

Liberalisation of Trade in Services in Four Arab South Mediterranean Countries: An Unutilised Vehicle for Intra-regional Trade Integration

The Egyptian Center for Economic Studies (ECES)
Cairo

Doha Round negotiations are in a freeze and the world is plunging into a state of recession that was only previously experienced in the early thirties. Can trade in services play a role in alleviating the problems associated with the stalling of multilateral trade and the aftermath of the financial crisis? This short essay argues that liberalisation of trade in services between four Arab South Mediterranean Countries (ASMCs) can play an important role in enhancing intra-regional integration. Regional liberalisation of trade in services can alleviate some of the potential negative repercussions of the financial crisis on trade in goods among ASMCs, provided some preconditions are met.

This essay aims to investigate some important means of enhancing trade in services on a regional level between four ASMCs, namely Agadir countries including Egypt, Morocco, Tunisia, and Jordan. The essay starts by pointing out the economic importance of services in ASMC economies and trade. It then explains how liberalisation of trade in services can act as an engine for enhancing intra-regional trade among ASMCs. It further highlights various approaches for liberalising services on an intra-regional basis. Finally, a list of policies and procedures that should be adopted by ASMCs before regionally liberalising trade in services to ensure a positive outcome of such liberalisation on intra-regional integration is presented.

Why Are Services Important in the ASMC Intra-regional Context?

Merchandise trade has not been able to play the leading role as an engine of intra-regional trade in the

Arab world in general and among ASMCs in particular. Despite the relative and absolute increase in intra-regional trade among ASMCs, they remain characterised by low intra-regional trade, ranging from two to 5% of ASMC trade.

There are several reasons for such a low level of intra-regional trade, including the similarity of production and export profiles of ASMCs, the lack of well-developed transport infrastructure, and the weak intra-industry trade pattern among these countries. Though such impediments are of a structural nature, they can change, but this requires ample time. Hence there is an urgent need to agree on a main driver of intra-regional trade. We argue that services can play this role due to their significant position in the ASMCs, where they constitute the lion's share of GDP and a significant portion of trade.

The services sector constitutes on average 50-60% of GDP in ASMCs, as depicted in Table 14. Hence, the importance of this sector for the growth and development prospects of ASMCs is paramount, especially since the share of the services sector in ASMCs has been rather stable for a period exceeding 10 years.

Table 15 reconfirms that services have been playing a major role in ASMC economies. ASMCs differ in the comparative advantage they enjoy in services. For example, depending on data availability, Egypt and Tunisia enjoy a comparative advantage in travel and transport services, whereas Morocco enjoys a comparative advantage in other business services, and finally Egypt and Jordan enjoy a comparative advantage in construction (based on data for 2003 calculated from the United Nations Conference on Trade and Development - UNCTAD, 2007). This is just an example of what ASMCs enjoy in terms of exporting services, which is an issue that can be built upon to enhance their regional integration.

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Egypt	50.92	51.12	51.83	52.02	51.77	50.13	50.11	50.34	48.78	47.95	49.01
Jordan	66.75	70.04	70.84	70.49	71.70	72.11	71.97	70.36	70.12	68.55	67.58
Morocco	52.40	49.66	51.59	51.20	52.70	54.24	53.47	53.55	53.47	53.75	55.92
Tunisia	59.24	57.80	58.24	58.93	58.77	59.07	59.61	60.16	59.66	59.09	59.69

Source: World Bank (2007), *World Bank Development Indicators CD Rom*.

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Egypt	22.38	21.23	20.59	17.25	17.58	17.34	16.47	18.15	21.16	28.18	28.14
Jordan	49.41	49.71	45.18	45.61	41.72	39.70	35.75	38.17	35.60	36.88	37.95
Morocco	12.32	12.35	12.55	13.37	14.52	14.78	18.13	18.77	19.03	20.31	23.14
Tunisia	21.42	19.79	20.08	20.26	19.97	20.49	21.70	19.63	18.20	19.96	21.57

Source: World Bank (2007), *World Bank Development Indicators CD Rom*.

Moreover, the world has started to focus on the ASMCs for outsourcing a number of services, including business services (such as back office services), communications, and computer services, implying that ASMCs are developing their services to meet such demand.

ASMCs should undertake all the necessary measures on the regional level to ensure that their service sectors prosper and benefit from the development and growth processes of their economies. Among the measures that can be undertaken to enhance regional integration among ASMCs is the intra-regional liberalisation of trade in services.

How Far Have ASMCs Gone in Liberalising Their Trade in Services?

The level of commitments among ASMCs in the General Agreement on Trade in Services (GATS) differs significantly as shown in Table 16. However, it should be noted that the level of commitments does not necessarily reflect the extent of liberalisation. On the contrary, the extent of GATS commitments in terms of number of commitments is rather a reflection of the date of membership in the World Trade Organization (WTO). Old members of the General Agreement on Tariffs and Trade (GATT) generally have a low level of commitments, whereas new members of WTO have a larger number of commitments, as a result of the pressure exerted on newly acceding WTO members to include a larger number of commitments. Hence, it is not surprising to

find that Jordan has the highest number of commitments among ASMCs, and even among the WTO members in general.

Country Name	Status of GATS Commitments in the ASMCs
Egypt	44
Jordan	110
Morocco	45
Tunisia	20

Source: WTO (2008), *Trade Profiles*.

ASMCs have also embarked on a number of regional liberalisation initiatives, although most of them did not materialise. ASMCs are engaged with the EU in negotiations of regional services liberalisation on a GATS-plus basis (i.e. deepening the existing commitments or undertaking commitments in new sectors or sub-sectors), as well as among themselves, following the framework agreement between Arab countries of 2003 to liberalise trade in services on a regional basis. In addition, Jordan and Morocco have signed free trade areas with the United States that include a services dimension. Hence, the evidence shows that the political will is signalled by ASMCs to liberalise trade in services on an intra-regional basis as well as between regions. So the question that then follows is how should ASMCs approach regional liberalisation of trade in services?

Approaches to Liberalising Trade in Services on an Intra-regional Basis

First Approach: ASMCs can start by comparing the sectors in which they have undertaken commitments. There are a large number of sectors where ASMCs have undertaken commitments that are highly similar, including finance, tourism, and communications services. This is not to say that commitments are the same, but rather that the inclusion of a certain service sector in the GATS schedule of an ASMC is a signal of the willingness of that country to open up its sector at some point in time. Moreover, the ASMCs' domestic regulations are in general more liberal than what they have committed themselves to in their GATS schedules, implying that the scope for regional liberalisation on a GATS-plus basis is high, while still preserving the national preference.

Second Approach: There are a number of service sectors that are more eligible for intra-regional liberalisation than multilateral liberalisation. The specific nature of such sectors, in terms of setting their standards and the rules and regulations governing their markets, makes it more convenient to liberalise on an intra-regional rather than on the multilateral level. Among such sectors are infrastructure-type and network services (e.g. transport and energy), where intra-regional liberalisation is more suitable than multilateral liberalisation for technical and/or economic reasons (such as economies of scale) (Stephenson, 2002; Fink and Jansen, 2007). Hence, ASMCs can start their intra-regional liberalisation by focusing on such sectors.

Third Approach: Intra-regional liberalisation of services can help ASMCs to improve their infant service activities that have the potential to compete at the global level, but need to get ready through "learning by doing" by liberalising within the region as a first step. There are a number of service providers in ASMCs that have started to play a role on the global scene (e.g. in the fields of telecommunications and construction). There are other potential champions that need to be promoted on the intra-regional level to be able to compete on the global level as business-services. In other words, regional integration can be viewed as a step towards opening up to the whole world in the WTO context. In this regard ASMCs can focus on sectors where their service providers have established a significant presence in the intra-regional context and ASMCs need to sharpen the competitiveness of such service

providers (e.g. in construction, telecommunications, and tourism).

The three approaches are not mutually exclusive, but they are complementary in some regards. The basic idea of listing such approaches is to have a starting point for adopting a strategy addressing regional liberalisation of trade in services among ASMCs.

Any liberalisation attempt, whether at the unilateral, regional, or multilateral level, should be undertaken mainly to enhance competition in the provision of services to increase positive welfare gains from liberalisation

Policies and Procedures that Should Be Adopted by ASMCs to Liberalise Trade in Services at the Intra-regional Level

Any liberalisation attempt, whether at the unilateral, regional, or multilateral level, should be undertaken mainly to enhance competition in the provision of services to increase positive welfare gains from liberalisation. For competition and liberalisation to work efficiently, there is a need for a healthy regulatory framework that aims to avoid service-specific problems associated with market failures and asymmetric information. In this context, intra-regional liberalisation is likely to enhance regional integration among ASMCs and is expected to enhance the competitiveness of their economies provided that certain procedures are undertaken before liberalisation. Among such procedures are the following:

1) Regulatory Audit as a Step for Streamlining Laws and Regulations

In many cases there are a number of laws and regulations that prevail and are outdated, and that hence remain a bottleneck for further reform and liberalisation. In this regulatory audit process, a comprehensive review of the rules and regulations governing specific sectors should be carried out. Unnecessary regulations should be eliminated.

2) Regulatory Convergence

As a step towards effective intra-regional integration, it is not necessarily needed to put it in the form of opening up. An alternative means is what is coined regulatory convergence. Regulatory convergence can be achieved through the unilateral removal of Non-Tariff Barriers (NTB) (after undertaking the regulatory audit), mutual recognition (banking licenses or professional certifications), or a compliance with global standards (e.g. international accounting rules) (Müller-Jentsch, 2004). Mutual recognition in the context of services can in principle span a wide range of practices, including recognition of prudential measures under financial services (in order to facilitate Mode 3), recognition of educational qualifications with a view to enrolment in higher education or further training (to facilitate Mode 2 consumption of education services and subsequently Mode 4), as well as recognition of professional qualifications (to facilitate trade under Mode 4) (Fink and Jansen, 2007). ASMCs should start initiating projects on a bilateral or sub-regional basis to facilitate the recognition of education qualifications that will have a positive effect on enhancing trade in business services.

3) Cooperation among Regulators in Network Industries

There are a number of service sectors that are called network industries, including electricity, gas, telecom, water, and rail. The establishment of independent regulators is an integral part of reform and liberalisation programmes in those sectors, which is often the case in ASMCs. To ensure effective liberalisation at the intra-regional level there should be cooperation between regulatory authorities. The optimal degree and type of cooperation, however, varies between sectors according to the nature of the sector. There is a need for creating institutional networks among regulators to facilitate the spread of the best practices (through information exchange and benchmarking). This type of cooperation indirectly helps effective liberalisation to level the playing field in cross-border markets through regulatory convergence (Müller-Jentsch, 2004). It is worth noting that the establishment of the Arab Countries Water Utilities Association in 2007 is a step in the right direction. Similar models in other network industries and among regulators should be adopted to enhance cooperation in such service activities.

4) Rules of Origin

Rules of origin play an important role in determining the preferential treatment allowed for regional partners. In the case of services, in contrast to the case of goods, rules of origin are more difficult to determine. Services can be provided by different modes, which in turn affect the rules of origin adopted. In Modes 1 and 2, rules of origin do not constitute a major problem, as the service is to be provided by the trading partner. However, there is a need to agree on the broad lines for rules of origin adopted in Modes 3 and 4. There are often three criteria that can be applied following Article V.6 of the GATS, including: "jurisdiction to which an entity belongs," and in particular, free trade areas often require that enterprises eligible for privileges be incorporated under the laws of one of the partner countries and that eligible individuals ("natural persons") be citizens or residents of one of the countries; and "location of services suppliers' economic activities", and in particular, enterprises may be required to have "substantial business activities" within the region and individuals are expected to have their "centre of economic interest" in the region. The criterion of "ownership and control" can be added to the other two criteria as long as Regional Trade Agreements (RTAs) involve developing countries only. The three criteria are not mutually exclusive and a mixture of the three can be applied, but there is a need for ASMCs to agree on which criterion is likely to be adopted (which can differ by sector) to ensure effective negotiations and avoid prolonging them (Fink and Jansen, 2007). To ensure that preferential treatment is granted only to regional partners and to avoid circumvention of rules of origin, ASMCs can adopt additional requirements similar to those adopted in other RTAs. For example, RTAs in the western hemisphere (with the exception of MERCOSUR) go further than GATS rules of origin, defining a service supplier not only as a legal entity under majority ownership or effective control but also as one that must conduct substantial business activities or operations in the territory of any of the member countries in order to benefit from the agreement. Moreover, given the wide-ranging nature and complexity of many sectors included within the service activities, various sectors can be subject either to separate protocols or annexes in RTAs (Stephenson and Prieto, 2002).

5) Including a Discriminatory Aspect in Domestic Regulations and Overcoming Legal Loopholes

Among the main challenges that increase the costs of liberalisation of services at the regional level is the need to revisit the domestic regulations to include a discriminatory aspect that favours regional partners. The inclusion of such a discriminatory aspect can entail a severe cost associated with the change of domestic laws and regulations. Flexibility in designing such laws and including provisions in the regulations and/or executive decrees should be maintained to ensure the ease of regional liberalisation without extra regulatory costs.

Intra-regional liberalisation is not expected to yield its potential positive outcomes before undertaking a number of necessary measures to ensure a fruitful outcome of intra-regional liberalisation of trade in services

Moreover, the challenge of tax treatment duplication or tax evasion, which is likely to arise in specific modes (mainly Mode 1) when providing a service, should be dealt with cautiously. To be more explicit, imagine for example that Egypt liberalises computer services with country Y. Firms in Egypt start to provide their services through Mode 1 to customers in country Y. What type of tax treatment should such firms receive in Egypt and in country Y? Are their services free from Egyptian domestic taxes? Or will they be subject to taxes in country Y as well as to Egyptian domestic taxes? And how to prevent tax evasion from the governments of both Egypt and country Y? Those are all questions that need to be considered up front in any regional liberalisation attempt.

This short essay pointed out that the potential of trade in services among ASMCs is still un-reaped. There are potential gains from regional liberalisation, espe-

cially in light of the freeze of the Doha Round, and the engagement of ASMCs with other trading partners in regional trade agreements, as with the EU and Arab countries. However, intra-regional liberalisation is not expected to yield its potential positive outcomes before undertaking a number of necessary measures such as those aforementioned to ensure a fruitful outcome of intra-regional liberalisation of trade in services.

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