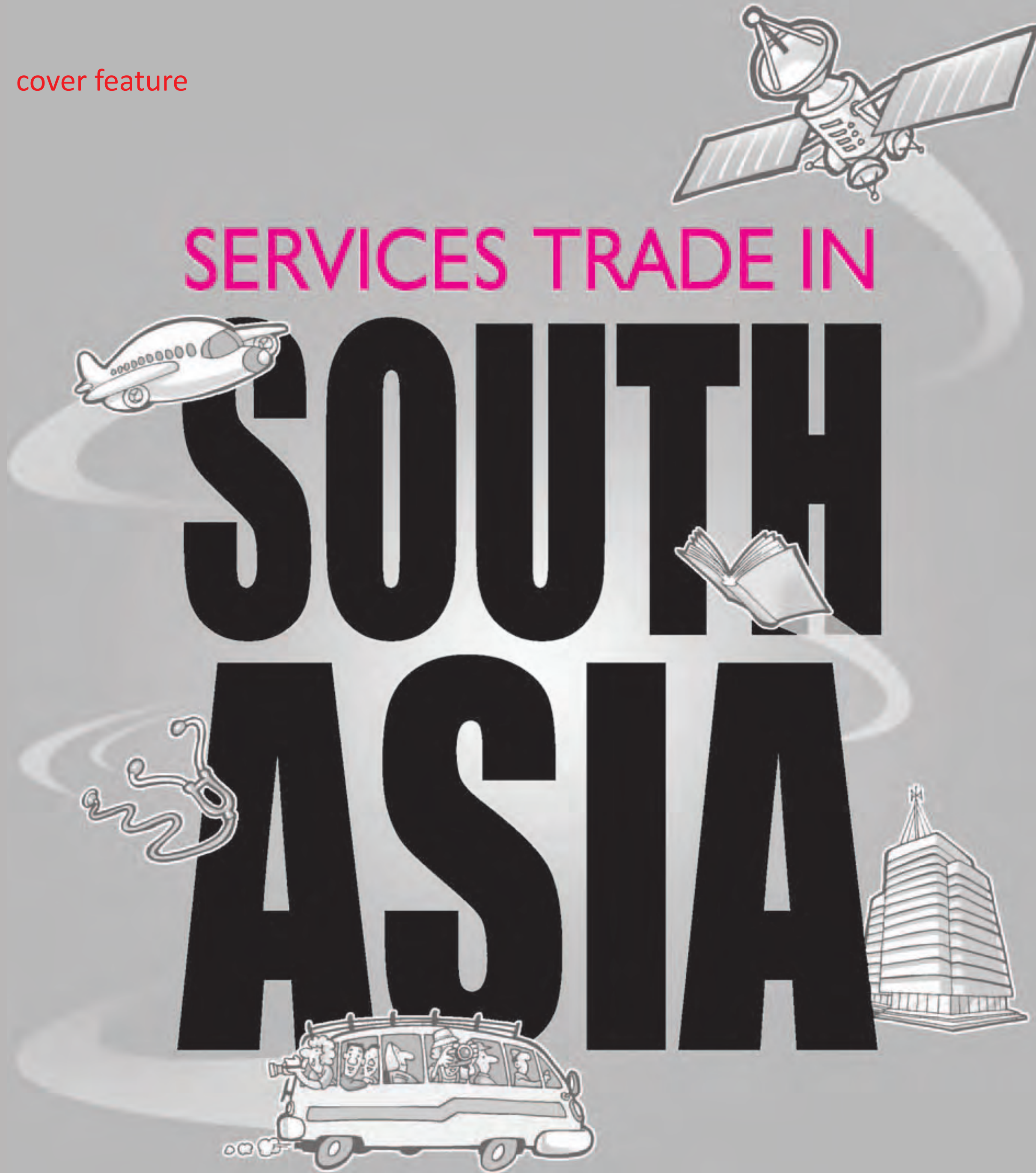
SERVICES TRADE IN SOUTH ASIA



The growing importance of services, the higher comparative advantage in services compared to goods, and the existence of complementarities provide a case for integrating services into SAFTA.

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The South Asian Association for Regional Cooperation (SAARC)—which includes Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan and Sri Lanka, and, more recently Afghanistan—has been much criticized for its failure to promote greater intra-regional trade and address key areas that underpin regional cooperation. Despite the introduction of the SAARC Preferential Trading Arrangement (SAPTA) in December 1995 and subsequently the Agreement on South Asian Free Trade Area (SAFTA) in January 2006, the share of intra-regional trade increased only marginally from 2.68 percent in 1990 to 4.8 percent in 2008. SAARC remains one of the most poorly integrated regions of the world. Intra-regional investment flows also remain limited.

The 14th SAARC Summit Declaration (2007) stated the need to integrate services into SAFTA and called for a collective vision of South Asia with a free flow of goods, services and ideas if SAFTA was to realize its full potential. It called upon member countries to work towards an early conclusion of a SAARC Framework

Agreement on Trade in Services (SAFAS). This point was also echoed at the subsequent 2008 SAARC Summit Declaration. In March 2008, the SAFTA Ministerial Council directed the drafting of SAFAS by 2009-end, though this target has been missed.

> The contribution of services to total trade in South Asia is comparable to that in developed regions such as the European Union.

The case for services integration

The single most important factor is the dynamism exhibited by services in South Asia and the sector's growing importance in overall output, employment, trade and investment in the region. The services sector has experienced higher growth rates than other sectors in almost all South Asian countries, and compared to those seen in other parts of Asia and in other countries with comparable levels of development. Services constitute close to 50 percent or more of gross domestic product (GDP) in all South Asian economies. The higher capacity of SAARC countries in producing and trading in certain services, the availability of high quality services in the region, and the role of new economic geography in driving tradability of certain services create scope for trade and investment complementarities within the region.[1]

This potential is further enhanced by the fact that in the past decade, most South Asian countries have undertaken considerable opening up and deregulation of their services sectors, and have been focusing on the development of segments such as tourism, telecommunications, transport and energy services. Hence, there is a certain convergence of interests and approaches to the services sector and, therefore, possibly a greater willingness to negotiate regional liberalization and explore intra-regional collaboration possibilities in services.

There is the added benefit of geographic proximity as well as cultural and linguistic ties, as relationship-based marketing, social networks and cross-border movement of service providers play an important role in driving services trade and investment flows. The recent entry of some South Asian countries into extra-regional economic cooperation that extends beyond goods to services further highlights the growing recognition of the importance of services to these economies and the possibility of realizing their interests in services through more broad-based regional and bilateral arrangements.

Let us next consider specific facts and figures which argue for the inclusion of services and investment under SAFTA.

Services sector performance

Services have been a key driver of overall economic growth in South Asia since the 1990s. Services have consistently outperformed overall GDP growth and helped compensate for volatility in other sectors (Figure 1, page 16).[2] The average annual growth rate for services output has consistently moved upward, from a little under 4.5 percent in the 1970s to a little over 6 percent in the 1980s, to over 6.5 percent in the 1990s, and further to 8.3 percent during 2000–2007. Although the manufacturing sector in the region has also shown an upward trend in growth, its performance has been less steady than in the case of services, while agricultural growth has not only been much lower but also highly volatile.

This relatively superior performance of the services sector over the previous decades has led to its growing contribution to South Asia's GDP, from 36 percent to nearly 50 percent over the 1980–2006 period. Meanwhile, the industrial sector's contribution has been largely stagnant.

South Asia's services exports have similarly shown a steady upward growth trend through the 1980s and 1990s, with a compound annual growth rate (CAGR) of 23.5 percent during 2001–2007, higher than for the world and other high-growth regions.[3] Similarly, there has been an acceleration in services import growth with a CAGR of 13.6 percent during 2001–2007, again higher than for world services imports.[4] As a result, the contribution of services to the region's total trade has increased, constituting around one fourth of all trade flows (merchandise plus services) in recent years. This is comparable to the contribution of services to overall trade in developed regions such as the European Union. South Asia's contribution to world services exports and imports has risen from around 1 percent to 3 percent and 2 percent, respectively, during 1991–2007, indicating the region's growing integration with world services markets, which potentially creates opportunities at the intra-regional level as well.

These trends are also reflected in South Asia's growing competitiveness in services. While South Asia's revealed comparative advantage (RCA) index for services has declined to less than 1 in the case of goods in the post-2000 period, it has increased and is close to 2 in the case of services during the same period (Figure 2, page 17). In fact, if one compares RCA indices across regions, South Asia emerges as one of only two developing-country regions which have seen an increase in the RCA index for services between 1995 and 2007 and is the region which has experienced the greatest increase during the period. Clearly, a sector that is experiencing rapid growth in trade, growing participation in world markets and rising competitiveness warrants serious discussion under SAFTA. It is, however, important to note that each country exhibits different trends in competitiveness across the different services sectors, and there is little overlap. For example, while India exhibits very high RCA indices

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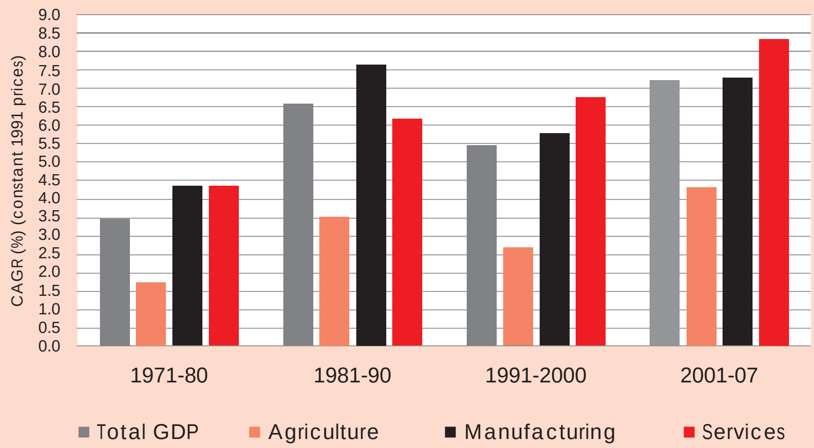
in computer and information services, the Maldives and Nepal exhibit RCA indices over 1 in travel and tourism services, and Sri Lanka and Pakistan in transport services. [5]

Figure 1

Trends in overall and sectoral growth in South Asia



Note: CAGR = compound annual growth rate
Source: Author's calculations based on UN online statistical database.

Harnessing the asymmetries

A country-wise examination of services trade data shows that South Asia's growing competitiveness and penetration of world markets in services is largely driven by India's performance. India is the only country in the region to have significantly increased its share in world services exports as well as imports during 1990–2007 while the shares of others have remained at around the same levels. India's share in world services exports increased from less than 1 percent in 2000 to 2.5 percent in 2007 and, likewise, its share in world services imports increased from a little over 1 percent in 2000 to over 1.5 percent in 2007. The shares in world services exports and imports for all others in South Asia have remained negligible at 0–0.3 percent throughout this period.

Such asymmetries obviously raise questions as to whether there is a sufficient convergence of interest across South Asian countries to push for services integration. They also suggest that any attempts at regional integration in services would obviously involve asymmetries in trade potential and interests, and that the dominant player, India, would need to play an important role in driving the intra-regional integration process.

However, an examination of the trends in competitiveness in services vis-à-vis merchandise trade at the individual country level shows that, notwithstanding such asymmetries, for all the countries, the RCA for services exceeds that for merchandise trade (although only India has experienced an increase in RCA for services, and all countries other than Bangladesh have remained at similar levels of competitiveness over the 1995–2007 period). This suggests that most South Asian countries may have greater trade prospects in services compared to merchandise where the RCAs are much below 1. Thus, there may be more scope for intra-regional trade in services than in goods from a competitiveness point of view.

Furthermore, there are possible complementarities across the countries in terms of their services trade structure. This could provide a basis for promoting intra-regional trade in services, particularly through greater investment flows within the region. Consider the trends in the profile of services exports and imports.

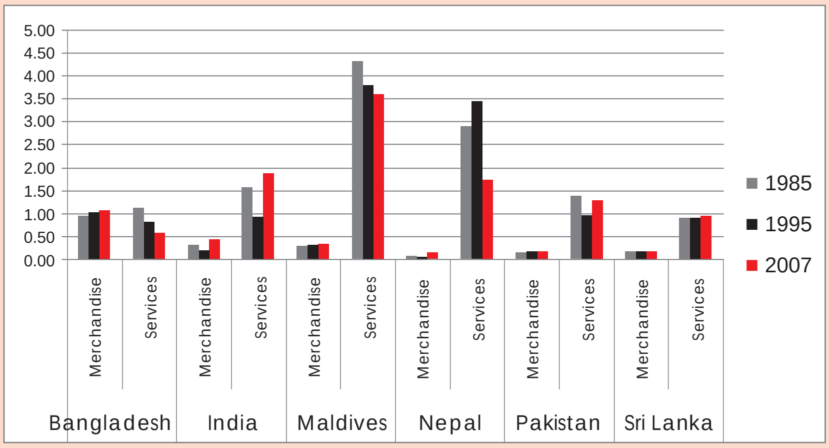
India's services export basket has become more diversified over time and today includes traditional services such as transport and travel as well as new services such as computer and information technology and other business services. On the other hand, the services export basket for the remaining countries is much narrower, with the Maldives and Nepal relying mainly on travel and tourism services. The composition of services imports in these countries shows a gradual diversification of the import basket between 1995 and 2006. Although travel and transport services are the most important, services such as business, financial, insurance and communication services have increased in importance, reflecting the outcome of services sector liberalization and reforms.

If one juxtaposes these trends in the composition of services exports and imports, complementarities and commonalities emerge. For instance, given the importance of travel and transport services in exports and imports, tourism services is clearly one area where all countries have a common interest and there is scope for greater intra-regional trade and related cooperation. Likewise, business and professional services constitute an important export segment for India and an increasingly important import segment for some other countries.

Related to these categories is the scope for greater cooperation in air and land transport services, and facilitation of business and leisure travel. Another important feature of the services trade basket in the region

Figure 2

Trends in RCA indices for merchandise and services



Source: Author's calculations based on UNCTAD Handbook of Statistics (online version).

is the significance of government services, i.e., non-commercial services, in some countries. Although sub-classification of government services is not available, given the significance of public services in South Asia's trade basket, any regional agreement on services has the potential to explore possibilities for collaboration, capacity building, and regulatory cooperation in areas such as health care, energy, education, environment and infrastructure development.

The potential role of intra-regional investment flows is also indicated by the services trade profile. Growth in areas such as communication, finance and information technology services in the region is a reflection of the reforms undertaken in these areas within SAARC, in particular foreign direct investment (FDI) liberalization. Overall regional- and country-level trends for FDI indicate that FDI in services in most of the member countries is growing, with India also emerging as a potential exporter of FDI in areas such as tourism, telecommunications, energy and health services within the region. There are many cases of Indian companies which have bidden for regional projects or established their presence through subsidiaries and joint ventures in the services sector in the region. Thus, the asymmetry that exists in favour of India in terms of trade volumes and potential could actually be harnessed to get Indian investment in certain services sectors in the other member countries. Such investment could in turn help the other countries to develop their intra-regional and overall export prospects in areas such as tourism, energy and information technology services. Thus, there is scope for exploiting synergies in trade and investment flows in services within South Asia.

Conclusion

All these commonalities, complementarities, asymmetries and synergies need not necessarily mean that countries in South Asia would want to trade with one another or invest in each other's markets. They may be more interested in markets outside the region. The relatively small size of some of the South Asian economies and their low per capita incomes will remain an impediment to intra-regional services trade and investment flows.

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However, this is where the architecture of SAFAS and the negotiating process will be critical for determining progress. It will be important to address critical issues such as investment regulations, taxes, mobility of business visitors and professionals, and regulatory cooperation if such inherent challenges are to be overcome and the regional market is to be made more attractive for intra-regional trade and investment flows. Given the complex nature of some of these issues, the negotiating process will need to be flexible, working through plurilateral and bilateral tracks alongside the regional track, at least in selected services, to achieve progress on critical issues where regional outcomes would be difficult to realize, and to provide sustained momentum to the services negotiations. ■

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Notes

1 SATIN. 2008. Regional Trade in South Asia: Towards Stronger Linkages and Growth—Executive Summary and Special Focus on adding Services to the South Asia Free Trade Agreement. Policy Paper. Commonwealth Business Council and SAARC Chamber of Commerce and Industry, Kathmandu, July.

2 The sector "utilities", i.e. electricity, gas and water supply, has been included under the manufacturing sector. If utilities are to be considered as a part of the services sector, there will accordingly be changes in the relative shares of manufacturing and services sectors in South Asia's GDP.

3 Author's calculations based on UNCTAD Handbook of Statistics 2008 (online version).

4 Author's calculations based on UNCTAD Handbook of Statistics 2008 (online version).

5 Author's calculations for RCA indices in individual services sectors based on UNCTAD Handbook of Statistics 2008 (online version).