54. **While the ASEAN dispute settlement mechanism was inspired by WTO procedures and institutions, actual practice has lagged.** The EDSM has never been put in motion, having addressed no dispute between ASEAN Member States. Similarly, the standing Appellate Body was never established. A few differences between ASEAN Member States regarding compliance with their economic agreements, such as on trade in goods issues, have been addressed bilaterally and eventually solved through mutual understanding. Practical difficulties such as funding or political will aside, the mutual understanding approach may be argued to be a reflection of ASEAN Member States' preferred approach to dispute settlement.

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[37] While it is understood that the EDSM applies to all ASEAN economic matters, which presumably encompasses any issue falling under the AEC agenda, there is no specific definition of the competence of the dispute settlement mechanism. Article 1.1 of the EDSM provides that it applies to the "covered agreements," which are the 46 agreements listed in Appendix I. That list, however, was produced in 2004, and has not updated, casting some uncertainty over any agreements concluded after that date.

[38] ASEAN recently incorporated another dispute settlement mechanism into its integration system that covers all other, noneconomic matters within the region, such as political collaboration or border disputes. The agreement providing for such procedures is the ASEAN Charter on Dispute Settlement Mechanisms, signed in Hanoi on April 8, 2010. See Woon (2011) for a description of the system.

[39] See, for instance, Jackson (1998), and Hoekman and Mavroidis (2000).

55. **While this diplomatic system for dispute resolution is effective in redressing conflicts among the ASEAN Member States, it also reduces the transparency and predictability of the system.** In addition, it casts doubt about its role in inducing effective compliance, since the bigger economies may exert greater influence in these information discussions, eventually buying their way out of compliance. Transparency is also reduced due to the absence of an independent third party that might provide an authoritative interpretation of the terms of the agreement. Finally, the lack of implementation of an ASEAN agreement itself, especially one with such a central institutional relevance, weakens the value of the system. In light of these factors, several ASEAN Member States have proposed amending the dispute settlement mechanism, by looking into options to make the system more functional.

56. **The reform of the dispute settlement mechanism should also address some unanswered questions regarding the system.** That should include the details of what agreements, protocols, and other ASEAN disciplines and procedures fall under the review of the EDSM, and how the EDSM is to relate to the ASEAN Charter. In addition, the revision of the system may address the relationship with the WTO framework and whether the interpretations made in the multilateral forum provide guidance on the ASEAN agreements, especially when the regional disciplines are an incorporation of the multilateral rules, as is the case with the AFAS.

57. **An important function of a dispute settlement mechanism is enhancing transparency.** This is done by ascertaining the meaning of common rules that may be unclear to the parties to the agreement. This interpretative function may take place during the process of dispute resolution, when deciding whether a measure by a party conforms to the agreements. The WTO dispute settlement mechanism, as well as the EDSM, grants its jurisdictional bodies this essential, and only, role. The EDSM, like the WTO, only considers disputes stemming from lack of compliance with the relevant agreements. Yet, the experience in other regional integration forums suggests that regional courts can play a more important role as interpreters of common rules than as third parties in a dispute.

58. **The court's consultative role can foster regional integration by clarifying the scope of regional rules.** This would promote common understanding of regional disciplines and help prevent disputes. The Tribunal of Justice of the Andean Community, for example, has the ability to issue "prejudicial interpretations" that clarify the meaning of specific provisions of the Andean Community treaties and decisions (Vigil Toledo 2004). The consultative role of the Andean Tribunal, inspired by the European Court of Justice, has in practice become its main function, accounting for more than 90 percent of its decisions (Porges 2011). These interpretative rulings have been praised for ensuring greater regional integration by permitting the participation of national tribunals in the uniform application of Andean disciplines (Grigera Naón 1996).

C. ASEAN Institutional Framework on Services

59. **ASEAN Member States have developed a sizable and evolving institutional framework to promote integration in services.** Four Ministerial Bodies have been established to oversee different services sectors. While this has allowed ASEAN Member States to make progress in multiple areas simultaneously, insufficient coordination mechanisms among these bodies hampers the region's ability to conduct a comprehensive and coherent approach to the integration of services markets.

General services trade negotiations

60. **The Coordinating Committee on Services (CCS) is the main body involved in services trade negotiations.** The CCS reports to the ASEAN Economic Ministers through the Senior Economic Officials Meetings (SEOMs), which provide political guidance. The CCS is the default body responsible for services negotiations for most of the services sectors and subsectors, unless specific areas have been attributed to

other ASEAN bodies. Exceptions are for financial services, air transport, and services incidental to manufacturing, agriculture, fishery, forestry, and mining and quarrying, which are not part of the CCS portfolio. Other than those areas, service negotiations have been effectively carried out by the CCS and several working groups that operate under the guidance of the CCS.[40] The working groups under CCS supervision had been divided into the following thematic areas:

- business services
- construction
- health care
- logistics and transport services
- telecommunication and IT services
- tourism
- education.

Some of the working groups have been disbanded and their liberalization effort transferred to the CCS over the last few years.

61. **The work carried out by the CCS and the seven working parties focuses on the negotiations of services liberalization measures.** The CCS puts in practice Article IV of the AFAS, which calls for negotiations on measures affecting trade in services, in light of the AEC goals on services set out in the AEC Blueprint. Since the AFAS and, especially, the AEC Blueprint, has oriented the services negotiations to the elimination of formal restrictions on trade in services, the CCS has not to date advanced into other issues relating to services integration. In that sense, the work of the CCS, like the AFAS in general, has been focused on expanding commitments on services liberalization. While there have been informal discussions toward advancing on issues like domestic regulation on services, the focus has been on restrictions on market access and national treatment, in terms of the AFAS and according to the schedule set out in the AEC Blueprint.

62. **In terms of modes of supply, service negotiations focus on cross-border trade, consumption abroad, and the establishment of a commercial presence (that is, Modes 1, 2, and 3 of services supply).** Commitments on the presence of natural persons to provide services (Mode 4), initially covered under the AFAS, have recently been moved to the framework of the Agreement on Movement of Natural Persons, as described in Section A, above.

63. **Since the CCS has no direct authority on the liberalization of various service sectors, its officials need to consult and get their mandates from relevant domestic agencies.** The negotiations are conducted by officials from the trade ministries or planning agencies, with support from other ministries or agencies in the various sectoral working groups. Some ASEAN Member States involve representatives from other ministries and regulatory agencies in their trade negotiating team. However, there are no requirements to do so, and it remains up to each ASEAN member to conduct such coordination internally.

Specific sectoral bodies

64. **In addition to the CCS, there are other ASEAN bodies with a mandate for particular service sectors.** These sectors include financial services; air transport; and services incidental to manufacturing, agriculture, fishery, forestry, and mining and quarrying (or in short, services "incidental to goods"). In the

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[40] The Informal ASEAN Economic Ministers (AEM) meeting held in June 1999, in Auckland, New Zealand, agreed that work in service sectors that falls under the purview of other Ministerial Bodies shall be led by these respective Ministerial Bodies, and areas not covered by any existing ASEAN bodies would continue to be under the purview of the CCS/SEOM/AEM. However, overall coordination of liberalization in services would still be under the purview of the AEM/SEOM. At the 33rd AEM meeting held in September 2001, in Hanoi, Vietnam, it was noted that the Tourism Sectoral Working Group, Maritime Transport Sectoral Working Group, and the Telecommunication Negotiation Group indicated readiness to return to the CCS for subsequent rounds of negotiations (ASEAN Secretariat 2009).

case of services "incidental to goods," the rules and liberalization modalities are in conformity with the ACIA agreement, since AFAS rules are not applicable here. Officials from some of the bodies, for example, in air transport and financial services, are also responsible for negotiations and regulatory cooperation in their capacity as members of other ASEAN bodies.

65. **Financial services.** Negotiations on financial services fall under the purview of the ASEAN Finance Ministers Meeting and, specifically, the Working Committee on ASEAN Financial Services Liberalisation (WC-FSL). The WC-FSL in effect acts as the CCS's counterpart in the context of financial services, but does not supervise other negotiating bodies. Representatives to the WC-FSL are generally officials from the finance ministries, central banks, monetary authorities, and securities and insurance regulators. Much like the CCS, the WC-FSL focuses on the elimination of restrictions to financial services following the negotiating mandate of AFAS and the AEC Blueprint. The attention lies on measures that may conflict with the "market access" and national treatment disciplines of the agreement.

66. **However, some specific regulatory matters have been considered by the WC-FSL.** In the context of the negotiations of commitments, ASEAN Member States are working on further improving the WTO Annex on Financial services in the ASEAN context. The WTO Annex does not go into promoting regulatory coordination among the members, but rather clarifies that prudential regulations on financial services are not inconsistent with the disciplines and commitments of the agreement. To further deepen regional financial integration, the ASEAN Central Bank Governors' Meeting (ACGM) in December 2014, endorsed an ASEAN Banking Integration Framework (ABIF), which will enable "Qualified ASEAN Banks" (QABs) to have a greater role in promoting intraregional trade and investment. The ABIF guidelines were also approved by ACGM in December 2014, and the provision for enabling QAB implementation was signed by ASEAN Finance Ministers in March, 2015 as part of the Protocol to implement the 6th Package of Financial Services under the AFAS.

67. **Capital Markets:** Initiatives to promote freer flow of capital and greater connectivity of ASEAN capital markets are being undertaken by the ASEAN Capital Markets Forum (ACMF). This includes the ASEAN Disclosure Standards for equity and plain debt securities (box 4.3), the ASEAN Trading Link, the Streamlined Review Framework for the ASEAN Common Prospectus, the Expedited Review Framework for Secondary Listings, the Framework for the cross-border offering of ASEAN Collective Investment Schemes and the ASEAN Corporate Governance Scorecard. The ACMF is also working on the ASEAN Capital Market Development Programme aimed at extending mutual assistance to all markets within the region to facilitate individual and regional market development. Further, the Working Committee on Capital Market Development (WC-CMD) is working on deepening and strengthening bond markets in the region, particularly towards enhancing the capacity and building critical capital market infrastructures. In addition, efforts to better integrate the region's bond markets are currently being undertaken by the Asian Bond Markets Initiative (ABMI) to develop local-currency denominated bond markets, and develop more accessible and well-functioning regional bond markets both for issuers and investors.

68. **Telecommunications, transport, and tourism services.** Substantial work on services integration is also taking place beyond the framework of AFAS negotiations. In particular, cooperation toward integration on telecommunications, transport, and tourism falls within the purview of the respective sectoral ministries.[41] These sectoral initiatives go outside the coverage of the AFAS work insofar as they do not seek to liberalize services per se, but rather focus on "cooperation" measures that may assist the integration process. Cooperation initiatives have focused largely on infrastructure issues like promoting connectivity, enhancing dialog, and increasing domestic capacity. Sectoral discussions on cooperation have also

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[41] The regional ministerial bodies involved are, respectively, the ASEAN Telecommunications and IT Ministers Meeting (TELMIN), the ASEAN Transport Ministers Meeting (ATM), and the ASEAN Tourism Ministers Meeting (M-ATM).

addressed some issues on domestic cooperation, such as development of common quality and safety standards.

Box 4.3 Regulatory Cooperation in Financial Services

The securities regulators in Malaysia, Singapore, and Thailand on April 1, 2013, announced the implementation of the ASEAN Disclosure Standards Scheme for multijurisdictional offerings of equity and plain debt securities in ASEAN. The scheme aims to facilitate cross-border offerings of securities within the ASEAN region by harmonizing disclosure requirements, and to enhance the investment opportunities within the ASEAN capital markets. Under the scheme, issuers offering equity and plain debt securities in more than one of the above three countries will only need to comply with a single set of disclosure standards for prospectuses, known as the ASEAN Disclosure Standards.

The ASEAN Disclosure Standards are a set of common disclosure standards for prospectuses used in offers of shares and plain debt securities. They are based on standards on cross-border offerings set by the International Organization of Securities Commissions (IOSCO). Under the scheme, an issuer wishing to make multijurisdictional offerings would need to provide only a single set of disclosure documents that comply with the ASEAN Disclosure Standards to investors in each of the participating jurisdictions. This is expected to bring about greater efficiency and cost savings. The scheme will apply to offers of shares and plain debt securities only. It will not apply to options, warrants, or any other rights or interests in shares or debt securities; or to debt securities that are not plain debt securities.

The scheme replaces the ASEAN and Plus Standards Scheme that was announced on June 12, 2009. Under the ASEAN and Plus Standards Scheme, issuers preparing prospectuses for a multijurisdictional offer had to comply with a set of common disclosure standards, and with additional requirements (known as the Plus Standards) prescribed by each of the respective jurisdictions. The benefit of the current scheme over the previous one is the advantage of having a single set of fully harmonized disclosure standards, instead of having to comply with additional Plus Standards for each jurisdiction. Implementation of the scheme is on an opt-in basis for ASEAN Member States.

On 3 March 2015, the securities regulators of Malaysia, Singapore, and Thailand, and the Singapore Exchange (SGX), signed a Memorandum of Understanding to establish a Streamlined Review Framework for the ASEAN Common Prospectus. Under this framework, the review process for a multijurisdictional offering of equity or plain debt securities will be streamlined, as long as the prospectus is prepared in accordance with the ASEAN Disclosure Standards. Issuers planning to offer or list equity or plain debt securities will benefit from a shorter time to market and faster access to capital across participating countries.

Source: Rajah & Tann 2013.

69. **In addition to meaningful progress on regional liberalization through negotiations on air transport under the Transport Ministers Meeting, air transport officials have also made inroads toward regulatory cooperation.** ASEAN Member States have agreed to establish the ASEAN Single Aviation Market, which has led to the conclusion of three agreements on the reciprocal opening of air transport rights, and to the initiation of discussions on regulatory matters such as safety measures, airport standards, and navigation systems.

70. **On tourism services, the Task Force on ASEAN Tourism Standards has attempted to complement liberalization negotiations with common standards on tourism.** The Task Force, established by the tourism ministers, developed common principles that should guide domestic regulation on six aspects related to tourism services.[42] These principles are meant to develop comparable standards (and improve services) in order to increase quality and enhance the value of tourism services in the region.

[42] The six areas of regulatory principles include homestay, green hotels, food and beverage services, public restrooms, ecotourism, and tourism heritage.

However, tourism ministers have not addressed how other regulatory barriers may affect tourism services within the region.

71. **Regulatory issues in the telecommunications sector have so far focused largely on development of skills and exchanges of information.** However, the telecom ministers have set the bar high, calling for "cooperation and harmonization of telecommunications and IT policies and programs" under their purview, which leaves room for more substantial discussions on regulation in the future.[43]

72. **In these services sectors, regulatory cooperation focused on common principles and the harmonization of some regulatory standards.** Telecom and transport ministers do not address liberalization measures in the form of restrictions on market access and national treatment, which are understood to be covered by the AFAS negotiations. These ASEAN bodies and their efforts may, however, address the domestic regulation measures that may act as barriers to trade and investment in these services sectors.

73. **Finance Ministers and Central Banks have initiated a number of steps toward regulatory cooperation that are worth noting.** <u>In the banking sector,</u> the ASEAN Banking Integration Framework aims to promote greater access and treatment for ASEAN banks. <u>In capital markets,</u> to date, the ACMF has completed initiatives on harmonization of rules and regulations such as ASEAN Disclosure Standards for equity and plain debt securities (2013), the framework for the cross-border offering of ASEAN Collective Investment Schemes (2014), and the Streamlined Review Framework for Common Prospectus (2015), among others. In addition, the Working Committee on Capital Market Development (WC-CMD) closely monitors the bond market development in the region, including areas on market access and tax treatment for nonresidents.

74. **Services incidental to manufacturing, agriculture, fishery, forestry, and mining and quarrying.** A few services fall under the purview of the Coordinating Committee on Investment (CCI), which is the CCS equivalent in the realm of investment in goods. In 2001, the AFAS's scope was amended to transfer the negotiations on the liberalization of commercial presence on services incidental to manufacturing, agriculture, fishery, and mining and quarrying to the scope of the CCI, with the goal of ensuring that the commitments on services and goods relating to those sectors were consistent.

75. **Negotiations on investment under the CCI led to a broad investment agreement.** The ASEAN Comprehensive Investment Agreement (ACIA) follows standard practices for investment promotion and protection treaties, including principles on nondiscrimination in the establishment and operation of foreign investment, fair and equitable treatment, guarantees against expropriation, and access to international arbitration. These principles apply to services incidental to manufacturing, agriculture, fishery, and mining and quarrying, unless they are excluded from the main liberalization obligations on a negative-list basis.

76. **The obligations under the investment agreement apply to the services sectors only to the extent they are provided through the establishment of a commercial presence (Article 3.5 of ACIA).** Cross-border trade in those services incidental to goods remains in principle under the scope of the AFAS. However, lack of a common understanding on the scope of both agreements with regard to these incidental services has led to their being de facto absent from AFAS negotiations, especially on Modes 1, 2, and 4 of these sectors.

[43] See Ministerial Understanding on ASEAN Cooperation in Telecommunications and Information Technology, signed in 2001 (http://www.asean.org/communities/asean-economic-community/item/ministerial-understanding-on-asean-cooperation-in-telecommunications-and-information-technology).

Other bodies relevant to services disciplines

77. **Two more ASEAN bodies have agendas that have relevance to services trade.** These deal with regulatory cooperation and the settlement of trade disputes. Regulatory cooperation is being discussed by the High Level Task Force on Economic Integration in an advisory capacity.[44] The Task Force has set up the ASEAN Regulatory Reform Dialogue as a channel for exchanging views and information on regulatory reform efforts and policy measures, and discussing measures and activities to take forward ASEAN initiatives on regulatory-reform-related issues.[45]

78. **The initiative on regulatory reform is aimed at supporting the integration process.** It acknowledges the impact that domestic regulatory measures may have on trade and investment, and is focused on the exchanges of information in regional and international practices as a way to advance the discussion. To date, two symposiums have been held, which focused on current regulatory practices on telecommunications, transportation, finance, and other services.[46]

79. **The current agenda of the Regulatory Reform Dialogue does not include exploring common guidelines or principles on regulation.** In principle, the work of the Regulatory Reform Dialogue could complement the liberalization agenda conducted under the AFAS, but it does not yet provide for concrete steps toward the reduction of regulatory divergence that limits economic integration.

80. **The decision-making process.** Decision making on services integration follows the dynamics typical of trade negotiations. The main body involved in services liberalization, the CCS, operates as a negotiating body where member countries define modalities for the exchange of liberalization commitments. The CCS meets on average four times a year. The duration of the CCS meeting is two to three days, or a week if it includes its subsidiary bodies meeting in parallel and back-to-back with the CCS. The agenda for the meetings typically covers all issues subject to negotiations, with a focus on those areas that pose the greater liberalization challenges. In addition to the actual preferences negotiations, the group also addresses institutional and procedural issues on the negotiations, including negotiating modalities, identification of priority sectors for future rounds, linkages with other ASEAN negotiating groups, and other issues that may be relevant to the ASEAN Economic Ministers. The ASEAN Secretariat provides support to the negotiations.

81. **The decision-making procedures follow the principles of international trade negotiations.** Decisions are taken by consensus among all Member States and take the form of international agreements. Each agreement must be ratified internally in each of the Member Countries, following their constitutional or legal procedures, to be in force at least for that member. Some formal agreements like the AFAS follow standard ratification practices for international agreements and require ratification by all parties to enter into force.[47] The protocols containing the schedules of liberalization, which are international agreements in nature and differ from package to package, provide further information on the approval process.[48]

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[44] The High Level Task Force on Economic Integration is composed of high-ranking trade officials from all Member States. It is responsible for advising the economics ministries on all issues pertaining to economic integration and for advancing discussions on one specific area when instructed by the ministries. There are also other bodies discussing regulatory issues.

[45] ASEAN 2011b (http://www.asean.org/news/asean-secretariat-news/item/asean-s-regulatory-reform-dialogue-a-first).

[46] PhilStar.com (http://www.philstar.com/business/713357/asean-discuss-regulatory-reforms-jakarta-meet).

[47] For instance, Article XIV.3 of the AFAS provides that the agreement "shall enter into force upon the deposit of instruments of ratification or acceptance by all signatory governments with the Secretary-General of ASEAN."

[48] The Protocol to Implement the Eighth Package of Commitments under the AFAS establishes in that regard that "5. This Protocol and the commitments set out in its Annexes shall enter into force ninety (90) days after the date of

82. **Since 2007, the modalities for negotiations based on previously agreed benchmarks have been incorporated into the AEC Blueprint** (table 4.3). The benchmarks set out time frames and targets for commitments in terms of number of sectors and types of obligations, building up to 2015. By entry into force of the AEC Blueprint, ASEAN Member States should have no restrictions on cross-border trade and consumption abroad, should maintain no discriminatory or quantitative restrictions, and allow at least 70 percent foreign ownership on all service sectors, subject to flexibility and with some exceptions.

Table 4.3 Evolution of Negotiating Modalities

Round	Modalities	Description
Round 1 (1996–1998)	Request and offer	• Similar to the GATS • Including exchange of information on services regime
Round 2 (1999–2001)	Common subsectors	• Common subsector = a subsector where 4 or more Member States made commitments under the GATS and/or previous AFAS packages • Member States are requested to make offer for these subsectors
Round 3 (2002–2004)	Modified common subsector	Same as above, but threshold is modified to 3 or more Member States (instead of 4)
Round 4 (2005–2006)	2 tables of subsectors	• Require a minimum number of subsectors to be submitted that meet certain levels of commitment: • Table 1 = Mandatory subsectors • Table 2 = List of subsectors and ≧5 of them shall be scheduled
Round 5 onward (2007–present)	AEC Blueprint	Follow thresholds listed in the AEC Blueprint

83. **While the use of thresholds has served to increase negotiation efforts and advance the adoption of liberalization commitments, the dynamics of trade negotiations have also posed some limitations on the integration process.** For example, the negotiations and meetings are a significant burden for the least-developed economies, which face larger financial and human resource constraints to participate in ASEAN negotiations, on top of the numerous negotiations conducted by ASEAN as a group with its trading partners.

D. ASEAN's Progress in Services Liberalization through Negotiations

84. **Against this legal and institutional background, how much has AFAS contributed to integration of the services market in ASEAN? Is ASEAN on track to fulfilling the goal of a "single market and production base" for the services sector in 2015?** The following analysis reviews progress

signature. Member States undertake to complete their internal procedures for the entry into force of this Protocol and its Annexes. Each Member State shall, upon the completion of its internal procedures for the entry into force of this Protocol, notify the ASEAN Secretariat in writing. Where a Member State is unable to notify the completion of its internal procedures within ninety (90) days of the date of signature, the rights and obligations of that Member State under this Protocol and its Annexes shall commence on the date on which the Member State notifies the completion of its internal procedures. 6. For a Member State that is unable to submit its full commitments under the Eighth Package by the time of signing of this Protocol: (a) commitments that are submitted thereafter but before the entry into force of this Protocol and its Annexes, shall also enter into force ninety (90) days after the date of signature of this Protocol; and (b) commitments that are submitted after the entry into force of this Protocol and its Annexes shall enter into force upon their submission."

on the liberalization of services trade and investment under AFAS, and compares it with similar agreements from the region and abroad.

Assessing progress in services liberalization

85. **The effectiveness of the AFAS in promoting services liberalization can be assessed by the level of commitments undertaken by ASEAN Member States.** This evaluation is necessarily partial, since it cannot take into account the actual level of implementation of those obligations. However, it does help in considering general progress in the removal of limitations on services trade within the region in formal terms. A closer look at the sectors and types of measures that are currently maintained (at least at face value in the schedules of commitments in services) provides additional information on the remaining challenges to services liberalization. This also allows comparing the progress made by AFAS with ASEAN's other services agreements at the multilateral, regional, or bilateral level, thus better assessing the value added of ASEAN in liberalizing services among its Member States. Assessing the commitments also allows a comparison with the quantitative goals set out in the AEC Blueprint, and an evaluation of whether the process is advancing as originally scheduled.

86. This section focuses on services integration in the 10 ASEAN Member States and examines the degree of liberalization of trade in services in terms of commitments in the following three trade agreements:

- The General Agreement on Trade in Services (GATS)
- The ASEAN Framework Agreement on Services (AFAS)
- The ASEAN-Australia-New Zealand Free Trade Agreement (AANZFTA).

87. **The section draws on a simple database of commitments in services trade liberalization in the GATS, AFAS, and AANZFTA agreements.** While this tool cannot precisely measure the depth of FTA commitments and their impact on domestic laws and regulations, several empirical patterns emerge:

- ASEAN Member States **have advanced significantly in terms of commitments mad**e to services liberalization over the last 18 years, when the AFAS was signed. The **extent of commitments made under the AFAS generally exceeds the commitments made under the GATS.**
- Generally, the most commitments has been made by Singapore, and by countries that only recently acceded to the WTO (Cambodia, Lao PDR, and Vietnam).
- In the AFAS, **among the sectors that are still largely protected from outside investors are health and social services and transport—**all of them sectors that have a high empirical sensitivity to market opening.
- Neither agreement provides an equal degree of liberalization across the four modes of service delivery. **Modes 1 and 2 (cross-border supply and consumption abroad) exhibit the fewest restrictions, while Mode 3 (commercial presence)—arguably the most important mode for foreign service suppliers—**exhibits many remaining restrictions.

88. The section does not measure commitments on the movement of natural persons. As mentioned, commitments on that mode have been moved away from the sphere of the AFAS and are under negotiations.

General sectoral scope of AFAS commitments

89. How is the AFAS performing in terms of progress on liberalization? A first, broad picture describes the level of liberalization achieved so far under AFAS negotiations compared to other agreements among ASEAN Member States and abroad (figure 4.1). In order to portray this general picture, commitments are aggregated into full, partial, and unbound commitments. "Full" commitments reflect the amount of service

subsectors that feature no market access or national treatment discrimination, while “unbound” points to the number of subsectors that have commitments in neither market access nor national treatment

Figure 4.1 Level of Commitments in Trade Agreements

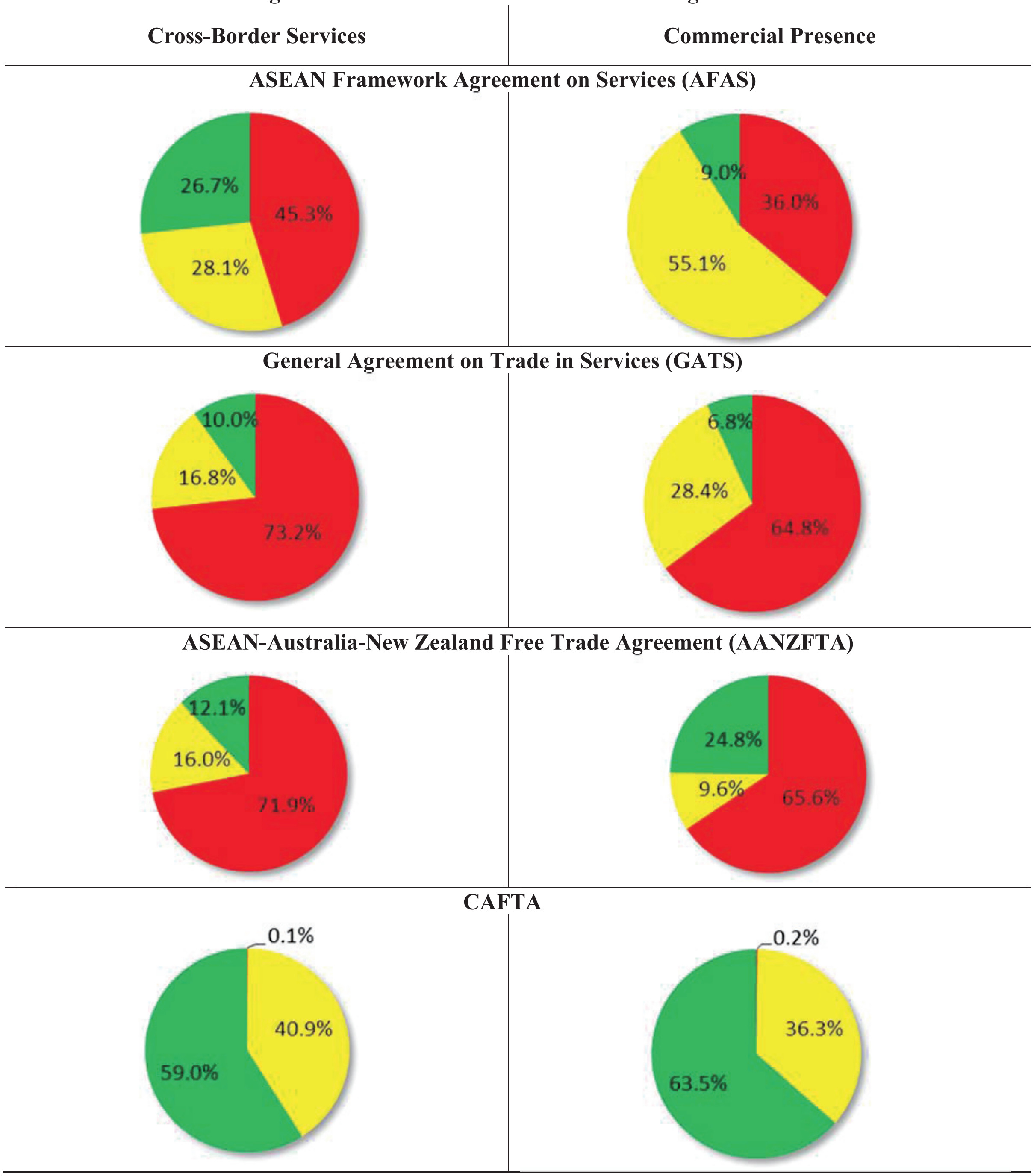
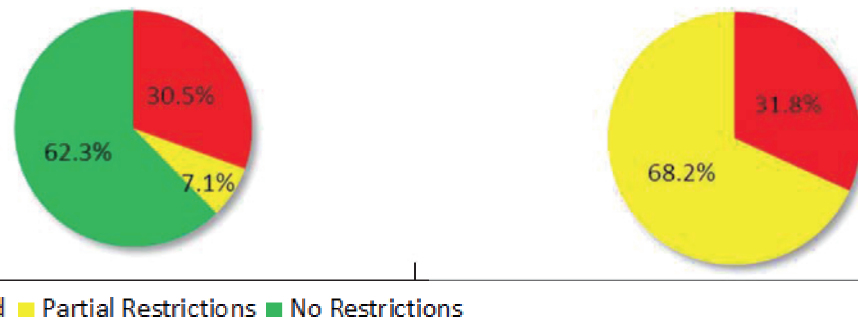


Figure 4.1 Level of Commitments in Trade Agreements (continued)

Hypothetical AEC Blueprint (2010)

Cross-Border Services | **Commercial Presence**



Source: Authors, based on commitments by ASEAN Member States under the AFAS (up to Seventh Package); GATS; AANZFTA; and by Central American countries in CAFTA.

90. **The AFAS and the GATS.** A first observation shows that the AFAS provides some meaningful progress over the GATS in terms of services liberalization. This is particularly the case for services provided through commercial presence, for which ASEAN Member States have almost doubled the aggregate number of committed services subsectors—expanding it from a total of 35 percent to about 65 percent of covered subsectors.[49] Services provided through cross-border supply have also seen a reduction of the uncommitted sector, as would be expected, but the total number of uncommitted sectors still remain high (45 percent). Some progress on cross-border trade can be seen, instead, in the amount of services subsectors that are fully open: almost 25 percent within the region, compared to only 10 percent at the multilateral level. This overall level of progress is compatible with earlier assessments, which have also noted the improvement of AFAS commitments over GATS commitments (Dee 2010; Fink and Molinuevo 2008).

91. **The AFAS and the AANZFTA.** The aggregate figures also show that the ASEAN–Australia–New Zealand FTA (AANZFTA) provides, in total, only marginal liberalization in services trade compared to the GATS. It is striking that the aggregate level of uncommitted sectors has not been reduced in the bilateral agreement compared to the GATS. Instead, the progress of the AANZFTA seems to have fallen on the removal of restrictions on foreign investment; while the overall number of committed subsectors has not changed between the AANZFTA and the GATS, the difference lies in that in AANZFTA, those subsectors are largely free of any market access or national treatment limitation. In fact, there are many more service subsectors free from restrictions in the AANZFTA than in the AFAS. This suggests that a number of limitations on commercial presence still found in AFAS schedules could easily be removed, and indeed are probably not applied in practice.

92. **In practice, this cautious approach to liberalization with third parties is needed for the AEC–AFAS' survival.** Services liberalization, in terms of the elimination of formal restrictions to trade in services, remains the main and only initiative on services in the ASEAN agenda. That is, no further steps toward services integration in ASEAN are being considered other than the elimination of market access and national treatment restrictions. The action plan and time frame set out by the AEC Blueprint confirms this. This means that greater liberalization commitments and wider sectoral coverage under the AANZFTA

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[49] The data based on commitments made under the AFAS Seventh Package underestimate AFAS commitments, since they do not take into account the commitments made under the Eighth Package, the commitments made under Air Transport negotiations, and liberalization obligations affecting services ancillary to goods production adopted by ASEAN Member States under the ACIA.

would have meant nullifying in the agreements with third parties the preferences that ASEAN Member States are granting each other under the AEC–AFAS.

93. **The question remains how to ensure ASEAN preferences in a context of the proliferation of and increasingly ambitious trade agreements.** As ASEAN embarks on further negotiations with other countries in the region, limiting the sectoral scope of the agreements may not necessarily be an option. Indeed, it is likely that ASEAN+6 negotiations (the Regional Comprehensive Economic Partnership) involving trading powerhouses like China, Japan, and Korea, will demand liberalization commitments well beyond those offered under AANZFTA. Some ASEAN Member States are also involved in the Trans-Pacific Partnership (TPP) negotiations, which will likely go well beyond the current commitments under the AFAS, perhaps closer to other agreements promoted by the United States, such as the Central America Free Trade Agreement (CAFTA). ASEAN Member States will need to deepen the regional preferences beyond those offered to third parties to ensure the progress of the integration process—and, in fact, the mere existence of an ASEAN services integration agenda.

94. **The AFAS and CAFTA.** Finally, a cross-regional comparison shows a striking contrast between the liberalization achieved by the AFAS and Central American countries. Figure 4.2 depicts the liberalization commitments undertaken by Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras, and Nicaragua in their free trade agreement with the United States concluded in 2004—called CAFTA. AFAS aggregate sectoral coverage, which amounts to 55 and 65 percent for Modes 1 and 3, respectively, pales in comparison with the whopping 99.8 percent of sectoral reach featured by CAFTA. Under CAFTA, a negative list agreement, Central American countries have undertaken commitments in every services subsector, save for two subsectors omitted by the Dominican Republic and El Salvador. Furthermore, well over half of services subsectors are free of any quantitative restrictions or discriminatory measures, compared to only one-quarter and one-tenth in the case of ASEAN for cross-border trade and commercial presence, respectively. The negotiating dynamics of the small Central American economies in an agreement with the United States are clearly different from the ones between ASEAN Member States, but the case of CAFTA does provide an example of the liberalization potential of a free trade agreement. This is so even though CAFTA's ultimate ambition is much more moderated than that of ASEAN, since it does not intend to integrate the services markets, but only to eliminate market access and national treatment restrictions. This suggests that the ASEAN Economic Community and the AFAS still remain far from free trade in services, even in terms of purely formal liberalization.

95. **The constraining issue is not whether the current AFAS commitments provide for free trade in services.** ASEAN Member States have set out a time frame in the AEC Blueprint meant to progressively lead toward the "single market and production base" in 2015. The time frame features the liberalization requirements for successive rounds of negotiations, pointing to the number of new sectors that must be scheduled and, roughly, the nature of the obligations. The current level of liberalization of AFAS should thus be measured against those requirements in order to assess whether ASEAN is indeed on track with the goals it has set out—formally, at least.

96. **The AFAS and the AEC Blueprint.** The last row of figure 4.1 depicts the level of commitments for services trade of a hypothetical "AEC Blueprint" schedule. Those parameters relate to the Eight Package of AFAS Commitments, the last round of commitments in force—the Eighth Package. These figures are subject to several strong assumptions about how the liberalization obligations apply in practice, namely (a) the liberalization requirements of the AEC are rather broad and lack specificity, (b) they refer to parameters of liberalization of national treatment measures that are not publicly available, and (c) commitments are also subject to a "15 percent" degree of flexibility, but how that 15 percent is calculated or applied is also

not public.[50] In fact, the lack of clarity on such rules is another substantial shortcoming in the transparency of the system. It not only prevents third parties from understanding the details of the services integration process, but it effectively suggests that some basic rules on the functioning of ASEAN are not meant to be publicly disclosed.

97. **Despite the limited progress of the AFAS compared to other trade agreements, ASEAN Member States are broadly on schedule with their AEC goals.** The figures suggest that, in the aggregate, the sectoral scope of the AFAS schedule is close to what should be expected from the AEC Blueprint and the various flexibility understandings surrounding it—particularly for commercial presence. For this mode of service supply, the aggregate of 36 percent uncommitted sectors is in line with the 32 percent of the hypothetical Blueprint. Instead, some greater progress may be needed in cross-border supply, both in terms of committed sectors, and level of openness of those commitments. ASEAN Member States do remain somewhat behind schedule, however, in implementation of the Eighth Package of commitments, and negotiations of the ninth should be more advanced in the Blueprint schedule.

98. **The question remains, however, whether the current plan for services integration can successfully lead to a single market in services trade.** In a single market, service providers should not face additional regulatory restrictions when acting in multiple jurisdictions of the unified market, so that once they have complied with the laws and regulations of one jurisdiction, their ability to provide services or establish themselves in other markets is guaranteed. This is not the case under the current ASEAN model, where service providers, like a provider from any third country, are subject to the regulatory requirements of both the domestic and destination market. These include both the entry and operation requirements that are legitimate regulations to ensure the quality and reliability of the services. In other words, once market access and national treatment obligations are fully assumed by a country, that is, full liberalization commitments are adopted, providers need in addition to overcome nondiscriminatory barriers related to the regulatory environment that affects trade in services. These regulatory barriers include the actual regulations, their implementation, and enforcement. Market access and national treatment commitment do not necessarily provide access to a market if the regulatory environment is too burdensome. In fact, that level of ambition seems to go well beyond the actual steps envisaged for 2015 in the AEC Blueprint.

Measures in AFAS schedules

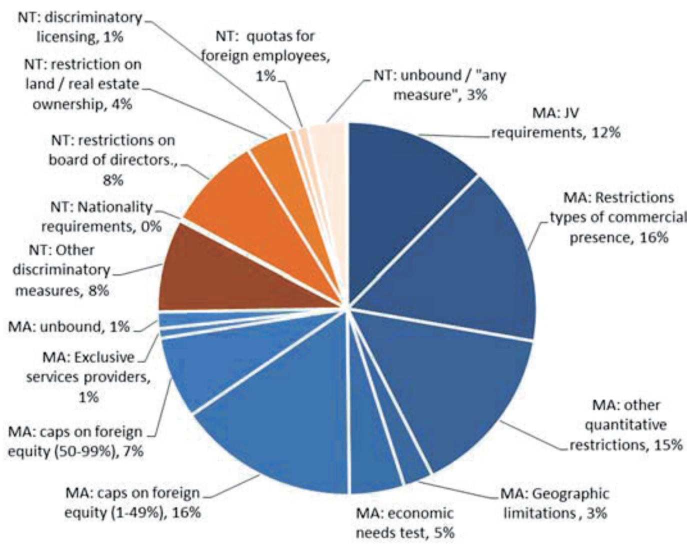
99. **ASEAN Member States have listed a broad range of restrictions on commercial presence in their AFAS schedules.** A closer look at the measures listed in the Member States' schedules provides further guidance on the remaining challenges of liberalization. Figure 4.2 displays the types of restrictions on services found in the Seventh Package of AFAS commitments.

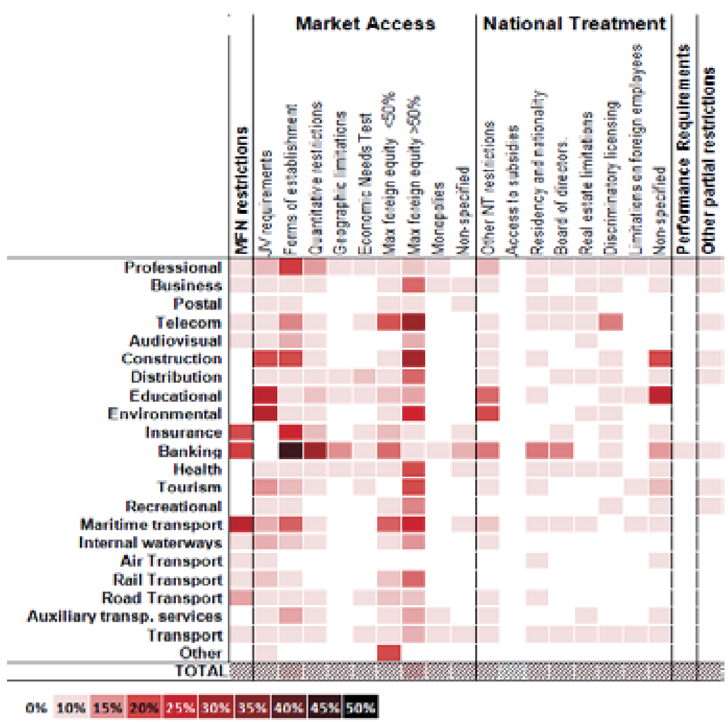
100. **The large majority of restrictions relate to measures affecting market access.** That is, however, in line with the AEC Blueprint, which gives priority to the removal of discriminatory barriers. But, restrictions on market access go well beyond the limitations on foreign participation foreseen by the Blueprint, which were to allow at least 51 percent foreign ownership by 2010. Indeed, those restrictions (caps on foreign ownership between 1 percent and 49 percent) account for only 16 percent of total restrictions. While restrictions on foreign majority ownership were to have already been abolished, ASEAN Member States have made use of their flexibility to maintain such restrictions, which account for 7 percent

[50] For the purpose of elaborating these figures, the following are assumed: (a) a 15 percent flexibility is reflected in subsector-specific deviations from the market access or national treatment obligations, distributed in equal parts between Modes 1 and 3, calculated over the total of 154 subsectors listed in this database and distributed discretionally among them, including on priority sectors; and (b) the parameters for Mode 3 liberalization currently allow one limitation on national treatment per subsector (Dee 2009), which is not applied to priority sectors (health, tourism, and logistics).

of the total. Yet, the allowance for restrictions on foreign ownership at all in a process of market integration is puzzling. Requiring domestic participation, even in minority stakes, de facto entails that service suppliers cannot move within the "single market" without substantial alterations in their corporate ownership.

Figure 4.2 Restrictions on Services Trade Under the AFAS





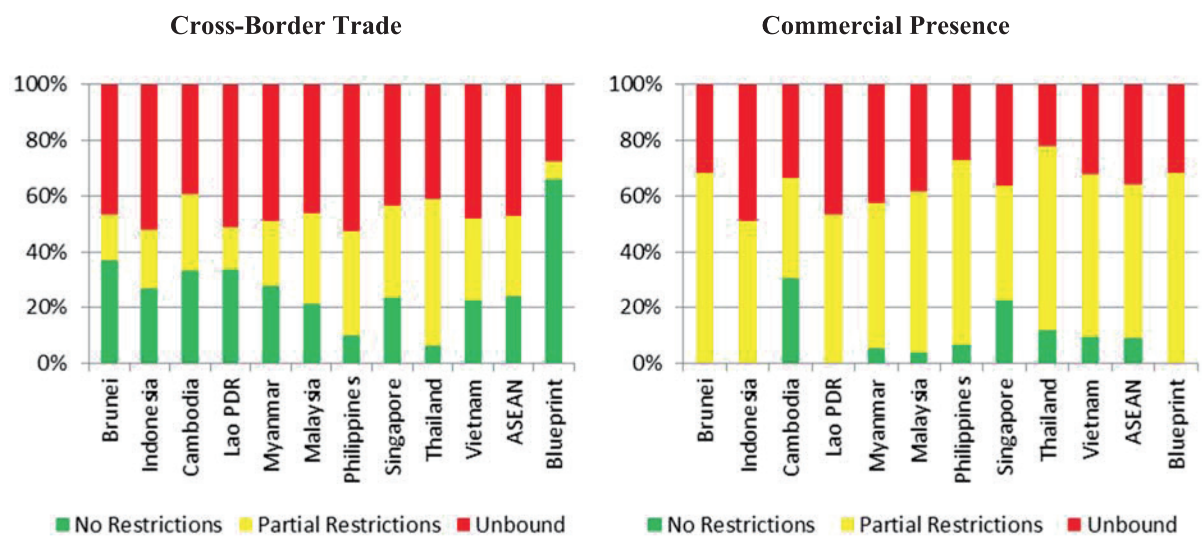
Source: Authors based on commitments by ASEAN Member States under the AFAS (up to Seventh Package).Note: JV = Joint Venture; MA = Market Access; NT = National Treatment.

101. **Other types of restrictions are also numerous,** such as restrictions on the types of commercial presence (often found in financial services and professional services), joint-venture requirements (telecoms, professional, and transport services), and "other" quantitative restrictions (financial services).

Commitments across ASEAN Member States

102. **While the AEC Blueprint sets out the same rules for everybody, not all ASEAN Member States are liberalizing services trade at the same pace.** In cross-border trade in services, subsectors subject to market access and national treatment commitments range between 40 and 50 percent for all Member States, but the degree of liberalization among committed services varies (Figure 4.3). Brunei Darussalam, Cambodia, and Lao PDR maintain no limitation to cross-border around or above 35 percent of service subsectors, whereas the Philippines and Thailand offer equally unrestricted access in less than 10 percent of their services list. Still, the benchmark of the hypothetical blueprint, at over 60 percent fully liberalized subsectors, remains distant even for the most ambitious countries.

Figure 4.3 Level of Commitments, AFAS



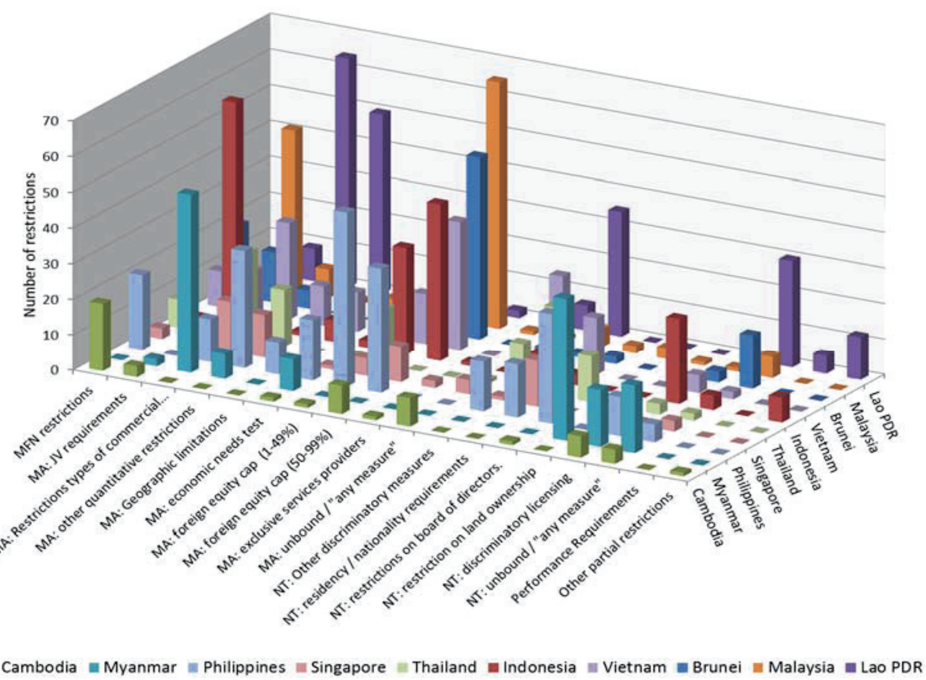
Source: Authors, based on commitments by ASEAN Member States under the AFAS (up to the Seventh Package).

103. **Commitments on commercial presence appear much closer to the Blueprint, at least for some Member States.** Indeed, commitments show a rather important variation among countries: committed services subsectors range from 88 percent (Thailand) to as low as 53 percent in the case of Lao PDR. However, the ASEAN average level of commitments is in line with the hypothetical blueprint, which suggests that not all members face similar difficulties for matching the blueprint schedules. A country-level picture of AFAS commitments also offers a preview of the countries' policies on investment in services: Cambodia and Singapore appear to be the most ambitious, offering 30 and 22 percent of services subsectors, respectively, with no formal barriers to foreign investment.

104. **Important differences also remain in the sectoral scope and types of restrictions that each ASEAN member applies.** As is evident from figure 4.4, some countries appear close to the sectoral scope required by the AEC Blueprint at this stage, especially on commercial presence, while other countries seem to have fallen behind in the scheduling of commitments. For instance, Lao PDR has inscribed restrictions on the type of commercial presence and/or "other" quantitative limitations in at least one-third of services

subsectors, while these measures are hardly used by other Member States like Brunei Darussalam, Cambodia, Singapore, or Vietnam. Indonesia and Malaysia have scheduled together over two-thirds of the joint ventures required of the whole region. Indonesia and the Philippines account for more than half the foreign equity limitations below 51 percent. In contrast, Myanmar has scheduled no limitations at all on foreign equity participation.[51]

Figure 4.4 Restrictions on Commercial Presence in AFAS Schedules



Source: Authors, based on commitments by ASEAN Member States in under AFAS (up to the seventh package).
Note: JV = Joint Venture; MA = Market Access; NT = National Treatment.

105. **These differences in the policies affecting trade and investment in services suggest that the "single market" still remains a distant goal.** In practice, however, these schedules do not mean that any of these countries in fact maintain this depicted level or openness or restrictiveness, or even the listed restrictions. Since there is no mechanism to assess implementation in the regulatory framework, these data say little about the actual services policies of ASEAN Member States, and can only serve as a reference vis-à-vis the AEC–AFAS obligations. From this perspective, however, the stark differences in sectoral coverage, as well as policies vis-à-vis the service sectors, are a reminder of the strong effort still needed to meet the AEC goals by 2015.

The need for an implementation monitoring mechanism

106. **The discussion above has focused on commitments adopted by the ASEAN Member States, and the measures they have referred to in such schedules.** Whether such commitments actually reflect the legal and regulatory framework of each ASEAN Member State is another matter. Chapter 2 of this

[51] Some experts point out that landownership restrictions are in fact not covered by the AFAS. Should there be such an informal understanding between ASEAN Member States in that the landownership policies fall beyond the scope of the AFAS, it should be made explicit and publicly available.

report attempts to cast some light in that regard by assessing the restrictiveness of services policies in ASEAN in several key sectors. However, a general understanding of the level of implementation of AFAS commitments would require a comprehensive review and assessment of the laws and regulations of ASEAN Member States.

107. **The difficulty in assessing the implementation of the AFAS in actual domestic laws and regulations is one of the major weaknesses of the system.** The AEC framework does not currently feature a procedure to identify how the ASEAN obligations and commitments are adopted by each member. That is, ASEAN Member States lack the ability to determine whether the AFAS has an actual effect in reducing restrictions on trade and investment in services. Absent such a mechanism, progress made in the regional agreements is purely nominal, or remains subject to anecdotal evidence of regulatory amendments or cases of noncompliance. In the context of the WTO, the institution that indirectly but effectively monitors implementation is the dispute settlement body, since WTO members tend to be concerned with being found in violation of WTO agreements. On the contrary, lack of establishment of ASEAN dispute settlement bodies, and general reliance on the "ASEAN way" by the members, have led to a system that has no incentives to implement ASEAN disciplines and no accountability for noncompliance. The lack of an adequate monitoring mechanism does not limit the transparency of the agreements, but casts doubts on the effectiveness of the services market integration as a whole.

108. **Unlike in the case of the GATS, an AFAS implementation monitoring body does not necessarily have to be linked to dispute resolution.** Instead, it could rely on gathering information from different sources on the implementation of the AFAS and other ASEAN agreements, in order to identify potential failures to implement. Such details could be provided by governments of other ASEAN Member States or, more importantly, by the stakeholders directly affected by those measures—the service providers. This information could be reviewed by a regional body and made publicly available, enhancing transparency. The discussion at the regional level and the disclosure of the measures would exert peer pressure on the ASEAN member under scrutiny, incentivizing the amendment of nonconforming measures and promoting implementation of the AFAS commitments.

109. **The AFAS monitoring mechanism would complement efforts already under way to reduce regulatory barriers to trade in goods.** Under the framework of the ASEAN Trade in Goods Agreement, ASEAN members are developing a mechanism similar to the one outlined above to reduce unnecessary nontariff measures to merchandise trade. An AFAS monitoring mechanism could build on this experience and expand implementation efforts to trade in services, thus ensuring the achievement of AEC goals and promoting effective integration of the services markets.

E. Conclusions and Policy Recommendations

110. **The chapter has confirmed that the AFAS delivered significant progress in commitments to the liberalization of intraregional trade and investment in services in ASEAN.** Indeed, commitments on market access and national treatment of ASEAN service suppliers have generally advanced on time with the schedule set out in the AEC. However, a comparison with other agreements highlights the modest levels of ambition of the AEC–AFAS, which fall short of the liberalization provided by many free trade agreements.

111. **To make further and deeper progress in the regional integration in services, ASEAN Member States need to direct their attention to regulatory barriers to trade and investment.** The current framework provided by AFAS fails to deliver effective integration in services due to pervasive regulatory barriers, bringing about a shallow level of integration. This, together with the limited liberalization ambition, entails that the conclusion of more ambitious free trade agreements by ASEAN Member States can de facto override the intraregional services integration agenda. To overcome this, ASEAN Member

States need to deepen regional services integration by developing common rules and principles, and enhancing cooperation on domestic regulation on trade and investment in services. Strengthening mechanisms to monitor and enforce the implementation of trade commitments would also foster greater integration by ensuring uniform and timely compliance with ASEAN obligations.

112. **The analysis also suggests that the AFAS structure has important shortcomings that limit transparency and clarity of the system.** This affects participation by smaller economies, whose limited resources are stressed by a complex and opaque structure. Lack of transparency also inhibits the reach of AFAS to the general public, which limits the practical effects of the agreement and reduces the overall legitimacy of the services integration process.

113. **Finally, the review here of the AEC–AFAS framework has helped identify some important policy recommendations for ASEAN Member States to address these challenges.** These policies are discussed below, grouped into four broad categories according to the main goal that each recommendation serves: (1) deepening integration in trade and investment in services, (2) ensuring implementation, (3) improving transparency, and (4) strengthening institutions and promoting the participation of smaller Member States. The categories and the measures are ranked from the perspective of how to enhance integration in services in ASEAN. A final category puts forward suggestions to promote the participation of ASEAN's smaller economics in the services integration process. The recommendations attempt to offer practical solutions to the main challenges identified in the study, many of them without requiring major changes in the existing framework, but rather working around existing rules and institutions.

1. Deepening integration in trade and investment in services

Addressing regulatory barriers

114. **Addressing regulatory barriers to trade in services should be the main priority in order to deepen integration in services and realize an ASEAN single market.** To that end, ASEAN Member States need to go beyond the negotiation of commitments on market access and national treatment and focus on regulatory cooperation and the harmonization of domestic regulatory frameworks. This section discusses a broad approach, and there is a more detailed discussion on this topic in Chapter 5, which addresses the forward-looking agenda of regulatory cooperation and harmonization.

115. **Regulatory burden is likely to be addressed more easily in a regional context than in a multilateral context.** This is because partners to regional integration are fewer and tend to share greater economic ties and legal traditions. The key question is how to achieve this goal. In other words, what mechanism can countries use to overcome the regulatory burden that service providers face because of differences in regulatory requirements to fulfill both home and host-country requirements? Mutual recognition, together with minimum harmonization requirements, has been identified, in different forums like APEC, the OECD, and in integration agreements like the EU, as a way forward to facilitate trade, even though mutual recognition has proven to be very difficult to negotiate and manage in practice, particularly from a political economy point of view. And yet, this has been the only available tool that countries have proposed to move forward.

116. **Regulatory cooperation should take place at two different levels of regulation.**[52] Cooperation at a horizontal level would require establishing common general principles that would guide domestic regulation on services trade and investment. At a minimum, ASEAN Member States should recognize that domestic laws and regulations should conform to certain principles of good regulation, such as

[52] Enhancing regulatory cooperation and harmonization is a key part of the forward-looking agenda, a subject discussed in more detail in Chapter 5.

transparency, consultations (both public and interagency), due process, and efficiency. To that end, ASEAN Member States can build on existing instruments, such as the APEC–OECD Integrated Checklist on Regulatory Reform, to establish certain basic procedures that must be complied with in the regulation-making process (box 4.4). In addition, common ASEAN guidelines may provide further guidance on aspects related to licensing procedures and standards, ensuring that domestic procedures in all ASEAN Member States respond to common regulatory objectives, able to prevent market failures and pursue social goals, without further impairing regional trade and investment in services. This would ensure that service providers registered in one ASEAN country can meet the requirements in other jurisdictions. Agreeing on such common regulatory goals is an essential step toward ensuring harmonization of regulation and eventual mutual recognition of licenses and authorizations. Although it may work differently for each mode of supply, common regulatory principles and harmonization of regulation is a key step for the realization of a single market in all modes.

Box 4.4 Good Regulatory Principles:
Excerpts from the APEC–OECD Integrated Checklist on Regulatory Reform

Regulatory reform refers to changes that improve regulatory quality to enhance the economic performance, cost-effectiveness, or legal quality of regulations and related government formalities.

A. Horizontal Dimension

A1. To what extent is there an integrated policy for regulatory reform that sets out principles dealing with regulatory, competition and market openness policies?

A5. To what extent has regulatory reform, including policies dealing with regulatory quality, competition, and market openness, been encouraged and coordinated at all levels of government (e.g., Federal, state, local, supranational)?

A6. Are the policies, laws, regulations, practices, procedures and decision making transparent, consistent, comprehensible and accessible to users both inside and outside government, and to domestic as well as foreign parties? And is effectiveness regularly assessed?

A8. To what extent are there effective interministerial mechanisms for managing and coordinating regulatory reform and integrating competition and market openness considerations into regulatory management systems?

B. Regulatory Policy

B2. Are the legal basis and the economic and social impacts of drafts of new regulations reviewed? What performance measurements are being envisaged for reviewing the economic and social impacts of new regulations?

B4. To what extent are rules, regulatory institutions, and the regulatory management process transparent, clear, and predictable to users both inside and outside government?

B5. Are there effective public consultation mechanisms and procedures, including prior notification, open to regulated parties and other stakeholders, nongovernmental organisations, the private sector, advisory bodies, accreditation bodies, standards-development organisations and other governments?

B8. To what extent have measures been taken to assure compliance with and enforcement of regulations?

C. Competition Policy

C9. To what extent does the competition law apply broadly to all activities in the economy, including both goods and services, as well as to both public and private activities, except for those excluded?

C12. In the absence of a competition law, to what extent is there an effective framework or mechanism for deterring and addressing private anticompetitive conduct?

D. Market Openness Policies

D2. To what extent does the government promote approaches to regulation and its implementation that are trade friendly and avoid unnecessary burdens on economic actors?

D8. To what extent are measures implemented in the countries accepted as being equivalent to domestic measures?

117. **More detailed regulatory cooperation principles should be developed on a sectoral basis, in particular for heavily regulated services.** This would follow the steps already taken in ASEAN in some services, like air transport and some financial services, to develop regulatory cooperation principles. Other key service sectors that would greatly benefit from common regional rules include land and water transport, telecommunications, and professional services, as well as those identified as ASEAN Priority Integration Sectors.

118. **Discussions on regulatory cooperation on the different services can take place either under the umbrella of the AFAS–AEC framework or under the already established sectoral bodies.** Regardless of the grouping taking the lead, however, cooperation between "trade in services" and "sectoral" bodies should be enhanced. Trade negotiators can focus on reducing regulatory restrictions to the services market, while sectoral expertise would ensure a sound regulatory framework for the sector that prevents market failures and achieves common policy goals.

119. **In addition, ASEAN Member States need to ensure that the administration of domestic regulation is not carried out in a way that invalidates the common regulatory objectives.** ASEAN Member States may pursue this goal by developing common guidelines on the administration of regulation and administrative procedures. Such guidelines may develop model forms and information requirements and promote the use of a one-stop shop for licensing and registration procedures. The development of these guidelines, that go beyond the integration of the services markets, could be taken up by the High Level Task Force on Economic Integration.

Completing intraregional liberalization and integration

120. **Completing the intraregional liberalization of services trade and investment is a requirement for the establishment of an ASEAN single market.** This entails the removal of all limitations on market access and discriminatory measures, including caps on foreign equity. On occasion, however, public order, safety of services, or prudential reasons may justify some restrictions, particularly regarding quantitative measures. In order to achieve this level of integration, ASEAN Member States should go further in their liberalization effort than currently envisaged under the AEC–AFAS framework. In particular, ASEAN should:

- go beyond the current requirements on foreign equity limitations, providing that any ASEAN person or company may have full ownership over its branches and subsidiaries in other ASEAN countries, as some ASEAN Member States already do in practice
- remove the 15 percent flexibility rule, except for the smaller ASEAN Member States
- record any remaining restrictions under a "negative list," which would highlight the achievements in terms of liberalization and improve transparency.

121. Such an initiative would make the liberalization of services trade comparable to that achieved on investment in the manufacturing sector. Indeed, to level the playing field between investment in the manufacturing and service sectors, ASEAN Member States may wish to increasingly incorporate investment in services under the scope of the ACIA, especially those services with greater linkages to trade in goods.

2. Ensuring implementation

122. **A major shortcoming under the current AFAS is the inability to monitor and, where needed, compel the implementation of commitments in services trade.** In fact, the lack of information on the level of implementation is such that there is no clear understanding of to what extent and how liberalization commitments are actually reflected on the ASEAN Member States' domestic laws and regulations. The

establishment of an Implementation Monitoring Mechanism, and improvement of the existing ASEAN dispute settlement mechanism, would prove valuable to that end.

123. **Creating an AFAS Implementation Monitoring Mechanism.** One initiative to address implementation shortfalls would be establishing an AFAS Implementation Monitoring Mechanism. The Monitoring Mechanism would review the level of implementation of AFAS commitments by ASEAN Member States, based on information provided by other members and/or private services suppliers to complement self-reporting information. As in the case of the review process for nontariff barriers, the involvement of the private sector—the ultimate beneficiaries of the integration process—is essential to ensure practical effects of the agreements. The Monitoring Mechanism would exert peer pressure in cases of nonimplementation, and it would allow clarification of their position to Member States who are fully compliant with their commitments.

124. **Establishing an interpretative procedure in dispute settlement.** The improvement and application of the dispute settlement mechanism is another key step to ensure implementation of the commitments. Ongoing efforts to improve the system should be strengthened, with a view to coming to a prompt conclusion. A renewed dispute settlement mechanism should include an interpretative procedure, for which ASEAN Member States could consult on the terms of the agreements and commitments without the need for a formal dispute with another member, in line with the successful experience with these procedures in other regional integration processes.

125. **Clarifying the scope of the Dispute Settlement Mechanism.** The ongoing review of the dispute settlement mechanism should also clarify the scope and other vague aspects of the EDSM and/or its successor. In particular, ASEAN Member States should:

- explain the relationship between the EDSM and the ASEAN Charter of Dispute Settlement Mechanism
- make clear the scope of the EDSM and/or its successor, by updating the list of "covered agreements" and defining in clear terms what subsequent agreements may fall under their purview
- spell out the relationship between the Enhanced Dispute Settlement Mechanism and the WTO Dispute Settlement Mechanism, providing guidance on whether and how WTO jurisprudence may or may not inform ASEAN dispute resolution.

3. Improving transparency

126. **The sensitivities of negotiating modalities might have contributed to transparency gaps in the services integration process, and there may be other cost-effective ways to promote transparency in the ASEAN services integration process to complement the current approach of using formal treaties.** To a large extent, this is because ASEAN has so far no other means of expression than formal international treaties, such as agreements, protocols, and ministerial declarations. These formal instruments are costly and cumbersome, because they typically require a complex administrative and legal effort.

ASEAN communications

127. **ASEAN could consider alternative non-binding mechanisms to provide greater clarity and transparency to ASEAN bodies, procedures and agreements**. The report has identified certain areas where better clarity will be of value, including the intricate relationships between ASEAN agreements and multilateral agreements in terms of the application of GATS disciplines to AFAS commitments. Such mechanisms would not only foster greater transparency, but also certainty which would improve the environment to trade and invest within the region, as well as with the rest of the world. For example, the

WTO Secretariat issues non-binding technical notes on applicable WTO decisions, while the European Commission issues non-legally binding Explanatory Notes[53].

4. Strengthening institutions and promoting participation of smaller Member States

128. **Amending the institutional framework and negotiating modalities to make it more oriented toward greater regulatory cooperation is a high priority.** The use of capital-led trade negotiations does not offer sufficient dynamism or incentives to cooperate and pursue regulatory harmonization. In particular, the CCS tends to meet too sporadically and be burdened with a heavy and varied agenda. To overcome these limitations, ASEAN should consider converting the CCS into a Permanent Services Committee Expert Group, with the mandate to advance services discussions on the sectoral level through common policy and regulatory principles. The Permanent Group would be composed of dedicated government officials who could meet several times a month to help accelerate the services agenda.

129. **While the new Permanent Group would be valuable for the process as a whole, the main beneficiaries of this setting would be ASEAN's smaller economies.** Indeed, the Permanent Group would not only entail a more efficient use of resources, but would help consolidate expertise on service negotiations, which will facilitate dialog with other ministries and service regulatory bodies.

130. **This should be complemented with clearer guidelines on the mandates of the bodies dealing with services integration and greater cooperation among them.** This would include the Permanent Group and other sectoral bodies that are engaged in cooperation in services. By reducing unnecessary complexity, smaller economies can free up resources to engage more actively in the regulatory discussions.

[53] EC's Explanatory Notes contain practical and informal guidance on how EU law should be applied based on the views of the Commission's Directorate General of the relevant bodies. The views expressed in the Explanatory Notes, however, do not represent the views of the Commission, nor is the Commission bound by any of the views expressed therein. The EC's Explanatory Notes are not legally binding and aim to provide better understanding of EU legislation and guidance to Member States and businesses for better preparations, and are a work in progress. Interpretation of the Union Law is ultimately the role of the European Country of Justice, however.

Chapter 5. Advancing Regulatory Cooperation

The previous chapters have shown that while ASEAN economies can obtain large potential gains from services integration, including through trade liberalization, this has not been fully realized. A key finding is that domestic regulatory reforms and regional regulatory cooperation can further advance services integration of ASEAN economies. This chapter focuses on how ASEAN can deepen services integration through promoting regulatory reform and cooperation in the region. While the scope for regulatory cooperation in ASEAN is broad, significant challenges remain. There is potential to reap substantial, additional unexploited benefits from more effective regulatory cooperation. Regulatory cooperation refers to the range of institutional and procedural frameworks within which national governments, subnational governments, and the wider public can work together to build more integrated systems for rule making and implementation, subject to the constraints of democratic values such as accountability, openness, and sovereignty (OECD 2014). Regulatory cooperation can be pursued through different tools ranging from the informal, such as basic information sharing, to the more formal, such as mutual recognition arrangements and regulatory harmonization. They can occur unilaterally, bilaterally, regionally, or multilaterally. The EU experience is used to illustrate a forward-looking agenda for regulatory cooperation. The discussion also looks at a range of institutional limitations on Regulatory Cooperation that need to be addressed.

A. The Agenda for Regulatory Cooperation

1. **A key policy priority that can be advanced through regional trade agreements is regulatory cooperation.** Services trade liberalization, as pursued under the ASEAN Framework Agreement on Services (AFAS), is a necessary but not sufficient condition for enhancing trade competitiveness. The main concern of trade agreements is with regulations that govern and restrict trade, such as regulations that affect foreign ownership or limit the number of service offers and service providers in a market. By eliminating such prima facie measures, service providers are in a position to expand the supply of services to new markets. Yet, in many cases service regulations aim at addressing market failures and achieving legitimate nontrade policy objectives. Market failures typically identified in the economic literature include the following (Mattoo and Sauvé 2003, 2008, 2010):

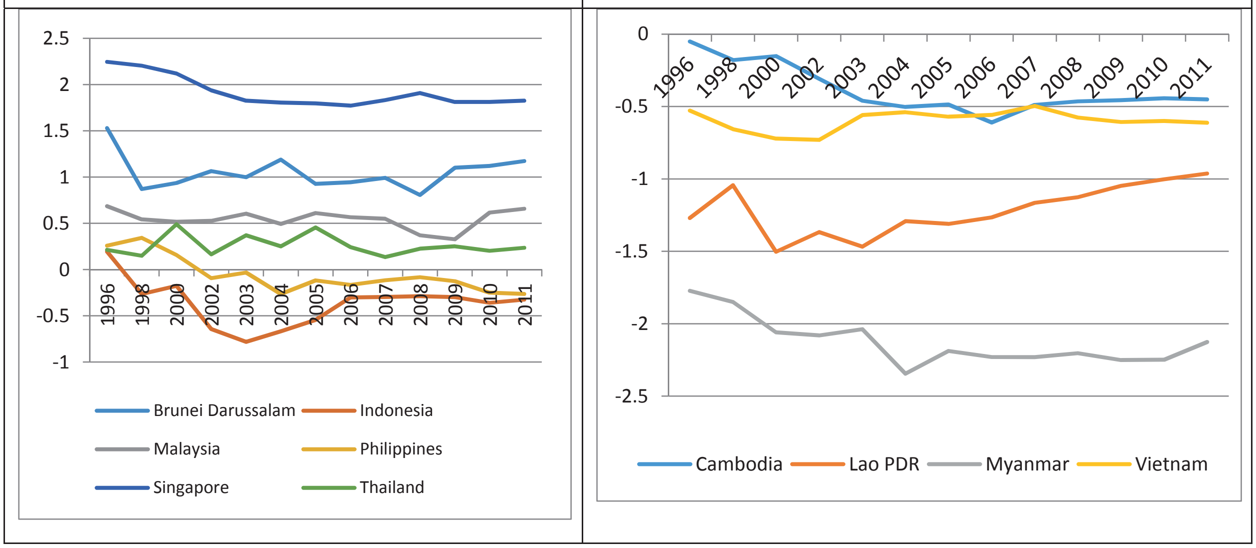
- monopolies in network-based services (for example, telecommunications, transportation, and energy services)
- asymmetric information in knowledge and intermediation-based services (for example, financial and professional services)
- externalities (for example, environmental externalities in tourism, transportation, or water services)
- the desire to ensure universal access in essential services (for example, health and education services).

2. **Regulatory cooperation is important for integrating services sectors, in general, and even more so for ASEAN economies because of diversity in quality of regulations** (figure 5.1). Although, regulatory matters are still to a large extent outside the current work of the AFAS, this is within the remit of the Asian Economic Community goals for free flow of services, and the services integration process in ASEAN can play a positive role in fostering services regulatory quality and governance. For all ASEAN Member States, regulatory quality has been stable since the entry into force of the AFAS (except for Brunei Darussalam and Malaysia), and has remained relatively modest except for Singapore, Brunei, and Malaysia (figure 5.1). Except for Singapore, Malaysia, and Brunei, all ASEAN economies rank in the bottom half of

countries worldwide (Worldwide Governance Indicators 2012 data). For the lower-income countries, the challenges in terms of regulatory quality are particularly high, and strong support from trading partners and international organizations will be required to improve it.

Figure 5.1 Regulatory Quality in ASEAN Economies is Heterogeneous

Singapore and Middle-Income ASEAN	Low-Income ASEAN



Source: Worldwide Governance Indicators.

3. **Regulatory cooperation would aim to reduce the regulatory burden through mutually beneficial trade facilitation measures, from information and experience sharing, capacity building, adoption of general principles and, where possible, harmonization.** The empirical literature identifies regulatory heterogeneity as a significant impediment to trade. Kox and Lejour (2005), for example, find a negative and significant effect of the level of regulations, as well as their heterogeneity on services trade. Kox, Lejour, and Montizaan (2005) find that the heterogeneity in regulation hampers bilateral services trade in the EU, as well as bilateral direct investment. They also assess the impact of the EU services directive in terms of lowering the intra-EU heterogeneity in product market regulation for services, and its effect on bilateral trade and investment in the internal market for services. They find that commercial services trade in the EU could increase by 30 to 60 percent and foreign direct investment stock in services could increase by 20 to 35 percent. These findings suggest that harmonization of regulations has a positive impact on services trade at the regional level among trading partners. Harmonization, or regulatory convergence, is at the extreme spectrum of regulatory cooperation. Because harmonization is not always feasible or may be too costly, EU member countries have complemented minimum levels of harmonization among Member States with mutual recognition.

4. **Mutual recognition is another means of collaboration.** It implies that countries accept that common policy objectives can be achieved through different means. Countries collaborate to accept differences in regulatory standards, as well as the conformity assessment of these standards. Because of the complex nature of regulatory cooperation, harmonization, and mutual recognition, it is useful and most promising to pursue regulatory cooperation at the regional level among like-minded countries striving to reach a common goal, such as ASEAN Member States (Mattoo and Sauvé 2011).

5. **Regulatory cooperation has both benefits and costs.** The higher the regulatory heterogeneity among countries, the higher the potential benefits of regulatory cooperation. The costs of regional regulatory cooperation depend on countries' institutional capacity, as well as regulatory preferences. For

example, least-developed countries will likely have more difficulty reaching regulatory levels or processes similar to developed countries. Moreover, if regulations already are adequate to achieve the prevailing policy objectives, adopting more complex regulations similar to developed countries may be unnecessarily costly. In this case, the country with the highest standard may be reluctant to cooperate in so far as this would mean adopting lower regulatory standards domestically. In such a situation, other approaches to regulatory cooperation can be explored, such as the sharing of information and best practices as well as capacity building.

6. **Regional trade agreements are also an opportunity to promote regulatory cooperation and, ideally, build optimal regulatory areas for services.** Such areas are composed of a set of countries whose welfare can potentially be maximized by regulatory convergence (Mattoo and Sauvé 2011). Closer regulatory cooperation that would boost the benefits of creating a truly integrated market, while minimizing costs created by differences in regulations and institutional capacity. Regulatory cooperation can be explored in three broad areas:

- regulatory cooperation, through harmonization or mutual recognition
- adoption of regulatory principles, in particular regarding the design, adoption, and application of regulations
- building regulatory capacity, which includes cooperation among regulatory bodies
- exchange of information for regulatory purposes and experiences on regulatory reforms
- identifying and adopting good regulatory practices in new areas.

7. **The scope for regulatory cooperation in ASEAN is broad.** ASEAN has been relatively successful in moving toward service markets integration, addressing the most significant impediments to trade embedded in regulations that affect services and foreign service providers. And yet, regulatory cooperation is uneven, and there is potential to reap substantial additional benefits. Although in the area of professional services, ASEAN Member States have agreed on mutual recognition arrangements for seven professional activities, there are several issues: (a) in two of the cases these agreements are framework agreements that require further negotiations of bilateral agreements to be fully operational; (b) implementation of these agreements is limited, because certain ASEAN Member States lack the required institutional infrastructure to apply the agreed commitments; and (c) there are legal questions on how much need there is to reform and adapt domestic legislation to the international obligations.

8. **Scope for regulatory cooperation also exists in other sectors not covered under AFAS.** In general, regulatory cooperation in ASEAN is not addressed in the context of AFAS, despite being envisioned under the first objective of AFAS. AFAS' main objectives, in practice, have focused on achieving the ASEAN Economic Community Blueprint goals, which have aimed to accelerate services commitments in countries' schedules. Some regulatory cooperation, in financial services and air transport, is being advanced outside of the AFAS negotiating framework. This is where ASEAN Member States discuss harmonization of regulations and infrastructure required to integrate services in the region. For example, while in the AFAS context the discussion that has been focusing on incorporating commitments on road or maritime transport services has shown significant progress, the discussion on harmonization of safety standards for road transportation or investment into port infrastructure to facilitate trade is undertaken under the umbrella of the Infrastructure Division in ASEAN Secretariat. This means that while formal integration under the AFAS may progress quickly because countries are committed to the increased incorporation of sectors in their services schedules, the real integration depends on regulatory harmonization among ASEAN Member States, and on implementation at the country level. This may have adversely affected the perception of stakeholders of the real progress of ASEAN services integration if seen only in the AFAS context. The implication of this is that services integration in ASEAN will require a more

comprehensive approach—one that looks at other sectors and regulatory cooperation more broadly than is currently offered under the AFAS.

B. Enhancing Regulatory Cooperation

9. **The ASEAN services integration model does not allow for regulatory competition. The AFAS model, which is based on the GATS/WTO agreement, provides for a national treatment approach to liberalization.** Under this model, services and service providers are granted equal treatment after being allowed full market access; that is, they face no limitations on market access, and there are no national treatment limitations or conditions that discriminate against foreign services and service providers, but they still need to comply with both the country of origin regulatory requirements and the destination market requirements.

10. **In the context of the ASEAN Economic Community goals, this model is insufficient to achieve seamless services trade flows, particularly where there is considerable regulatory heterogeneity.** Table 5.1 helps illustrate this point. The assumption in this table is that all market access barriers and national treatment limitations have already been eliminated. In this case, services and service providers confront four potential situations. In the case of the first quadrant, both the origin and the destination countries maintain their respective laws and regulations to allow services trade under any of the modes of supply. This means that the service supplier needs to fulfill all the regulations required providing services in the origin and destination countries, no trade facilitation or cooperation measure and no harmonization takes place, and thus there is a high regulatory burden. The other extreme is full regulatory cooperation, in which countries fully (or substantially) have harmonized their respective laws and regulations, allowing any service provider to freely move from one country to another to provide services. In theory, this is what would be expected in a country like the United States where, although individual states can still regulate services, by and large, service providers can move across the country to provide services if they fulfill certain specific requirements at the state level.

Table 5.1 Regulatory Cooperation

		Destination Country	
		National Treatment	Regulatory Cooperation
Country of Origin	National Treatment	I No Harmonization High Regulatory Burden	II Mutual Recognition Medium Regulatory Burden
	Regulatory Cooperation	III Exchange of Information Medium/High Regulatory Burden	IV Harmonization Low Regulatory Burden

11. **There are two additional, lighter, regulatory cooperation approaches.** In quadrant II, there is some sort of regulatory cooperation, usually mutual recognition agreements that facilitate trade, and there is medium regulatory burden. This is, in theory, what the EU initially aimed to achieve. Service providers duly established in any of the EU Member States according to that Member State's laws and regulations could provide services under any mode of supply provided by the Treaty of Rome. This approach may risk promoting regulatory competition, which created fears among stakeholders that there would be a race to the bottom to a lighter level but poorer quality of regulations (Rubalcaba 2007). The approach evolved and was combined with some sort of minimum common requirement that all the providers in all Member States needed to fulfill, for instance, on financial services. Under quadrant III, some cooperation among the

countries may take place, usually in the form of information exchange and collaboration among regulators, which may help service providers. This can be the case of financial services industries, where regulators can exchange information on financial services institutions operating in their jurisdiction. In this case, the impact on the reduction of the regulatory burden is indirect and may be limited. In ASEAN, where harmonization may be limited, regulatory cooperation is being done through mutual recognition arrangements, phased-in participation based on readiness, collaboration, and information exchange that may help services providers.

12. **Countries regulate similar issues differently, including in some cases opting not to regulate.** For example, in the context of the EU, Mustilli and Pelkmans (2013a) find that despite significant liberalization progress among EU countries, a high level of regulatory heterogeneity among countries remains (box 5.1). In this case, regulatory heterogeneity is purely about differences among regulations, not their intensity or impact on restricting competition, and only alters the fixed costs of entry, which may be disproportionately high for small and medium enterprises. As has been shown by the empirical literature, regulatory heterogeneity may have a strong negative impact on service flows (in this case integration; see Kox and Lejour 2005). In the context of the EU, mutual recognition has a positive impact in three dimensions that affect heterogeneity: regulatory and administrative opacity, the area of explicit barriers to trade and investment, and the area of barriers to competition (Brujin, Kox, and Lejour 2006). Box 5.1 presents lessons from the EU's efforts to accelerate implementation of services integration through its services directive of 2006 and then introducing a mutual evaluation process.

Box 5.1 Lessons of Experience from the European Union's Implementation and Evaluation of Services Integration

Although the ASEAN Economic Community goals do not refer to the creation of a common market, the EU's experience of integrating services markets may offer relevant insights. The EU has highlighted the role of regulatory barriers to trade as major obstacles to the common market in the services sector. In an assessment of the internal market for services, conducted in 2002, the European Commission concluded that the internal market for services was far from being a reality, due to the persistence of legal barriers and the increasing challenges posed by "nonlegal" barriers. The European Commission characterized "legal barriers" as those deriving directly or indirectly from a legal constraint and that may prohibit, impede, or render less advantageous the provisions of services. Main sources of such legal barriers were found to be divergent national regulations, problems relating to the behavior of national authorities, and the legal uncertainty caused by the complexity of some cross-border situations. In addition, nonlegal barriers arise from the behavior of administrations, including the use of discretionary powers or heavy and nontransparent procedures that favor domestic operators, as well as lack of access to regulation and inconsistent administrative practices (European Commission 2002).

In this context, the EU issued Services Directive 2006/123 to help accelerate services integration, and two unusual approaches were followed to support its implementation. First, a detailed handbook for implementation was published, and second, a multiyear cooperation effort in several joint implementation committees (Member States and the Commission) was established. In the EU-27,[a] about 35,000 service provisions were checked. This domestic screening was bound to uncover many illegitimate restrictions that had gone unnoticed, all of which have been removed. In addition, art. 39 of the directive imposed a "mutual evaluation" among Member States of the implementation and screening in 2010, again a uniquely cooperative exercise. The mutual evaluation report (European Commission 2011) reveals in great detail how much has been achieved by this joint exercise among the Member States. The upshot is that the removal of barriers, including hidden discrimination, has been far more rigorous and extensive than anyone could reasonably have expected. It is also clear that the mutual evaluation among the EU Member States has given rise to numerous discussions about the regulatory rationale of lingering restrictions. These discussions have included topics such as the justification and scope or boundaries of market failures, and the assessment of the proportionality of the tools of government intervention. In other words, the evaluation has had a "better regulation" effect, as well. Intra-EU market access has improved considerably, and EU enforcement will be less problematic than initially feared.

Box 5.1 Lessons of Experience from the European Union's Implementation and Evaluation of Services Integration (continued)

Another innovative mechanism of "mutual evaluation" has been included in the current EU Services Directive. Article 39 of the directive provides for a review process of Member States in two different contexts and with two different objectives (European Commission 2007). First, a review of authorization schemes and certain establishment-related requirements is mandated. The aim is to assess these requirements in light of the directive. In this context, unjustified or disproportionate authorization schemes and other requirements should be abolished or amended. Second, a review of the requirements applied to establish service providers in another Member State to provide services is mandated. In this case, an assessment of the consistency of the application of these requirements with the provisions of the directive is required.

In addition, Member States are mandated to report any changes in the requirements, including new requirements they apply or are planning to apply. The aim of this provision is to achieve transparency and legal certainty for service providers, in particular small and medium enterprises wishing to provide cross-border services. A report and subsequent updates are communicated to the other Member States, and the European Commission produces on an annual basis "analysis and orientations on the application of these provisions in the context of this Directive."

The principles recognized in the Services Directive are further supported by a regime harmonizing the conditions for the establishment of firms. These rules are embodied in the framework of EU Company Law. The ultimate goal of this framework is to ensure that regulatory heterogeneity among EU Member States does not prevent companies from establishing themselves in the territory of other EU Members States to provide services. While the rules on company law go beyond the services sector, since they apply to firms on any economic activity, they are particularly relevant to the integration of the services market, since the establishment of a commercial presence remains the main mode of supply for service suppliers. Since the 1960s, the EU has advanced toward the freedom of establishment through the development of a regime on company law oriented to harmonizing the main regulatory requirements applicable to firms from an EU Member State that wishes to establish itself in any other Member State, while recognizing each Member State's ability to maintain substantial authority to safeguard legitimate domestic policy concerns. The EU experience offers valuable guidance on the kind of issues that need to be addressed in order to reduce regulatory heterogeneity; in particular, EU directives and regulations address key issues of company law such as company formation requirements and procedures, corporate governance, capital maintenance, mergers and acquisitions, accounting and audit, and market regulation.

Source: Mustilli and Pelkmans 2013a, 2013b.
Note: a. EU-27: Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, and the United Kingdom.

13. **International cooperation, more broadly, can take place in other forms, as well. One of the recommendations of this report is consideration by all ASEAN Member States of adopting basic good regulatory practices, as discussed in Chapter 3.** One of the guiding principles of good regulatory practices is transparency, including through providing sufficient opportunities for comments for interested parties and sharing information with counterparts. In the context of an economic community, this may also mean allowing trading partners to participate in the regulatory process. For example, the EU services directive mandates a list of essential information that Member States must make easily accessible through the "points of single contact" to service providers and service recipients. In addition, this directive obliges Member States to give each other mutual assistance, in particular to reply to information requests and to carry out, if necessary, factual checks, inspections, and investigations. It also requires creating a communication network among regulatory and supervisory authorities with the aim, primarily, of mutual assistance. In such cases, regulatory cooperation can facilitate agreement and common understandings of the issue or on underlying technical or scientific issues, and contribute to informing all phases of the rulemaking process. In addition, cooperation can address existing regulatory differences and help avoid future regulatory differences (see Rubalcaba 2007; Davies 2012; GAO 2013).

14. **Further integration in the services market can be pursued through regulatory cooperation among ASEAN Member States,** for example in the area of company law, so as to facilitate cross-border mobility of service providers. Following the EU experience, ASEAN Member States may wish to consider addressing basic requirements for the establishment of companies, including areas like compulsory disclosure of information, and power of representation of company organs. Requirements on disclosure, in particular, may include the harmonization of information requirements and the establishment of an official company register accessible by all Member States.

C. Institutional Limitations on Promoting the Regulatory Cooperation Agenda

15. **The AEC–AFAS institutional framework underpinning trade negotiations has not yet been fully effective in promoting integration of the services markets in the region, due in part to inadequate emphasis on regulatory cooperation.** The goals of trade negotiations, the way they are led, the manner in which the resulting obligations are adopted, and, importantly, the transparency of the process, have been successful in removing the most glaring formal restrictions to trade in services, but not in addressing implementation challenges. Further, their impact on reducing the regulatory divergence among Member States - which is critical for the effective regional integration of the services market - has been limited. Two issues stand out in particular in creating this outcome: (a) the narrow scope of negotiations, and (b) inadequate transparency. These are discussed below.

Narrow scope of negotiations

16. **The scope of trade negotiations has been narrow, with a strong focus on liberalization measures but to the neglect of promoting regulatory cooperation.** Policy coordination discussions aimed at overcoming regulatory heterogeneity and barriers do not form part of the negotiating agenda. In the broader ASEAN framework, common regulatory policies have been advanced for specific sectors, largely separating such discussion from trade liberalization talks. Commercial aviation stands out as a case in point. The factors discussed below combine to explain the limited potential to advance regulatory cooperation for the services market under the current AFAS institutional framework:

- ***Grand bargain dynamics.*** Discussions under the AFAS follow the trade negotiations tradition in tackling multiple services sectors in parallel. From a negotiating point of view, this has the benefit of allowing for a "grand bargain" in which concerns with commitments in specific sectors may be compensated by preferences obtained in other sectors. This format creates incentives for all parties to reduce their barriers to trade, but does not provide a channel for addressing regulatory coordination issues. Furthermore, bundling commitments in multiple sectors in the negotiations may also lead to the undesired result of stalling progress on some sectors because of concerns on others, thus slowing the whole process of services liberalization.
- ***A vague and ambiguous mandate on regulatory measures.*** Trade agreements rarely feature extensive and detailed provisions on domestic regulation. Instead, they tend to rely on vague, ambiguous language that leaves ample space to keep subtle regulatory concerns off the negotiating table. Advancing regulatory cooperation requires specific guidance that is not well reflected in the current AEC–AFAS disciplines. In the absence of such guidance, negotiations tend to steer away from thorny, often highly technical talks on services regulation.
- ***Composition of negotiating groups.*** Trade negotiations are led, logically, by trade negotiators. Trade negotiators, however, may lack the technical expertise to make substantial contributions on services regulation, for which they typically have to refer back to their capitals to seek guidance from the concerned line ministries. As a result, any regional initiative on regulatory integration on services trade is subject to lengthy and cumbersome procedures.

- ***Lack of formal cooperation channels.*** This problem is exacerbated by the lack of formal cooperation channels among the different ASEAN bodies. Representatives in some institutions attempt to overcome that by promoting consultations and information exchanges with representatives from related bodies. For instance, negotiators involved in negotiations on transport and logistics in the Coordinating Community on Services (CCS) have reached out to their counterparts working under the Transport Ministries Meeting to learn about their work and to consider areas of common interest. However, the lack of specific procedures to this end has resulted in these consultations taking a long time to materialize, with many months between meetings, thus limiting the actual effectiveness of a positive initiative. The effectiveness of interagency coordination also varies across ASEAN Member States.

Transparency

17. **Greater transparency can facilitate progress in regulatory cooperation.** Lack of transparency has affected procedures in the decision-making systems and obscured the scope and meaning of the decisions. This has exacerbated the complexity of the system, to the detriment of the smaller partners, in particular. It also limits the potential for progress in the regional discussions, and altogether reduces the impact of the integration process. In addition, the opaqueness of the system means that the ASEAN integration process remains distant from the general public.

18. **Internal transparency in the decision-making process.** International trade negotiations tend, by nature, to be secretive. Each party keeps its strategies and sectoral policies confidential in order to be able to reap the most preferences from the other parties, while minimizing its own concessions during the negotiations. While in some cases this mercantilist logic may at times be relaxed, giving room for some greater reciprocal disclosure, transparency in the decision-making process is not among the highest priorities in trade negotiations.

19. **In contrast to the elimination of restrictions through trade negotiations, the reduction of regulatory obstacles for integrating services markets requires a higher degree of collaboration than can be afforded by the trade negotiation process.** Indeed, while elimination of formal restrictions can be done on a quid-pro-quo basis, regulatory cooperation must be based on the establishment of common regulatory goals and principles, taking into account the current policies and regulations in place, and the challenges faced by the different countries. Trade negotiations do not offer the mechanisms for the type of collaborative decision making needed to advance into deeper services market integration.

20. **Available information on services rules is limited to international treaties.** The limited public information on ASEAN services rules is also a result of the nature of the decisions that embody any understanding between the parties. As discussed earlier, all decisions related to services negotiations take the form of international treaties. The references to these decisions as “agreements,” “frameworks,” or “protocols” does not change their legal nature, which requires a number of legal steps to enter into force, including, in many countries, parliamentary ratification. Once these instruments are properly ratified and entered into force, they are made public through different means, including online access. Thus, the system is fully transparent in the sense that all formal decisions are not only publicly available, but have also been ratified by domestic legislative bodies.

21. **This leads to only the most relevant regional decisions being reflected in actual instruments, leaving a number of other rules and understandings in the dark.** Indeed, procedural rules on the functioning of the different bodies, understanding of the interpretation of certain rules, and other arrangements that do not warrant a full international agreement are not officially reflected in any instrument, nor are they made otherwise public.

22. **Limited access to ASEAN procedural rules and understandings makes the process complex and opaque.** This adversely affects the smaller Member States, such as Cambodia, Lao PDR, Myanmar, and Vietnam, in particular. It also curbs the knowledge and interest of the general public in ASEAN market integration efforts, including by academia, think tanks, or private stakeholders, whose inputs could be valuable to the advancement of the regional integration process.

23. **While this limitation on information is the result of the ASEAN decision-making process, other forums offer some alternatives on how to increase transparency within this institutional framework.** In the WTO, for instance, the secretariat often publishes “Notes from the Secretariat” that explain to the Member States certain aspects of the negotiations or the agreements. The content of these notes is not binding on the Member States, nor does it entail an authoritative interpretation of the agreements, but it is understood that it does reflect some general understanding among the Member States on that issue. The notes, among other measures, help increase the transparency of the negotiations and inform about the rules and procedures, improving the legitimacy and spurring participation from academia, governments, and other interested parties.

24. **Another factor constraining transparency of the ASEAN services integration efforts is the limited user-friendliness of the information that is publicly available.** Not only is the current framework for services negotiations complex, but the information it provides is limited, scattered across multiple documents, and presented in uninviting trade-negotiations jargon. To a large extent, this is due to the fact that ASEAN information media tends to reproduce verbatim the agreements and protocols as their sources of information. The ASEAN Secretariat has published a number a reports for general dissemination that improve on this. However, the reach of those publications is limited and, while they are made generally available online, the organization of ASEAN Secretariat’s website (following the complex ASEAN institutional structure in chronological order) is hardly a welcome mat to the uninitiated. This poor and rather technical information on the ASEAN services framework fails to communicate the importance of these rules to a broader audience, which further limits the impact of the integration process. Entrepreneurs who are not familiar with ASEAN and general international trade technicalities cannot relate their business activities to the ASEAN integration process, and thus fail to understand its benefits and remain distant from the discussion.

25. **A related problem to the lack of transparency is the complex institutional structure for services integration in ASEAN.** While much of it is not directly related to services trade, the broad scope of services negotiations, which touches upon a number of different sectors and policies, exacerbates this problem. As noted above, at least six negotiating bodies have mandates on services integration, be it through liberalization of formal restrictions or through cooperation. In effect, the different work agendas do not stem as much from their mandates (some of which are not publicly available) as from their actual practices. Most mandates are vague and ambiguous enough to create certain overlaps in the organizations’ goals and work agenda. The lack of standardization in the decision-making process adds to this complex framework. Rules and procedures may appear ad hoc, or are often modified to fit the different working groups and bodies.

26. **Ultimately, the smaller ASEAN Member States are the ones more heavily affected by this complex institutional framework.** Smaller administrations, such as those of Cambodia, Lao PDR, Myanmar, and Vietnam, are more hardly pressed to stay up to speed with the negotiations on services trade and investment in the different ASEAN bodies. Streamlining negotiating issues and providing for clearer guidelines in the mandates of the bodies dealing with services integration would foster efficiency of the system and facilitate greater and more active engagement from lower-income ASEAN Member States.

D. Conclusion

27. **Two consistent themes have run through this report.** First, most ASEAN economies and the region have yet to fully realize the large potential gains from and complementarities in services trade and integration. Second, domestic regulatory policy reforms and cooperation will be necessary to deepen integration in services and enhance ASEAN economies' performance and competitiveness. Services integration has a strong potential to contribute to economic growth in the region by reducing the costs of intermediate inputs for other sectors in the economy, creating a new source of value and innovation, and by providing attractive offers to domestic and foreign consumers.

28. **One reason for the uneven services trade performance and integration appears to be services trade restrictiveness within ASEAN.** Analysis based on information from a new database of services trade restrictions shows that the regulatory regime in most ASEAN Member States (AMS) is more restrictive than in comparator countries outside Asia. Also, there has been only minor progress in reducing services trade restrictiveness since the adoption of the AEC Blueprint in November 2007. One explanation for the limited impact is the fact that actual service market policies in AMS are more liberal than the countries' AFAS commitments, suggesting that the latter serve primarily as a tool to reassure investors and trading partners against policy reversals, rather than as means to reform policies on the ground. Several bilateral agreements that some AMS have concluded with partners outside the region are also more ambitious in their scope and extent than what has been committed regionally. Hence, there seems room for AMS to further advance their integration efforts.

29. **Because actual service market policies in AMS tend to be more liberal than the countries' AFAS commitments, the latter result in limited regional preferences.** In most sectors, ASEAN economies are not integrating faster or more profoundly than with the rest of the world. Yet, some regional preferences emerge out of air transport liberalization and mutual recognition agreements that provide incremental value to Member States.

30. **Concerning the institutional arrangements, the ASEAN Economic Community and the AFAS have generally provided a useful platform for negotiations on the reduction of formal services trade restrictions, but have not been effective in promoting deeper integration through regulatory reform and cooperation.** The existing institutions have made it possible to make progress in multiple sectors simultaneously. However, the commitments and negotiation-focused approach of the AFAS seems less suitable for promoting deeper integration through regulatory reform and cooperation. Indeed, the largest benefits from regional integration of services markets arguably accrue through regulatory cooperation, which is an area where ASEAN has not advanced to a significant extent. Several mutual recognition arrangements have been concluded, but the extent of their implementation is unclear, and their practical impacts seem limited to date.

31. **The institutional assessment also revealed that the existing AFAS commitments can be further improved to realize the creation of a single services market.** Several bilateral agreements that some ASEAN Member States have concluded with partners outside the region contain commitments in few areas which are more ambitious in the extent to which they advance services sector integration. Hence, there seems room for ASEAN Member States to further advance their integration efforts in order to realize the aim of a single regional services market by 2015.

32. **The findings from case study analysis highlighted the pockets of success in services in various ASEAN countries, and the complementarity of private sector initiatives and government support for success in services exports.** For example, the strong trade performance of higher education services in Malaysia, medical tourism in Thailand, and back-office processing in the Philippines have been based on private investments that were accompanied by an enabling business and regulatory environment, as well as

an active government role in establishing and monitoring quality standards. Also, the public authorities often have a crucial role in mitigating adverse distributional effects and social hardship that might result from trade-induced structural adjustment in social sectors.

33. **Going forward, the ASEAN services integration process could usefully be refocused on stronger efforts to pursue regulatory cooperation and increased attention to the implementation of commitments, including with respect to mutual recognition arrangements.** ASEAN has embarked on a promising path to service market integration, but there is a large potential to further accelerate and deepen reforms, and thereby catch up with developments in other emerging regions around the world. Indeed, experiences in other regional integration areas, including those in the European Union, show that the required reform processes can be complex and laborious, but the potential rewards in terms of competitiveness, growth, and employment are such that these efforts clearly seem worthwhile.

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