ISSUES PAPER

TRADE IN SERVICES - NOT JUST A POOR COUSIN TO MANUFACTURERS

The trade in services is often regarded as a poor cousin to the trade in manufactured goods, but in reality it is becoming increasingly important, especially to Australia. There is much scope for future multilateral, regional and bilateral trade liberalisation talks to achieve some real progress in this area provided that negotiators are committed to removing trade barriers that are often opaque and embedded in government regulations, practices and standards.

THE SERVICES SECTOR

The importance of the services sector, and the trade in services, to the Australian economy should not be underestimated.

It is not widely recognised that services dominate the Australian economy, accounting for 78 per cent (or some $A550 billion) of our national output, and 84 per cent of all jobs (about 8.2 million people).

However, this economic contribution figure is likely to be an underestimate, given that many services are embedded within manufactures, mining and agriculture.

Services are also an important part of our export performance, with services' share of total exports increasing from around 16 per cent in the early 1970s to 23 per cent in the early 2000s - totalling more than $A37 billion in calendar 2005.

Over the past 30 years Australia's services exports have grown at a trend rate of around 7 per cent per annum, well ahead of the comparable figure for manufactured exports.

The biggest services export income earners by sub-sector are tourism (more than $A18 billion in 2004/05), education ($A7.5 billion), and a variety of business and professional services (also $A7.5 billion).

At the same time, our main services export markets appear to be changing, away from western industrialised nations toward greater emphasis on markets in Asia.

For example, while services exports to the United States grew strongly in the 1990s, they have declined over the past five years, as have those to the United Kingdom, our second largest market.

By contrast, our services exports to New Zealand, Singapore and particularly to China have grown strongly – in the latter case from $A380 million in 1995 to nearly $2.5 billion a decade later.

While little known, we also earn services export income from Australian-affiliated or owned companies operating abroad.

Figures produced by the Australian Bureau of Statistics (ABS) estimate the sales of services by affiliates of Australian companies operating abroad totalled more than $A65 billion in 2002/03, the great majority of which (over $A59 billion) were sales in the host economy.

Whilst it is difficult to get precise figures on such sales, most Australian affiliates abroad are located in the United States of America (USA), the United Kingdom (UK) or New Zealand (NZ).

Prominent Australian companies with substantial direct presence in foreign markets include Flight Centre (in the travel industry), Brambles (transport and related services) and Westfield (property management).

Tourism

Australia has long prided itself being as a destination of choice for international tourists, welcoming around 12 million people annually.

However, this flow of visitors is not solely the conventional tourist.

In reality, just half of all foreign visitors come here primarily for a holiday, with another one fifth visiting family and friends.

Contrary to broader perception, the other one third of this people flow comes for business reasons, for conventions or conferences, or for education.

Indeed, the growth rate for business, conference and education travellers has outpaced that for holiday-makers fairly consistently over much of the past decade.

The Australian inward tourism market is dominated by just a handful of source-countries, namely NZ, the UK, Japan and the USA.

However, patterns may be changing, with strong growth in the first two source countries, more modest growth in the latter two, and signs of emerging sustainable demand from high-potential countries such as China and India.

The Australian Government's Tourism Forecasting Council is generally optimistic for the future of the tourism industry, predicting visitor numbers to Australia will jump from 5.5 million in 2005 to 9.2 million in 2015, an increase of over 65 per cent. Compare both figures to the some 1 million tourists who arrived each year in the mid 1980s.

The strongest growth in foreign visitor numbers is likely to come from China (up by a factor of 4.2) and India (by a factor of 4.3), albeit from admittedly modest bases in terms of absolute numbers.

Education

The Australian education sector has also been performing very well over the past decade, with the number of international students in this country more than trebling from around 110,000 in 1995 to nearly 350,000 in 2005. Both figures are well above the mere 5,000 international students in Australia in 1986.

The main driver of this strong performance has been an increased number of students from Asia, accounting for 9 of the top 10 countries of origin. China alone provided one-quarter of all foreign student enrolments in 2005, with India and South Korea accounting for a further 8 per cent each.

Chinese students in Australia are estimated to be worth more in earnings from the export of education services than are Australia's total wheat exports to that country.

Our international competitiveness as an education supplier reflects several factors, such as our proximity to Asia (our major markets), our lifestyle and high levels of personal safety (especially compared to some major competitors), and the integration of our education and migration policies which offer the prospect of permanent residency in certain cases.

Australian universities are also becoming more entrepreneurial, and less bureaucratic, in their approaches to attracting and retaining students. Several of them, such as Monash University, have established campuses in Asian countries, and some host very large numbers of foreign students.

International demand for education services, especially in native English-speaking countries, is projected to grow at a healthy rate in coming years.

Forecasts indicate the global demand for international education places could nudge 6 million by 2020, with demand for the main English-speaking destinations surging from around 1 million now to 2.6 million in a little over a decade.

If Australia is just able to maintain its share of the global market, foreign student numbers may well more than double in the next ten or so years.

A number of other factors driving international education are also likely to be favourable to Australia.

These factors include the high proportion of young people in many East Asian countries (the feedstock for tertiary level education in the future), and the growing demand for new skills as developing countries grow and move up the manufacturing and services supply chain.

Whilst many of these foreign students are coming for an Australian higher/tertiary education, a substantial proportion is also pursuing vocational and ELICOS (English Language Intensive Courses for Overseas Students) programs.

Even so, we cannot take these expanding opportunities for granted, as the nature and level of competition to supply such education services is expected to increase, in particular from countries such as Canada, NZ, Singapore and the USA.

LIBERALISATION

The international trade in services suffers from an extensive range of barriers, most of which are opaque and deeply embedded in government regulations, practices and standards.

These hurdles, generally labelled 'non tariff barriers' (NTBs), are usually designed to at least constrain how and where business is done, and at worst discourage services from being delivered in the host economy.

In contrast to the trade in manufactures, where liberalisation is about identifying and then winding back tariff and other measurable barriers, freeing up the trade in services often involves tackling 'behind the border' impediments.

Trade barriers typically encountered by services exporters include foreign equity limitations, lack of recognition of qualifications, restrictions on rights of practice, and constraints on commercial presence (for example, on the number and location of branches or representative offices).

Unlike tariffs, which are reasonably easy to find, one of the greatest challenges in liberalising the trade in services is just identifying, let alone estimating the impact of, the various non-tariff barriers.

In 2000, the Australian Productivity Commission made some useful estimates of the incidence of barriers to the trade in services in the form of Restrictiveness Index Scores (RIS) for a range of tradeable services.

The Scores comprise restrictions on establishment and on operations for both domestic and foreign service providers in the host country, and take into account issues such as constraints on licensing and accreditation, advertising and marketing, fee setting, investment and ownership, and temporary movement of natural persons.

The results of the Productivity Commission's work for the accountancy, engineering and maritime transport services sectors can be seen in Figures 1, 2 and 3.

Each chart shows the RIS for local services operators and foreign suppliers (all figures are for 2000).
All of these countries under review impose more restrictions on foreign service suppliers than they do on locals.

As a broad statement, it would appear the restrictiveness wedge (the difference between constraints on foreign and local service providers) averaged over all seven countries featured is widest for maritime (around 29 index points), followed by accountancy (24 index points) and engineering (8 index points).

For Australia, our restrictiveness wedges are above average for accountancy, below average for engineering, and about average for maritime (see Figures 1, 2 and 3).

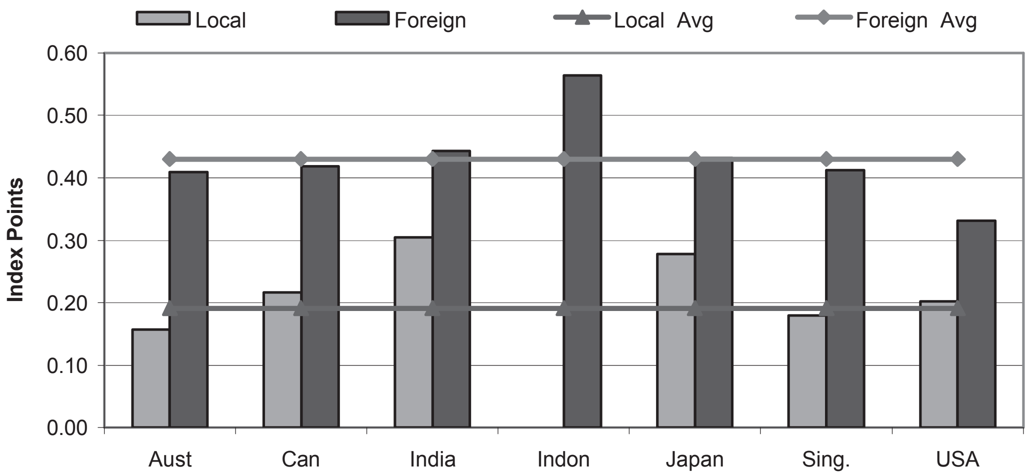
The magnitude, and the distortive impact, of barriers to the trade in services can also be seen in the potential dividends which could come from liberalising such trade.

Economic research for the Australian Government has calculated just halving global barriers to the trade in services could be worth as much as $A300 billion annually to the world economy, with the dividends spread widely amongst developed and developing countries.

At the same time, a high quality outcome from the Doha Round's trade in services negotiations could add as much as one half of a percentage point to Australia's annual economic growth rate.

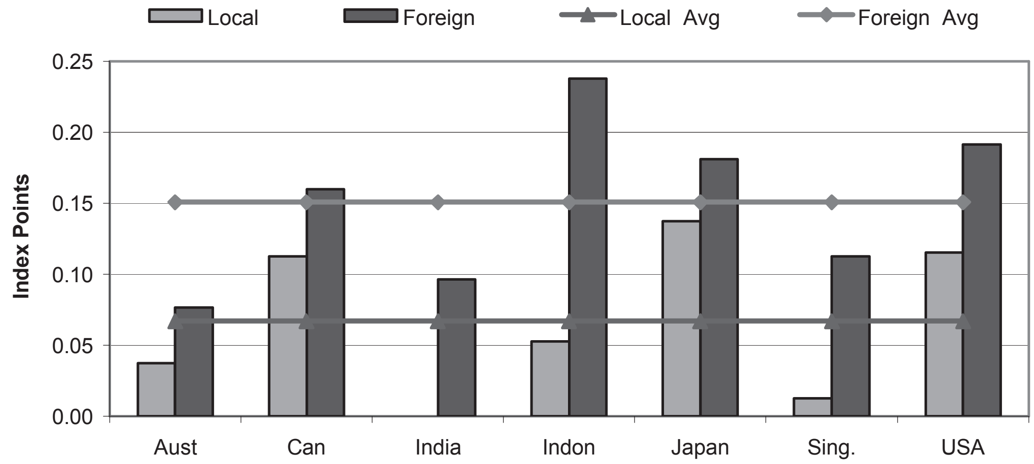
American researchers have estimated bold and comprehensive services trade liberalisation could deliver dividends more than double those from similar levels of liberalisation of the trade in manufactures, and more than

Figure 1
Restrictive Index Scores
Accountancy



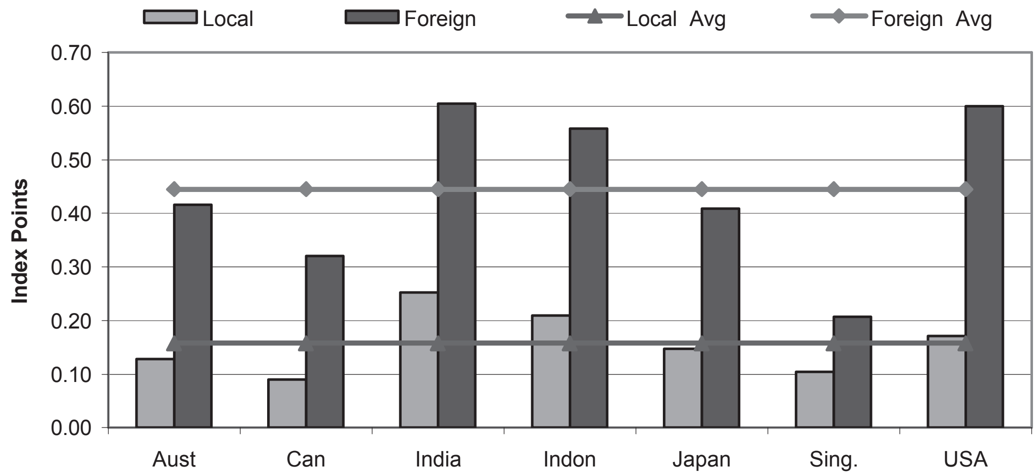
Source: Productivity Commission, 2000.
Note: A low RIS indicates no or few restrictions and a high RIS points to a market with high government regulatory barriers to entry.

Figure 2
Restrictive Index Scores
Engineering



Source: Productivity Commission, 2000.
Note: A low RIS indicates no or few restrictions and a high RIS points to a market with high government regulatory barriers to entry.

Figure 3
Restrictive Index Scores
Maritime



Source: Productivity Commission, 2000.
Note: A low RIS indicates no or few restrictions and a high RIS points to a market with high government regulatory barriers to entry.

30 times those from agricultural trade reform.

THE GATS

The General Agreement on the Trade in Services (GATS) is the core multilateral instrument covering the international trade in services, and builds on four main modes for the delivery of services (Figure 4).

The GATS contains features which are both pro-services trade liberalisation, and others which are less conducive to such reforms (but more a reflection of politico-economic pressures).

On the pro-liberalisation side, the GATS requires domestic regulatory regimes to be the least burdensome necessary to achieve their objectives, while it also recognises the right of governments to regulate for non-economic purposes and that services delivered by governments can be quarantined from GATS coverage.

In contrast to manufactures and agriculture, which negotiate on a multilateral basis of modalities and formulae, the GATS operates on a 'request and offer' approach and usually on a bilateral basis.

The Australian Government, to its credit, has taken constructive steps to progress the Doha Round's GATS negotiation, including working with like-minded members to present collective market access requests across 13

Figure 4
The GATS Four Modes

The GATS categorises services as being traded under four modes, namely:

Mode 1
Cross border supply, which deals with services that flow from one country to another. An example of Mode 1 services would be architectural services supplied from Australia to Indonesia by email.

Mode 2
Consumption abroad, where a consumer of services travels temporarily to another country to obtain a service abroad. An example may be a Fijian comes to Australia for advanced surgery.

Mode 3
Commercial presence, where the services supplier from one country establishes a physical presence in another country to provide the service in that market. For example, an Australian marketing company may open an office in Malaysia to produce advertisements.

Mode 4
The movement of natural persons, involving service providers from one country travelling temporarily to another country to supply a service. For example, an Australian medical specialist travelling to South Africa to undertake a highly technical procedure.

Source: ACCI (compiled from World Trade Organisation material).

priority services sectors.

However, such efforts have not been embraced by the great majority of WTO members and it would appear only 40 or so of the some 150 members are seriously interested in the GATS negotiations.

Part of the difficulty in progressing the GATS negotiations within the Doha Round may well be a design fault within the broader WTO system.

This flaw arises from the 'request/offer' nature of the negotiations, and in particular the use of the term "concession" to describe trade-offs made by participating governments as they converge on agreement.

Such terminology sends the wrong message – namely that offering concessions implies making a reluctant compromise or surrendering something of value.

It also implicitly contradicts the basic tenet of the WTO, which is trade liberalisation, bogging down negotiations in outdated mercantilist thinking of trade negotiations as a zero-sum game, where an increase in exports amounts to a win, and a rise in imports is a defeat for negotiators.

Perhaps trade negotiators could find a better word or term to describe such shifts in negotiating position, like "consideration"?

Regrettably, the WTO Doha Round appears unlikely at this stage to deliver bold and comprehensive trade liberalisation and it may not even produce any outcome at all.

In the services area, this is likely to reflect the seeming lack of meaningful commitment to the trade in services negotiations.

At best, WTO nations have offered standstill commitments (that is, no new barriers) rather than substantive offers of genuine liberalisation.

Many have been ambivalent participants, maintaining little more than a passive watching brief over talks or making patchy offers. Some have barely engaged at all.

AUSTRALIA'S PREFERENTIAL TRADE AGREEMENTS

The Australian Government has taken a proactive approach to ensuring comprehensive treatment of services within the various preferential trade agreements (PTAs) we already have, or are negotiating.

In the Australia-Singapore Free Trade Agreement (ASFTA), for example, the Australian Government has secured national treatment for Australian service providers (except in a few specified areas).

The ASFTA also includes services trade promoting provisions such as improved visa conditions, and expanded recognition of professional qualifications (for example, certain Australian law degrees).

The Australian Government's broader strategy for the trade in services chapters in the various PTAs currently under negotiation is based on securing substantial improvements in market access for services such as education, telecoms, business and professional services, financial services, and transport services.

CONCLUSION

Australia has much to gain from active engagement in the global trade in services.

In the past, we have done well in services such as tourism and education, and in extending our footprint in business and professional services.

However, we cannot rest on our laurels.

Realising repeat visits is a major challenge for the Australian tourism industry, whilst education, and business and professional services, are very much exposed to increasing competition from a range of sources.

The lack of meaningful progress with the WTO GATS negotiations remains disappointing, although some forward movement on services trade liberalisation could be made through the various PTAs Australia is currently negotiating on a bilateral and/or regional basis.

Either way, services trade liberalisation requires much more transparency in the nature, and extent, of barriers to such trade, both those at the border and of increasing importance, those behind the border.