

IMPACT OF SERVICES LIBERALIZATION

Case Studies of Five Countries

AANZFTA



The ASEAN Secretariat, with the support of the ASEAN-Australia-New Zealand Free Trade Area (AANZFTA) Economic Cooperation Programme and under the technical supervision of the AANZFTA Committee on Trade in Services, has commissioned a project to create awareness and better understanding of the liberalization of services sectors.

The Project studies the cases of five AANZFTA Parties who have successfully undertaken liberalization measures in the sectors of business services, financial services, logistics, telecommunications and tourism. The attached factsheets highlight evidence of successes and lessons learned from the five case studies, together with a closer look into the air transport sector.

The factsheets of the case studies were developed based on a report written by Jose L. Tongzon, Habibullah Khan and Inkyo Cheong. None of the case studies purport to reflect the opinions or views of any government or the ASEAN Secretariat.

Case Study on Services Liberalization Summary

What is Services Liberalization?

The World Trade Organization (WTO) defines the liberalization of services as improving market access for services suppliers through establishment of a competitive environment conducive to market entry. Increased market access is understood as a reduction or elimination of restrictions and limitations on the provision of services and establishment of foreign branches across national borders.

Instruments for Services Liberalization

- The General Agreement on Trade in Services (GATS) came into force in 1995 and is the most prominent instrument of services liberalization introduced by the WTO. Its main objectives include encouraging the expansion of services trade, progressively liberalizing trade in services through successive rounds of negotiations, encouraging transparency of rules and regulations, and increasing the participation of developing countries in trade in services.
- ASEAN-Australia-New Zealand Free Trade Agreement (AANZFTA) Parties are committed to progressively liberalize the trade in services among the Parties and achieving substantial sectoral coverage in their commitments.

Economic Impact

The services sector has already accounted for a significant part of ASEAN countries' overall national output and employment. Specifically:

- Output of the services sector in 2014 accounted for 75 percent of Singapore's GDP, followed by the Philippines with 57 percent, Thailand with 53 percent, Malaysia with 51 percent, Vietnam and Cambodia with 43 percent each, and Indonesia with 42 percent (World Bank, 2016a and UNCTAD, 2016).
- In the same year, the services sector directly accounted for 71 percent of total employment in Singapore, 60 percent in Malaysia, 54 percent in the Philippines, 45 percent in Indonesia, and 39 percent in Thailand (World Bank, 2016b).

The case studies examined here demonstrate that unilateral services liberalization can bring about efficiency improvements, higher quality of service,

lower charges for service users, greater national output, increased overall employment and international competitiveness.

Basic Principles of Services Liberalization

The above economic benefits can be best achieved if services liberalization is implemented based on the following basic principles:

- Clarity in policy objectives, timelines and reporting requirements
- Broad and institution-based liberalization, covering all sectors of the economy and thus reducing inter-sector bottlenecks and facilitating market integration.
- Strong government support, complemented with other microeconomic and macroeconomic reforms/national development plans, including to improve capacity and international competitiveness.
- Implementation, carried out by efficient and politically-independent institutions that protect the interests of the consumers and services users.
- Strong support and cooperation from the private sector.

Recommendations for Further Services Liberalization under AANZFTA

- Periodic assessments of the economic implications of removing restrictions in those subsectors that are "unbound" or less liberalized, in consultation with stakeholders.
- Development of a comprehensive database of services statistics, disaggregated by sector and year, on trade, productivity and employment.
- Improving the transparency and clarity of existing liberalization commitments, laws and regulations on services as well as services statistics by regularly updating and making them accessible to the public.
- Establishment of efficient regulatory agencies to ensure effective, sustainable and fair competition.
- Encouragement to set up independent institutions and/or regulatory bodies to protect the interests of consumers and services users.
- Enhancement of macro and microeconomic reforms to improve capacity, international competitiveness and facilitate technology transfer, and introduce measures to mitigate the adjustment costs of liberalization.

Logistics Services Liberalization

The Case of Australia



Context

Australia's geographical isolation, relatively small population density, and vast distances between important industrial and economic centers, makes it difficult to operate logistics services as efficiently as some other countries.

Reforms Undertaken

- Australia's liberalization of its logistics sector began in the 1990s, as part of Australia's overall national policy shift and microeconomic reforms to introduce more competition in the economy which started in the 1970s.
- Full market access was offered to foreign suppliers in road and maritime freight transport (except cabotage), storage and warehousing, and several other auxiliary services, in the WTO Uruguay Round negotiations. Australia offered further market access commitments in maritime cargo handling and agency services, air transport ground handling services, airport operation services, selling and marketing of air and rail transport services and customs clearance services, in the Doha Round of WTO negotiations.
- Deregulation and privatization undertaken in the transport sector were part of nationwide deregulatory efforts and microeconomic reforms which started in the 1970s.

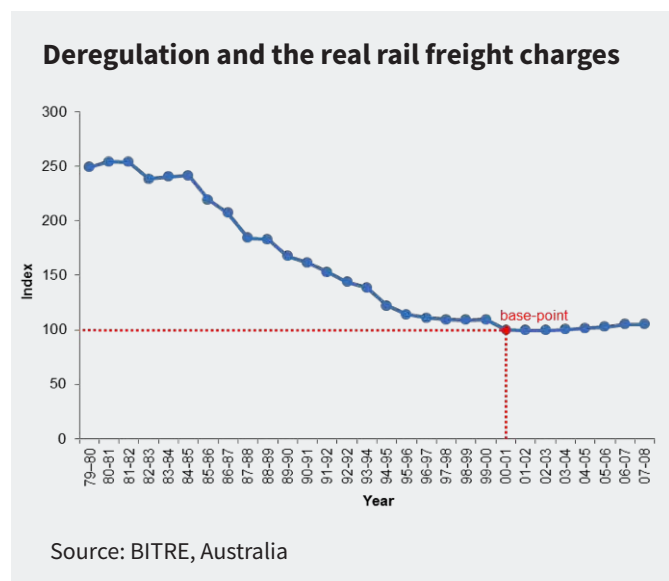
- A National Competition Policy was adopted to ensure efficiency in the market through effective competition.
- The Australian Productivity Commission and Australian Competition and Consumer Commission were set up to provide independent analysis of government policies, and strengthen the level of competition and protect the interest of consumers, respectively.
- Substantial trade facilitation reforms were introduced in the field of customs clearance procedures and practices, import and export procedures to provide a consistent and predictable environment for logistics services providers and users.
- Simplification of Australia's customs procedures, implementation of a highly efficient customs clearance system, introduction of liberal foreign investment policies with less restrictions on employing management personnel for its logistics sector.

Sectoral Impact

- Australia has one of the most liberal trade policies for the logistics sector.
- Greater competition, innovation, higher productivity, better service quality and lower charges were

evident in all transport modes, storage/warehousing and transport agencies, such as third-party logistics providers, during the liberalization period.

- Specifically, the market for road transport became highly competitive, more innovative and productive. More foreign road transport companies entering the road transport business led to greater innovation to improve productivity and service to customers.
- Real rail freight charges were significantly lower in the post-deregulation period (1993-94 to 2007-08) compared with the period before deregulation (1979-80 to 1992-93). See chart below.



- Significant decline in the international maritime freight rates resulting from the entry of more foreign registered ships to operate between Australian and foreign ports without any market access restrictions. Real coastal shipping charges significantly reduced especially in 2000-01 to 2005-06 in Perth as well as in Tasmanian coastal trades.
- Real air freight rates have generally been on a decline since 1995 as a result of additional liberalization including additional capacity being negotiated with other countries.
- A decline in employment in the rail sector was more than offset by significant increases in employment in other sectors of the logistics industry, particularly in road and air transport, storage and warehousing and transport agencies. As a result, an increase in overall employment in the logistics industry was recorded.

- Logistics liberalization contributed to Australia's overall economic growth and employment in other sectors of the economy. Its contribution to Australia's GDP increased from 0.48 percent in 2012 to 2.17 percent in 2016, and is predicted to reach 2.73 percent in 2026.
- It is predicted to result in 5 percent and 8 percent net accumulated increases in demand for skilled and unskilled labor, respectively, throughout the economy, as a result of significant positive employment implications for capital goods, machinery, and electrical/electronic products.

Lessons Learned

- The freeing up of the market for logistics services in Australia was complemented by deregulation and privatization.
- Australia's experience has shown that liberalization of an industry does not necessarily mean an end to the need for regulation. In Australia, regulations, applied on a non-discriminatory basis without interfering in the efficient operations of the market, have played an important role in the provision of logistics services, particularly in areas where the market fails.
- The Australian approach to liberalization includes a consistent, predictable and transparent set of policies and measures to implement the liberalization process. The quality of institutions therefore is crucial to the success of this institutional approach.
- Australia also set up independent institutions that have played a significant role in ensuring that liberalization results in greater benefits for the Australian public.
- Australia's liberalization approach is broad-based and economy-wide, instead of sector-specific. This has allowed policy makers to understand the underlying economic dynamics of every sector in the economy and thus formulate appropriate policies and measures to achieve certain economic objectives.
- The liberalization process was implemented gradually and in phases to provide the affected sectors with opportunities to retrain and upgrade, as well as support alternative employment. The maritime transport sector was particularly affected by the logistics services liberalization in terms of employment.

Spill-over Impact

- Greater efficiency and lower costs in the logistics sector led to lower export costs and thus improved international competitiveness, and better export performance.

The Liberalization of Business Services

The Case of Viet Nam



Pre-liberalization Context

Viet Nam maintained a centrally planned economy throughout the period 1975-1986.

Reforms Undertaken

- 1986: Government launched economic reform towards a “market oriented economy” which included a role for the private sector.
- 1990: Private Enterprises Law was established.
- 2000: Enterprise Law enacted, replacing the 1990 Private Enterprises Law.
- 2005: Provincial Competitiveness Index on Viet Nam’s business environment introduced as an annual business survey tool for the assessment and ranking of the governance capability of the provincial authorities in creating a favorable business environment for the private sector.
- 2014: Two Administrative Decisions Nos. 509/QĐ-BTC and 510/QĐ-BTC for customs simplification issued, simplifying 7 procedures, eliminating 1 step of the National Tax Services Office and 38 steps of customs offices.
- As of 2015, major laws and regulations including business company law, investment law and housing law have been adjusted in favor of businesses and foreign investments.

Notably, six sectors are allowed for foreign direct investments (FDI) and 267 other sectors are conditionally allowed, and regulations on conditional investment were improved in favour of foreign investors.

- Viet Nam offered an improved package of liberalization commitments for business services in the ASEAN+1 FTAs. Under the AANZFTA, many business services subsectors were liberalized for modes 1, 2 and 3.

Sectoral Impact

- Viet Nam’s business services sector commitments in AANZFTA have been ranked as third most liberal among the ASEAN Member States.
- Viet Nam’s business environment rank moved up from 99 (in 2014) to 78 (in 2015) out of 189 countries in the World Bank’s Doing Business report.
- Procedures for business registration, approval and other business transactions have been significantly simplified and improved. Processing time for tax and social insurance payment has been reduced from 121.5 hours to 49.5 hours; for completing export procedures reduced from 21 days to 13 days, for processing bankruptcy from 60 months to 30 months.
- Notable improvement in firms’ fulfillment of tax



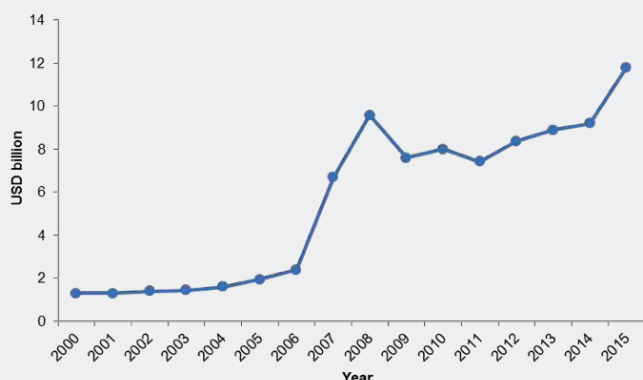
obligations. On average, 95 percent of businesses fulfilled their tax liabilities, 90 percent of whom paid online.

- Remarkable progress in GDP growth and poverty reduction, poverty dropped from almost 60 percent in the 1990s to less than 3 percent today.

Spill-over Impact

- Viet Nam is now the second most popular destination for foreign investment in the Asia Pacific region, behind China, and ahead of India, Malaysia and Indonesia. Particularly, FDI's share to total export has been 67 percent in 2013 and 2014.
- Improvement of the overall business services has been one of most critical factors in making FDI the major source of the country's export growth and continued rise in national income. See chart below.

FDI into Viet Nam, 2000-2015



Source: World Bank FDI Database

Lessons Learned

- Low labor cost is just one of the determinants for investment, and improvement of the overall business environment has acted as one of the most critical factors contributing to investment.
- FTAs have contributed to the improvement of Vietnam's business environment.
- Viet Nam should be more active in agreeing to services commitments in FTAs, should implement its FTAs effectively, and strive to improve existing FTAs to cope with changes in the global business environment.
- Strong commitments of the government is needed. The government has been playing a critical role in increasing the quality of business services and business environment by making the necessary improvements to the relevant legal framework and institutions, and restructuring the economy.

The Liberalization of Financial Services

The Case of Indonesia



Pre-liberalization Context

- 1960s and 1970s:
 - Indonesia had a tight-controlled banking sector in the 1960s and 1970s. Foreign banks were allowed to enter Indonesia in 1967 but with numerous restrictions on operations. In 1968, Bank Indonesia was established to supervise and regulate the financial system.
 - State-owned banks had larger and easier access to priority loans at highly subsidised interest rates though they were also subject to deposit ceilings and interest on deposits. Foreign and domestic private banks, as well as NBFIs, were free to set their deposit and credit rates. The interbank money market was small and lacking liquidity.
 - Money and capital markets were underdeveloped. The Indonesian stock market, reopened in 1977, was largely inactive due to complex regulations.
- 1983-1992
 - Reforms were introduced in two phases of policy adjustments and liberalization programmes that covered exchange rate devaluations, deregulation of the trade, industry and financial sectors, as well as greater fiscal discipline including the resumption of short-term debt and liquidity instruments.

- Competition in the banking sector remained subdued due to stringent requirements on new entries and the monopoly of the state-owned banks in foreign exchange businesses and taking deposits from state enterprises.
- The 1997-98 Asian Financial Crisis took place, negatively affecting the economy, and prompting the Government to introduce a significant policy shift towards financial sector liberalization.

Reforms Undertaken

- Substantive reforms in the banking sector, including the lifting of barriers against new entries, allowing unlimited branch expansion for local banks and branch expansion in up to 7 cities for foreign banks and non-bank financial institutions, allowing private banks to take up to 50 percent of state enterprises' deposits, and streamlining foreign exchange licensing procedures.
- Comprehensive institutional and regulatory reforms were initiated for money and capital markets, including the privatisation of the Jakarta Stock Exchange, removing the privileged tax treatment of bank deposits over other debt and equity instruments, permitting banks and other non-bank financial institutions to issue shares.

- Indonesia Financial Services Sector Master Plan 2015-2019 was introduced, with emphasis on sustainable finance and financial inclusion strategies, improving access to formal financial services for poverty groups.



Sectoral Impact

- The economy experienced its highest average growth of 7.1 percent in 1983-1992 (illustrated by chart below) when a number of reform measures were taken to liberalize the banking sector.
- Reforms taken effectively eliminated the direct instruments of monetary control used by the central bank.
- Government debt market developed.



Lessons Learned

- Indonesia's shift in emphasis from "exclusive" to "inclusive" development after the Asian Financial Crisis is a pragmatic strategy to help the country obtain the full benefits of financial liberalization and give a broader segment of the population access to financial services.
- Greater emphasis has now been placed on sustainable finance and given that it is the largest Muslim nation in the world, Islamic finance could also play a vital role as sustainability is believed to be consistent with the Islamic principles.
- Going forward, appropriate productivity enhancement measures should be undertaken to ensure continuous economic growth, given the importance of the financial sector and its linkage with the real sector and the economy.



Liberalization of Telecommunication Services

The Case of Philippines



■ Pre-liberalization Context

The telecommunications industry in the Philippines was suffering from low efficiency and poor quality of service in the presence of limited effective competition with four private companies in key aspects of telecommunication services in the country.

■ Reforms Undertaken

Major liberalization efforts started in 1989 and continued until 1995.

- 1989: Deregulation started as new business licenses were granted and new operators allowed into the market. Domestic and international trunk services were also opened to competition.
- 1991: Foreign Investment Act was issued with transparent rules and regulations on private and public investment and ownership. Fiscal and non-fiscal incentives for foreign investments introduced by Philippines' Board of Investment.
- 1993: Two major regulations, namely Executive Orders 59 and 109, were passed to foster domestic and foreign investments and improve the geographical coverage of telecommunications services. Order 59 required compulsory interconnection of authorized public telecommunications carriers to integrate

the national telecommunications network. Order 109 required Cellular Mobile Telephone Services Operators to install at least 400,000 telephone lines in 3 years and International Gate Facilities operators to install 300,000 lines within 5 years.

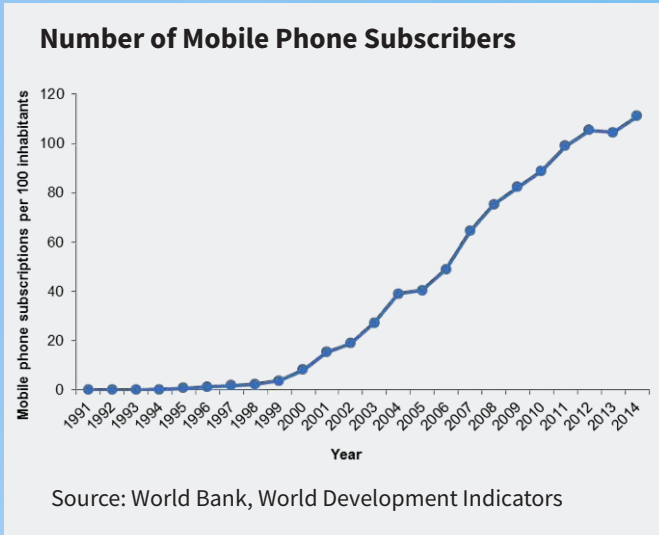
- 1995: Public Telecommunications Policy Act was enacted to encourage more private firms in the telecommunications services sector. The National Telecommunications Commission was established as the regulatory agency with the role of ensuring fair competition in the industry and promotion of consumers' welfare.

Sectoral Impact ■

- More service providers, bringing more and better service options for the consumers. The number of Local Exchange Carriers increased by 69 percent from 45 in 1992 to 76 in 1998; while the number of Cellular Mobile carriers more than doubled from 2 to 5 for the same period.
- Improved operational efficiency and profitability for telecommunication providers. Operating profit margins for one major provider increased from an average of 20 percent during the reform period 1987-1995 to 33 percent for the post-reform period 1996-2012.

- Telephone density significantly improved. The number of fixed line subscriptions per 100 inhabitants increased almost fourfold since 1993 to its peak of 4.51 in 2008.
- The number of mobile cellular phone subscriptions soared from 8.31 in 2000 to 111 per 100 inhabitants by 2014.

- With more choice and better quality of telecommunications service providers, the Philippines was able to establish itself as one of the top destinations globally for Information Technology–Business Process Outsourcing (IT-BPO), increasing the country's revenues from IT-BPO services from less than US\$100 million in 2001 to US\$ 11 billion in 2011, employing over 1 million people across 638,319 establishments, making the IT-BPO industry a major export contributor to the economy.



Lessons Learned

- The government's strong support, despite vehement opposition from vested interests, was a major factor behind its success in implementing the liberalization measures.
- Transparent and consistent set of policies and vision supported by stakeholders across the industry was another key factor.
- Going forward, the following measures need to be undertaken or adopted to maximize the benefits of services liberalization:
 - A strategic master plan in consultation with the private sector and other relevant stakeholders.
 - A regulating authority that is not only competent with relevant industry experience but also independent with the national interest in mind.
 - Strong government support in the form of subsidies or fiscal incentives is necessary since network and backbone installation costs are high.
 - A productive collaboration between the regulating authority and other government agencies in charge of regulating other aspects of telecommunication operations in relation to safety, health and the environment.

- Significantly lower phone charges to benefit consumers. Average charges declined by 75 percent from more than 30 pesos per minute in 1989 to 7.50 pesos per minute in 2015 for inter-network mobile, and 87 percent for in-network mobile during the same period.
- Enhanced technical and marketing innovations, mainly driven by a more intense competition among telecommunications service providers. Most notable are the adoption of digital equipment for local exchange service, digital standard GSM for cellular services and tailored service plans for loyal customers.

Spill-over Impact

- Impact of telecommunications efficiency on the Philippines' GDP is estimated to be 1.32 percent in 2016 and expected to increase further to 1.87 percent by 2026.
- Improvement in international competitiveness of the nation's exports services due to the improved efficiency of the telecommunications services.



Liberalization of Tourism and Travel-Related Services

The Case of Thailand



Pre-liberalization Context

- Worldwide increasing recognition of tourism industry as important for economic and social progress.
- Thailand is endowed with rich natural resources and cultural heritage, meaning tourism has a great potential to be a major contributor to its national economy.

Reforms Undertaken

- The Ministry of Tourism and Sports was established in 2002 for coordinating efforts to develop, support and promote tourism, sports and recreation.
- Regulatory measures taken to ensure that the entire tourist system, encompassing tourist markets, bridging components and supply of tourist products, develops in a systematic manner.
- Community-based tourism introduced as part of Thai tourism policy, aiming to benefit local communities including villagers and indigenous people.
- Enhanced institutional support provided. Thailand Community-based Tourism Institute was established in 2006 to support such activities by developing small scale tourism projects based on

the cultures and practices of Thai communities, with financial support from Bank of Agriculture and agricultural cooperatives.

- Strong government support. Thailand joined ASEAN in adopting the region's Mutual Recognition Arrangement for Tourism Professionals in January 2009 to ensure the equivalence of skilled tourism personnel and to facilitate their movement in the region. At national level, Thailand's National Tourism Development Plan (2012-2016) explicitly states in its vision "to make Thailand a quality tourism destination with tourism competitiveness at the international level, thus enabling the country to generate more income and distribute wealth on a sustainable basis". The objective of the Plan is to move Thailand's tourism competitiveness up at least 15 places, which would put it among the top five destinations in Asia.

Sectoral Impact

- International arrivals grew at an average annual rate of 7.3 percent, achieving a record number of 26.5 million visitors in 2013, with the accompanying tourism receipts increased by 10.2 percent on average within the period from 1995 to 2014.
- In 2014, the tourism sector employed 5.4 million people or 14.1 percent of total employment in

Thailand. It is estimated that tourism will provide more than 8 million jobs in the future, roughly 20 percent of total employment for the country in 2025.

- Thailand ranked number two of the world's top 20 most-visited cities of the world by the Mastercard 2014 Global Destination Cities Index.
- Despite fluctuations in receipts in 2008 and 2013, tourist arrivals continued to increase, which also led to increasing labour productivity. See chart below.

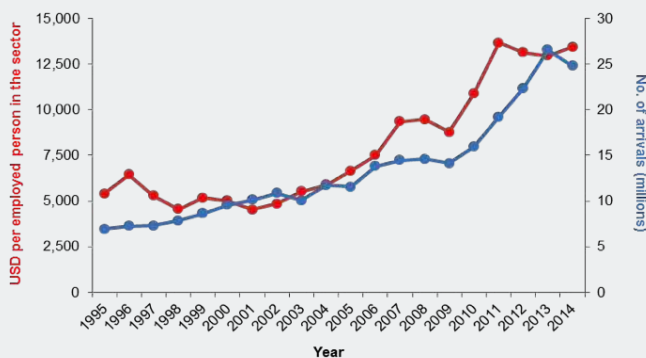
Spill-over Impact

- Owing to liberalization policies adopted since 1995, on average terms over the past two decades from 1995 to 2014, GDP share of Thailand's tourism sector grew by 7.6 percent, reached 19.3 percent in 2014 and forecasted to rise to 25.8 percent in 2020; employment share rose annually by 2.25 percent, and average productivity of the tourism industry rose annually by 5.7 percent for the same period.

Lessons Learned

- Tourism is an amalgam of industries and therefore tourism liberalization requires effective collaboration between various government agencies at different levels and with the private sector.
- Collaboration should include increasing awareness and application of liberalization tools and policies related to the tourism and travel-related services sector.
- The focus on community-based tourism, alongside development of high value added tourist projects and activities, was considered positive for sustainable tourism and balanced economic growth.

Tourist Arrivals and Labour Productivity



Source: Department of Tourism, Thailand



Air Transport Services Liberalization in ASEAN



Pre-liberalization Context

- Air transport services are not regulated by bilateral free trade agreements, nor by the multilateral trade system, such as the General Agreement on Trade in Services (GATS). Most countries pursue liberalization of air services through bilateral Air Service Agreements, including Open Skies Agreements.

Reforms Undertaken

- As part of ASEAN's regional integration efforts, the ASEAN Single Aviation Market Agreement was signed in 2007; under which the Multilateral Agreement on Air Services (MAAS) was adopted in 2009, and the Multilateral Agreement on Full Liberalization of Passenger Air Services (MAFLPAS) in 2010.
- Major restrictions on flight operations between capital cities of ASEAN Member States have been removed since 2008, and additional liberalization on traffic rights between all capital cities was made in 2011.

Sectoral Impact

- Liberalization paved the way for more air transport

carriers which provided more choices to consumers at a lower cost. The market share of Low-cost Carriers (LCC) increased from 35 percent in 2008 to 52 percent in 2012. The number of LCCs in ASEAN jumped 4 times from 4 in 2000 to 20 in 2012.

- Liberalization led to more employment in the sector. For example, air transport liberalization in Viet Nam is estimated to generate 199,300 new jobs in the aviation and tourism sectors.

Spill-over Impact

- Air transport services liberalization impacts not just the travel and tourism sector but is also a critical input to productivity, employment, and business connectivity. For instance, a competitive air transport service helps countries participate in the global supply chain.
- Liberalization of the sector contributed to economic output. A 30 percent growth in air traffic is predicted to lead to an increase in the sector's contribution to the GDP of some ASEAN Member States.
- Liberalization led to an increase in the number of air passengers. The growth of passenger traffic following the introduction of the ASEAN Single Aviation Market



was significantly faster than prior to the agreement. Between 2000 and 2008, air passenger growth in the region averaged 8.1 percent annually. From 2009 through 2012, growth averaged 13.2 percent.

- Increased connectivity led to productivity growth. For example, in Cambodia, a 61 percent increase in airport connectivity is associated with a 19 percent annual economic rate of return between 2000 and 2005 (See Chart Below).

Economic Rates of Return from Aviation Investment in Cambodia (2000-2005)

Airport Investment (US\$ million)	248
Aircraft Investment (US\$ million)	290
Increase in airport connectivity	61%
Increase in national connectivity / GDP	46%
Impact on GDP (%)	0.323
GDP in 2000 (US\$ million)	31,085
GDP Increase (US\$ million)	100
Annual Economic Rate of Return (%)	19

Source: IATA (2007, p.28), Table 3: Economic Rates of Return from Aviation Investment

- Liberalization led to job creation in other sectors. A 30 percent growth in air traffic is predicted to lead to 0.329 – 2.52 percent increase in demand in skilled labour, and 0.347 – 2.56 percent in unskilled labour between 2016 and 2026.

Lessons Learned

- Greater connection via the liberalization of air transportation services can be a new source for a country's productivity and economic performance.
- Liberalization of the sector facilitates a country's integration into the global economy, providing direct benefits for users and wider economic benefits through its positive impact on productivity and growth.
- A more active approach to air transport liberalization in free trade agreements would increase the potential to gain more benefits.



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