

# **Does AFAS have Bite? Comparing Commitments with Actual Practice**

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## **Abstract**

The purpose of this paper is to undertake a broad review of the commitments achieved so far under the ASEAN Framework Agreement on Services (AFAS) and its associated negotiations on financial services and air transport. This review compares the trade commitments with actual regulatory practice. It therefore identifies whether significant progress has been made in reality, rather than merely on paper. It also identifies the sticking points, and assesses whether the gaps that remain are the result of sectoral sensitivities, features of the negotiating framework, or gaps in the broader regulatory environment. In each of the sectors examined, there are examples of all three problems. The paper concludes with suggestions for additional directions that could be taken and negotiating strategies that could be employed to accelerate the reform process and thus contribute to achieving an ASEAN Economic Community (AEC).

## 1 Introduction

A key component of the ASEAN Economic Community (AEC) Blueprint towards a single market and production base is the ‘free flow of services’ in the region. Towards this end, successive rounds of negotiations have produced a 7<sup>th</sup> package of commitments under the ASEAN Framework Agreement on Services (AFAS) covering most services sectors, with the 8<sup>th</sup> package nearly finished at the time of writing, as well as a separate 5<sup>th</sup> package of commitments for financial services and a 7<sup>th</sup> package for air transport.

The purpose of this paper is to undertake a broad review of the commitments achieved so far under AFAS and the financial services and air transport negotiations. This review compares the trade commitments with actual regulatory practice. It therefore identifies whether significant progress has been made in reality, rather than merely on paper. It also identifies the sticking points, and assesses whether the gaps that remain are the result of sectoral sensitivities, features of the negotiating framework, or gaps in the broader regulatory environment. The paper concludes with suggestions for additional directions that could be taken and negotiating strategies that could be employed to accelerate the reform process and thus contribute to achieving an ASEAN Economic Community (AEC).

## 2 The reform agenda

### Liberalization of services trade

Services trade reform, narrowly defined, has two dimensions:

- removal of discrimination against foreign services suppliers;
- removal of other specific barriers to market access, whether or not these discriminate against foreign suppliers.

Measures may discriminate against foreign suppliers either by limiting their entry into a market, or by limiting the scope and nature of their operations once they have entered. Measures may discriminate against any or all of the modes of services delivery — cross-border trade (where neither the consumer nor the supplying firm moves), consumption abroad (where the consumer moves), commercial presence (where a supplying firm establishes permanently in the country of the consumer) or the movement of natural persons (where a supplying individual moves temporarily). Services trade liberalization can potentially target all these types of discrimination.

Services trade liberalization can also target the following specific barriers to market access, as delimited in the General Agreement on Trade in Services (GATS) under the World Trade Organization (WTO):

- limitations on the number of services suppliers, such as through explicit quotas, nationality requirements (a form of implicit quota), the granting of monopoly rights, the granting of rights to exclusive supply, or the requirements of an economic needs test;
- limitations on the total value of services transactions or assets, such as in the form of numerical quotas, economic needs tests, or market share requirements;
- limitations on the total number of services operations or on the total quantity of service output, again through numerical quotas or economic needs tests;

- limitations on the total number of employees, either through quotas (in either absolute or percentage terms) or needs tests;
- limitations or restrictions regarding the type of legal entity (eg subsidiaries, branches, representative offices) or joint venture; and
- limitations on foreign equity participation (maximum percentage limit on foreign shareholding in either individual or aggregate terms).

Such limitations on market access can affect any or all of the modes of services delivery, and all potentially can be the target of services trade liberalization.

The AEC Blueprint lays out a relatively ambitious agenda to achieve services trade liberalization in these dimensions. By 2015, there should be substantially no restriction on ASEAN services suppliers in providing services and in establishing companies across national borders within the region, subject to domestic regulations. For four priority sectors — air transport, healthcare, e-ASEAN and tourism — this target was to be achieved earlier, by 2010. For logistics services, the target is to be achieved by 2013.

In successive rounds of negotiations, the number of sectors to be liberalized is to be expanded. For each new group of sectors, the liberalization commitments are to include:

- no restrictions on service delivery via mode 1 (cross-border trade) and mode 2 (consumption abroad), except where there are bona fide regulatory reasons, such as public safety;
- gradual expansion of the foreign (ASEAN) equity participation permitted in each sector, to be no less than 70 per cent by 2010 in the four priority sectors, and to be no less than 51 per cent by 2010 and 70 per cent by 2015 in all other sectors; and
- progressive removal of other limitations on market access via mode 3 (commercial presence) by 2015.

The negotiations were also to set the parameters of liberalization for limitations on national treatment, liberalization of service delivery via mode 4 (the movement of natural persons) and the liberalization of horizontal limitations on market access (ie limitations that apply across a range of services sectors), and commitments were then to be made according to these parameters.

The blueprint allows for some overall flexibilities in achieving these objectives, including via an ASEAN minus X formula (where countries that are ready to liberalize can proceed first and be joined by others later). In financial services, the process of liberalization also needs to take place with due respect for national policy objectives and the level of economic and financial sector development of the individual members.

### **Accompanying regulation**

Services trade reform cannot take place in a vacuum. This is because governments often want to regulate services markets to correct for market failures and/or to meet equity objectives. Unless such regulation is appropriately designed, services trade liberalization may not be feasible, or if feasible, may not generate its intended benefits.

Therefore, in addition to monitoring the implementation of services trade liberalization itself, it is important to monitor whether the broader regulatory environment is operating to thwart the either

the implementation or the impact of services liberalization. This knowledge can contribute to the design of strategies to accelerate the services trade liberalization process. Alternatively, if services trade liberalization is not yet taking place, but if the necessary regulatory environment is being put in place, then this could count as *indirect* progress towards achieving the Blueprint targets.

Broader regulatory impediments to successful services trade reform depend on the sector involved. In general, however, problems occur when legitimate regulation unnecessarily restricts competition.

One key impediment is having a regulator that is not independent from industry, or from sectoral interests within government. So independence of the regulator is an important precondition.

Generically, other problems are of three main types:

- regulation in finance industries (banking, insurance securities);
- regulation in network infrastructure industries (transport, telecommunications, energy); and
- regulation in social infrastructure industries (health, education, the professions).

The following is a brief discussion of the regulatory environments that can thwart the implementation and/or benefits of services trade reform in each of these cases.

### *Finance industries*

In finance industries, prudential regulation is designed to guard against systemic instability and financial sector collapse. Problems arise when prudential regulation is underdeveloped and/or it is not enforced in an effective and impartial manner.

When prudential regulation is underdeveloped, authorities may resort to entry barriers that, while easier to design, are less tightly targeted to checking the financial health and prudent risk management of financial institutions. For example, authorities may resort to screening criteria such as having to be in the top 500 financial institutions. Alternatively, they may place a moratorium on granting new licences, which means they do not have to assess the financial resilience of new entrants. These options have drawbacks — they do not ensure that the best, most competitive and innovative institutions enter the market. And the latter type of screening mechanism can also prevent inefficient, uncompetitive providers from being driven out of the market.

These types of regulations can act as a barrier to trade in services. But liberalization would probably need to be preceded by the implementation of better designed prudential regulation. This can sometimes explain why services trade liberalization is not occurring. Alternatively, if barriers to trade in financial services are not yet being liberalized, but if better-targeted prudential regulation is being put in place, then this could be recorded as indirect progress towards achieving the Blueprint targets.

When capability to enforce prudential regulation is under-developed, similar problems arise. Authorities may resort to screening mechanisms, such as checking the probity of shareholders, that are less tightly tied to the way in which a financial institution is *managed*. Overly restrictive requirements on shareholders may act as a barrier to trade, but reform may depend on building the capability and/or willingness to enforce more traditional methods of prudential regulation.

### *Network infrastructure industries*

A common feature of many network infrastructure industries is that parts of the industry may have the characteristics of a natural monopoly — meaning that it is cheaper to have that facility provided by one firm rather than by two or more.<sup>1</sup> One regulatory challenge is to prevent the monopoly operator from then exercising its monopoly power to price above cost, to the detriment of users.

Another challenge is to allow competition in other segments of the industry. This requires ensuring that the operator of the monopoly facility does not use its position to thwart competition in other segments, typically by denying competitors in those segments access to its bottleneck facility (eg incumbent airlines denying other airlines access to their computerized reservation systems). It is also important to ensure that any price controls that are used to discipline the pricing patterns of the monopoly provider do not indirectly thwart competition in other segments.

These network industries are also areas where governments often want to ensure access on an affordable basis to all consumers. A final regulatory challenge is to design ways of imposing universal services obligations on service providers that do not thwart competition.

The details of what constitutes a competition-friendly regulatory environment vary from industry to industry, and even from country to country.<sup>2</sup> Nevertheless, some key features include:

- avoiding price controls in competitive segments (which typically include retail);
- finding means other than price controls to ensure universal service (eg explicit budget funding to meet universal service obligations);
- regulating to ensure access to bottleneck facilities on non-discriminatory and reasonable terms, especially when there has not been structural separation of the bottleneck facility;<sup>3</sup>
- having an independent regulator to oversee the above.

Having a competition-friendly regulatory environment is necessary to ensure that foreign providers will in fact be willing to enter the market, once explicit trade barriers are removed. By the same token, it also ensures that services trade liberalization does not simply replace a domestic monopoly with a foreign one — it ensures that new domestic providers have the same opportunities as foreign providers in the competitive segments of the market.

Lack of a competition-friendly regulatory environment may explain lack of progress on services trade liberalization. Conversely, progress towards implementing a competition-friendly regulatory environment may count as indirect progress towards achieving services trade liberalization targets.

Finally, a competition-friendly regulatory environment should avoid multiple, overlapping forms of regulation. This can occur when there is both sector-specific and generic legislation and regulation affecting a particular industry. For example, international airlines are often covered by generic investment legislation. They are also governed by bilateral air services agreements, which determine

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<sup>1</sup> This does not preclude competition entirely. Some governments allow competition for the right to be the monopoly provider, with foreign suppliers able to participate in the bidding process.

<sup>2</sup> Natural monopoly essentially occurs when the most efficient scale of operation exceeds market size. Small countries may therefore find it a more extensive problem than large ones, so they may have to pay more attention to the problem of monopoly pricing and less to the problem of access to bottleneck facilities.

<sup>3</sup> The incentives for the monopoly operator to deny access to competitors are strongest when it is vertically integrated and so also competes directly in the competitive segments of the market.

where they can fly and on what terms. These air services agreements have so-called ‘withholding’ clauses that dictate the extent of non-source country ownership allowed in the airlines of a particular source country flying to a destination country. Thus the source country may liberalize its foreign investment legislation, but this will have no effect unless the destination countries also liberalize their withholding clauses.

Thus services trade liberalization will not generate benefits if some other forms of regulation remain in place to negate its benefits. Alternatively, the rationalization of regulation may be an important precursor to services trade liberalization, and could count as indirect progress towards that goal.

### *Social infrastructure industries*

A common regulatory objective in social infrastructure industries such as health and education is to ensure quality, given that consumers may not have the information or knowledge to be able to judge quality themselves. Another is ensuring access on an affordable basis for all segments of society. These regulatory objectives also arise in many of the professions (for example, legal or accounting services), although these sectors may not meet some people’s definition of social infrastructure industries.

When quality assurance and accreditation frameworks are underdeveloped, authorities may resort to entry barriers that are less tightly targeted to checking the quality of the services providers. For example, they may refuse to grant licences to foreign providers, on the grounds that they cannot check their quality. Alternatively, they may allow foreign providers, but restrict their activities to highly specialized services that are not provided by domestic providers.

These types of restrictions can act as a barrier to trade in services. But liberalization would probably need to be preceded by the implementation of well-specified quality criteria and better designed quality assurance processes. This can sometimes explain why services trade liberalization is not occurring. Alternatively, if barriers to trade in these kinds of services are not yet being liberalized, but if better-targeted quality assurance processes are being put in place, then this could be recorded as indirect progress towards achieving the Blueprint targets.

Authorities may use public funds to subsidize access to health or education services for vulnerable groups, but for budgetary reasons will typically use screening criteria to limit the funds they spend on such subsidies. When screening criteria are underdeveloped, they may act as barriers to trade in services. For example, authorities may decide to deny subsidies to the clients of foreign providers, even though some of those clients may perhaps be in vulnerable groups. While there is typically no perfect screening mechanism, some will be less competition-friendly than others. Services trade liberalization may not occur until more competition-friendly mechanisms are found. Conversely, if barriers to trade in these kinds of services are not yet being liberalized, but if better-targeted screening mechanisms are being put in place, then this could be recorded as indirect progress towards achieving the Blueprint targets.

Progress towards liberalizing trade in services is likely to be slow, precisely because it often needs to be accompanied or preceded by moves to a more competition-friendly regulatory environment. The assessment of progress in this paper tries to identify whether slow progress is the result of the negotiating framework, the broader regulatory environment, or sectoral sensitivities.

### 3 Assessing progress

Progress towards the AEC Blueprint targets can be assessed in several ways. One is by counting commitments — that is, calculating the number or proportion of sectors and modes of supply in which commitments have been made, and recording whether those commitments are full or partial. Comparing how this coverage has changed over time also gives an indication of the rate at which this progress has been made.

Nevertheless, counting commitments gives only a partial picture of progress, for several reasons. First, simple counts or ratio calculations implicitly give equal weight to each mode of delivery. In practice, for any given service, some modes of delivery are more important than others. For example, cross-border trade is an important mode (along with commercial presence) for air and maritime transport services, while commercial presence is the most important mode of delivery for telecommunications services. Consumption abroad (mode 2) is rarely an important mode of delivery, though it rates more highly for health and education than for many other services. Furthermore, most governments find it difficult in practice to impede mode 2 trade, because the transaction occurs outside the home government's jurisdiction. The AEC Blueprint rightly sets the ambition of binding the current degree of openness in mode 2 trade. Yet a raw count of mode 2 commitments might overstate the extent to which the negotiations have improved economic outcomes (as opposed to preventing reversion).

Similarly, simple counts or ratio calculations implicitly give equal weight to each services sector or subsector. But within ASEAN, some services sectors are likely to be more economically significant than others. One source of ASEAN's current economic strength and future economic growth is the way in which it is tapped into manufacturing production networks in the East Asian region, performing tasks that take advantage of its skills base. Another is its strength in the processing and export of primary commodities. Thus the services that are critical to ASEAN's future prosperity are likely to be those that contribute to the productivity of the production base, and facilitate the movement of manufactures and primary commodities around ASEAN region, as well as to outside markets. Air transport and logistics services are clearly critical to this process, and are among ASEAN's priority sectors. But also critical are maritime and land transport services, telecommunications services, and the sectors that provide transport insurance and trade finance. Energy distribution is also vital to the productivity of manufacturing production networks and primary processing. And within each sector, some sub-sectors are more important than others. For example, in the finance area, the core banking and insurance services are more important than financial advisory services.<sup>4</sup>

A third drawback of simple counts or ratio calculations based on commitments is that they do not measure progress in terms of impact on actual policies. This is not just an academic quibble. Research to date suggests that services commitments in trade agreements can lag actual practice by a significant margin. Dee and McNaughton (2011) provide a comprehensive review of the evidence,

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<sup>4</sup> By itself, a comparison of commitments with actual practice cannot take into account the relative economic significance of different sectors. However, it can inform a computable general equilibrium modelling assessment of further reform, which can take into account relative sector sizes and intersectoral linkages. A companion paper (Dee 2013) carries out a computable general equilibrium modelling assessment of the effects of further reforms under AFAS and its associated negotiations on financial services and air transport, using the current assessment of real progress to date.



showing that while no study has directly compared the services commitments of regional trade agreements with actual practice on a comprehensive basis (though Barth et al. (2006) have done so for banking), some studies have compared regional trade commitments with WTO commitments, and others have compared WTO commitments with actual practice. A representative study in the former category is by Roy, Marchetti and Lim (2006), who concluded (p. 33) that preferential trade agreements ‘generally have provided for significant improvements over GATS commitments, sometimes even leading to real liberalization of the market’. The most recent, comprehensive assessment in the latter category is by Borchert, Gootiiz and Mattoo (2010), who found that services commitments under the Uruguay Round were on average 2.3 times more restrictive than currently applied policies for 93 WTO members. And while the best Doha Round offers improved on current GATS commitments by about 10 per cent, they remained on average twice as restrictive as actual policies.

Thus if WTO commitments lag actual practice by a significant margin, then even if regional trade agreements improve on WTO commitments, they may still themselves lag actual practice. AFAS aims to be WTO-plus. But pending a comprehensive comparison of its commitments with actual practice, it remains an open question whether the services commitments under AFAS have been sufficiently bold to generate actual reform.

A final drawback of simple counts or ratio calculations based on commitments is that they do not give an indication of the economic significance of the reform task that remains. This requires knowledge of the actual trade restrictions that remain in place, not just the number of sectors that remain uncommitted. This knowledge also gives additional insights into the nature of the sticking points, thus helping to suggest strategies to accelerate the reform process. Some suggestions are offered at the end of the paper.

#### **4 Comparing commitments with actual practice**

Over the last three years, economic researchers from each ASEAN country have collected systematic information about actual regulatory practice in a number of services sectors — air and maritime transport, telecommunications, healthcare services, accountancy, banking and insurance services — and the results have been summarized in a series of reports (Dee 2009, 2010, 2011). For these sectors, it is therefore possible to make a comparison of trade commitments with actual practice. But the comparison is subject to several important caveats.

The information on actual practice was provided in terms that were generally less precise, and often less comprehensive, than that required in trade agreements. So there is a risk that apparent mismatches between commitments and actual practice will simply reflect inadequate information about actual practice. In particular, if a particular regulatory restriction has been recorded as a limitation in the trade commitments, but missed in the more broad-brush assessment of actual practice, it might appear that commitments are *less* generous than actual practice, whereas in fact the finding reflects information gaps. However, the comparison below concentrates on the major disparities, which are hopefully more likely to be substantive.

The information on actual practice was collected on a most-favoured nation basis — that is, is was about regulatory policies that applied to all trading partners, and did not reflect any preferential

treatment granted to other ASEAN countries. Thus a particular ASEAN country's trade commitments under AFAS could appear to be *more* generous than recorded actual practice because preferential treatment has in fact been granted. Alternatively, trade commitments could appear to be more generous than actual practice because ASEAN countries are not implementing their ASEAN trade commitments. Evidence suggests that these implementation lags do occur. Barth et al. (2006) found that in banking services, the developed countries were on average *less* open based upon actual practice than their WTO commitments. Generally, such evidence in ASEAN countries will be interpreted as evidence of preferences being granted, although the possibility of implementation lags cannot be ruled out.

## Air transport

### ASEAN commitments

AFAS has followed the GATS by severely limiting its coverage of air transport services.

The Annex to the GATS on Air Transport Services states that the agreement shall not apply to measures affecting 'traffic rights, however granted' or 'services directly related to the exercise of traffic rights'. It states that the agreement can apply to 'aircraft repair and maintenance services', 'the selling and marketing of air transport services', and 'computer reservation system services'. Among its definitions, it defines traffic rights to mean 'the right for scheduled and non-scheduled services to operate and/or to carry passengers, cargo and mail for remuneration or hire from, to, within, or over the territory of a WTO Member, including points to be served, routes to be operated, types of traffic to be carried, capacity to be provided, tariffs to be charged and their conditions, and criteria for designation of airlines, including such criteria as number, ownership and control'. It defines maintenance to exclude so-called line maintenance — any maintenance that is carried out before flight to ensure that the aircraft is fit for the intended flight.

There has been considerable debate among WTO members about how broadly or narrowly to define 'services directly related to the exercise of traffic rights', and in particular, how many of the services classified (according to the UN Central Product Classification used by the GATS) under 'Supporting services for air transport' fall into this category. WTO (1998) even canvassed the possibility that ground handling and airport management may not be ruled out, and Australia, for example, has commitments in these areas. However, WTO Members have generally taken a conservative approach, being willing to consider only such services as aircraft rental and leasing with and without crews, and catering services.

ASEAN's commitments made in the various rounds of air transport negotiations fall into this pattern. In the 7<sup>th</sup> package, all ASEAN members have made commitments in the three key areas mentioned in the GATS — repairs and maintenance, selling and marketing, and computer reservation system services. Most have also made commitments in at least some of the following areas — aircraft rental with and without crew, air freight forwarding, and aircraft catering. Lao PDR has also made commitments for aircraft line maintenance, an area explicitly excluded from the GATS.

In virtually all cases, the commitments involve no limitations on either market access or national treatment for mode 1 (cross-border trade) and mode 2 (consumption abroad). The commitments for mode 3 (commercial presence) are more circumscribed. Half of the ASEAN member countries have failed to make commitments under mode 3 for at least some services that they have committed

under modes 1 and 2. Three ASEAN countries have restricted foreign equity in at least some of their committed services to less than 100 per cent, and in all three cases, at least some of those limits are also less than the 70 per cent target established in the Blueprint. As in most other services, the commitments in mode 4 (movement of people) are horizontal rather than sector-specific. They govern the movement of intra-corporate transferees and as such, are generally in support of the mode 3 commitments rather than independent from them. Brunei's commitments on the proportions of foreign workers in air transport even go as far as matching exactly its commitments on the proportion of foreign equity. Thus the remainder of this paper does not pay much attention to the mode 4 commitments, since they are generally not independent of those for mode 3.

Air transport services involving the exercise of air traffic rights are covered outside of AFAS, in the ASEAN Multilateral Agreement on Air Services, the ASEAN Multilateral Agreement on the Full Liberalization of Air Freight Services, and the ASEAN Multilateral Agreement on the Full Liberalization of Passenger Air Services. These are essentially open skies agreements for passenger and freight transport.

In key respects the commitments under these agreements are somewhat limited.<sup>5</sup> In freight services, 5<sup>th</sup> freedoms were granted between cities with international airports by December 2008. There was no provision for 7<sup>th</sup> freedoms to be granted for freight-only services.<sup>6</sup> In passenger services, 5<sup>th</sup> freedoms are to be granted between cities with international airports by 30 June 2013, subject to the proviso that only one of them can be a capital city.

Neither the freight nor the passenger agreement involve any loosening of ownership requirements — both agreements allow countries to continue to require 'substantial ownership and effective control' to be held by the country that designates the airline. This would preclude countries that had established a significant commercial presence in another country from using that as a base from which to offer passenger and freight services among ASEAN members. More liberal ownership provisions are also allowed, but few ASEAN members are willing to make public the details of their air services agreements, so it is impossible to check whether more liberal ownership clauses have been adopted in practice.<sup>7</sup> In any event, at the time of writing not all ASEAN members had ratified all these agreements or their protocols.

These multilateral open skies agreements clearly cover mode 1 and mode 3 trade in international passenger and freight transport services. But what about trade in domestic air transport services,

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<sup>5</sup> The dimensions in which air services agreements are generally being liberalized is in the granting of the fifth, sixth and seventh freedoms and cabotage. The *fifth freedom* is the freedom to carry passengers between two economies by an airline of a third economy on a route with origin or destination in its home economy. The *sixth freedom* is the freedom to carry passengers between two economies by an airline of a third economy on a route that goes via its home economy. (Note that sixth freedoms can also be constructed via a combination of the third and fourth freedoms from different bilateral agreements, and so are rarely specified explicitly.) The *seventh freedom* is the freedom to carry passengers between two economies by an airline of a third economy on a route with no connection to its home economy. *Cabotage* is the freedom to carry passengers within an economy by an airline of another economy on a route with origin or destination in its home economy.

<sup>6</sup> Note that most freight is carried in the belly of passenger aircraft, and is thereby governed by the freedoms granted to passenger flights.

<sup>7</sup> The most liberal regime (*principal place of business*) removes the substantial ownership requirement, but still requires the designated airline to be incorporated in the designating economy, and to have its principal place of business there.

that is, services within a particular country? Mode 1 trade in domestic air transport services is covered by the cabotage provisions of international air service agreements. Because no ASEAN member grants cabotage rights, there are no commitments to allow free mode 1 trade in domestic air transport services.

Mode 3 trade in domestic air transport services does not appear to be covered by either of these frameworks. It is not included in AFAS, presumably because AFAS follows the GATS by excluding services involving the exercise of traffic rights, including those 'within' a country. But the rights to fly within a country by airlines having a commercial presence in the same country are likewise not covered by international air service agreements.

Countries have typically taken unilateral action to liberalize the foreign ownership limits on locally incorporated airlines that offer domestic transport services. Some countries have done so to a significant degree. For example, both New Zealand and Australia allow 100 per cent ownership of domestic carriers, even though they only allow 49 per cent foreign ownership of international carriers. Low cost airlines in particular have used these liberal ownership clauses to spread their services internationally. ASEAN countries have had the opportunity to use the AFAS process to bind current ownership arrangements for domestic carriers, and to negotiate further access. To date, they have not chosen to do so.

In December 2011, ASEAN Ministers signed an Implementation Framework of the ASEAN Single Aviation Market. As well as covering safety, security and air traffic management, it also contains economic elements, including market access, ownership and control and 'commercial activities'. The specified commercial activities include some already covered by AFAS — sales and marketing, maintenance and repair, computer reservation systems, aircraft leasing, and bringing in of non-national personnel to operate air services — as well as ground handling, airport access, establishment of offices and 'airline commercial arrangements'. The specified actions under market access are simply to ratify the open skies agreements and to review their implementation. The specified actions under ownership and control are to 'work towards' the adoption of the 'principle place of business' criterion for designation and to 'commence discussion' on further liberalization of ownership and control. The specified actions under commercial activities are to liberalize these and to provide access on a non-discriminatory basis.

While these new initiatives appear promising, it is unclear whether and how they overlap with existing AFAS commitments will be coordinated. While there are target end dates attached to the new initiatives, there are no implementation milestones, as there are with the AFAS process. There is no provision to immediately bind the existing degree of openness. And it is not clear whether or how the new Single Aviation Market framework would handle mode 3 trade in domestic air transport services.

### *Comparison with actual practice*

When attention is restricted to the few ancillary air transport services for which services trade commitments have been made, there are relatively few instances where those commitments lag actual practice. There are also a few cases where the committed foreign equity limits appear to be more liberal than actual most-favoured nation policies, presumably reflecting preferences granted to ASEAN trading partners.

The gaps between commitments and actual practice are much wider for services involving the exercise of traffic rights. Most ASEAN countries have well-articulated foreign ownership limits for their domestic and international carriers, as well as for airport infrastructure. According to the survey results in Dee (2010), all allow at least some foreign ownership of international carriers, half allow at least some foreign ownership of domestic carriers, and all but two allow at least some foreign ownership of luggage and freight loading and unloading. In some cases, market entry via commercial presence is also subject to restrictions such as economic needs tests, but only for a few specific services in a few countries is foreign entry completely precluded.

Thus the services trade negotiations have ensured liberal commitments in the peripheral ground services that are covered by GATS negotiations. But the ASEAN negotiations have not gone further. This has left the conditions of supply of international air services to be determined under so-called 'open skies' arrangements that are still relatively restrictive — they do not allow liberal cross-border trade in freight services, and they do not bind the existing degree of openness to foreign investment in international air transport, airport operation or luggage and freight handling. Furthermore, the current arrangements and new Single Aviation Market initiative seem to leave no venue in which to negotiate the terms of foreign investment in domestic air services.

As noted earlier, transport and logistics services are arguably the most important services for ensuring ASEAN prosperity. Good performance of these services requires adequate infrastructure as well as appropriate regulation. But these two are not independent of each other. Private sector investment, including foreign investment, can contribute to ensuring adequate infrastructure, but the private sector will be loath to invest if the regulatory environment is unduly restrictive. In air transport services, ASEAN countries have an opportunity to be truly GATS-plus by relaxing the exclusion of services that involve the exercise of traffic rights, particularly when it comes to commercial presence. Most ASEAN countries already allow significant foreign commercial presence. Binding this practice and negotiating further access under a well-specified set of milestones would provide further surety to foreign investors. It would also make a contribution to ensuring ASEAN connectivity.

ASEAN countries would need to ensure that liberal foreign ownership limits for commercial presence were not nullified by unduly restrictive withholding clauses in international air services agreements. For example, Singapore currently allows 100 per cent foreign ownership of international carriers based in Singapore, but if ASEAN partners only grant traffic rights to Singapore-based airlines that have 'substantial ownership and effective control' by Singaporean citizens, then Singapore's foreign-owned international carriers would not be able to offer international services to other ASEAN members. Greater external discipline on air service agreement negotiations under the Single Aviation Market initiative would be required to ensure that their provisions did not remain inconsistent with services trade commitments. And greater transparency of air service agreements would be needed to ensure that such discipline could be exercised. The International Air Transport Association's (IATA's) Director General once labelled the bilateral system of air service agreements, the ownership rules and the attitude of competition authorities towards airline mergers and alliances as 'the three pillars of stagnation' that have hindered the modernization of air transport industry. If ASEAN is going to achieve its vision for an efficiently connected ASEAN Economic Community, it can ill afford to retain this source of stagnation.

## Maritime transport

### *ASEAN commitments*

ASEAN countries already take a relatively liberal approach to the regulation of shipping services compared to many other countries, and this is reflected in their AFAS commitments for maritime services. The coverage is much more comprehensive than in air transport, with two key exceptions (cabotage services and ports), and the commitments, when made, are also relatively liberal.

Recalling that mode 1 is a key mode of delivery for maritime transport, all ASEAN countries have committed to free cross-border trade in the basic passenger and freight transport services, although all of those with significant domestic shorelines have excluded cabotage services. Matching commitments have been made in mode 2, although this mode has much less real economic significance. For mode 3 (commercial presence), three countries have committed to allow 100 per cent foreign ownership of domestically-based companies providing international passenger and freight services, while several more have committed to this subject to additional conditions being satisfied in order to fly the national flag. The remaining ASEAN countries have committed to allow foreign ownership of 40–60 per cent for these basic services.

All ASEAN countries have also made notable commitments in the so-called ‘tier 1’ logistics services in maritime — cargo handling, storage and warehousing and freight transport agency services (eg brokerage, freight forwarding). The structure of those commitments tends to mirror those made for the basic passenger and freight transport services. Where commitments are made at all, they generally involve no limitations on mode 1 and mode 2 trade, and a range of foreign equity limits for mode 3 trade.

A few ASEAN countries have made commitments for maintenance and repair of vessels, pushing and towing, and vessel salvage. None have made commitments for free trade in pilotage and towing services, although some have committed to allowing non-discriminatory access to these services. And only the Philippines has made commitments regarding port and waterway operation services.

Finally, only some of the ASEAN countries that border the Mekong River have made commitments regarding inland waterways, even though trade commitments in this area could contribute to ASEAN connectivity.

### *Comparison with actual practice*

In maritime services, there are cases where commitments appear to lag actual practice. Brunei, Cambodia and Singapore appear to allow 100 per cent foreign investment in some services that they have not committed to, while Malaysia and Vietnam appear to have no regulatory restrictions on entry into services that they have not committed to. On the other hand, some ASEAN countries appear to have made preferential concessions to their trading partners. Malaysia and Indonesia appear to have made preferential concessions on foreign equity limits, while the Philippines appears willing not to enforce its ‘one port-one operator’ and ‘one port-one cargo handling operator’ policies that otherwise apply at some ports. In general terms, however, the successive rounds of negotiations appear to have succeeded on bringing ASEAN’s trade commitments closely into line with actual practice.

Furthermore, actual practice is in turn relatively liberal, with two important exceptions — cabotage arrangements, and port operations. These are the two areas where significant commitments have not been made.

While cabotage restrictions remain a key impediment to ASEAN connectivity, there are no significant domestic regulatory impediments to relaxing these restrictions. In some cases, it is not even clear that the cabotage restrictions serve a useful protective purpose. For example, at least some of the Singapore-based shipping companies that would offer cabotage services to Indonesia (were Indonesia to relax its cabotage restrictions) are in fact Indonesian-invested companies that have chosen to register in Singapore because of the easier regulatory and financing environment there. The rationale sometimes given for retaining cabotage restrictions is that much of the developed world also has them. But this is one area (along with air transport) where making bolder commitments than in the rest of the world will be necessary to ensure efficient transport and logistics services. ASEAN cannot significantly improve its maritime connectivity while it remains impossible for a single international shipping service to make multiple calls within a single country. And private investors will be loath to modernize shipping fleets whose transport routes are restricted by regulation to inefficiently small local services.

The key problem with port operation services is regulatory — greater competition *in or for* port operation services requires that the new operators be able to gain access to existing port or port superstructure facilities. In many cases, this would require significant reform of the incumbent port operator, including separating its operational from its regulatory functions. The way in which the AFAS process can be extended to encourage such domestic regulatory reforms is considered in the last section.

## Telecommunications

### *ASEAN commitments*

One of the factors critical for trade in fixed line telecommunications services is an access regime of the type outlined in the WTO Reference Paper on Telecommunications. Accordingly, one of the more significant features of the AFAS commitments on telecommunications services is that most ASEAN members have committed to the WTO Reference Paper on Telecommunications, or something like it, as part of their AFAS commitments. The wording of Malaysia's commitment is more circumscribed than the WTO Reference Paper itself. Thailand has not included a reference paper as part of its commitments, but has promised to do so. Neither Lao PDR nor Myanmar has included a reference paper. Lao PDR is not currently a member of the WTO.

ASEAN countries have tended to make unlimited mode 1 and 2 commitments for the same (or similar) telecommunications services for which they have made (often qualified) mode 3 commitments. But mode 1 and 2 commitments are not of much economic significance in telecommunications services. In mode 3, foreign equity limits vary widely — some countries allow 100 per cent foreign ownership in all services where commitments are made, whereas other countries restrict foreign equity to proportions less than 50 per cent. The commitments often contain qualifications over and above foreign equity limits. Some countries will allow foreign investment in existing but not new operators. Some will allow only a fixed number of new operators. Lao PDR requires entrants to provide services outside of the capital city.

### *Comparison with actual practice*

Telecommunications appears to be an area where there are significant gaps between commitments and actual practice.

Indonesia's commitments contain foreign equity limits of 40 to 51 per cent, which are less generous than the most-favoured nation limits of 65 to 95 per cent contained in the latest negative list of its investment law. Similarly, Singapore has limited foreign equity to less than 100 per cent in its commitments for public switched services, even though the most-favoured nation limit is 100 per cent. Thailand has limited its foreign equity commitments to 25–40 per cent for a range of services, although its domestic regulatory regime allows 49 per cent foreign ownership for facilities-based licences and 100 per cent foreign ownership for type-1 licences (which cover resale). Malaysia has restricted its commitments to investment in existing licensed operators, even though investment in new operators is possible in principle under its most-favoured nation treatment.

Commitments for some countries are more mixed. Brunei has made no commitments for data services, leased lines and internet service provision, even though it appears to have no limitations on entry in these areas. On the other hand, Brunei has allowed its ASEAN partners 100 per cent foreign equity in services such as local, international, mobile and prepaid, even though the most-favoured nation treatment is to require a local shareholder that holds more than 50 per cent of the equity. Similarly, Vietnam has limited its commitments to 49 per cent foreign ownership for some services, but up to 65 per cent for others, even though its most-favoured nation limit appears to be 51 per cent foreign equity for all services.

In some cases, commitments appear to reflect development concerns. Lao PDR has failed to make commitments on services that are not currently available — data services, leased lines and internet services — even though entry is possible in principle. The telecommunications market is very underdeveloped in Lao PDR, teledensity is very low, and regulatory capacity is poorly developed.

The overall pattern of these commitments suggests that the countries with more developed telecommunications markets are tending to keep their trade commitments less generous than actual practice. One possible interpretation is that they are endeavouring to retain leverage in the 'request and offer' process so as to encourage others to improve their offers. Another interpretation is that regulations are lagging technological developments. The survey of actual practice in Dee (2010) shows that a majority of ASEAN countries (with the exceptions of Brunei, Indonesia, Malaysia and Myanmar) have relatively competitive market structures in telecommunications services, irrespective of their regulatory structures. In these circumstances, there is no practical reason for retaining restrictive regulations over entry, either on a preferential or most-favoured nation basis.

Some less developed countries are failing to make commitments for services for which there is yet to be a market in their economies. But if the technologies for these services are scalable (as they generally are for value-added services), then regulatory capacity cannot be seen as a binding constraint on making trade commitments in these areas. And trade commitments may in turn provide foreign investors with additional assurance to invest in these technologies.

In mobile markets, the technology is relatively scalable so there are few market failure problems preventing competition. In fixed line markets, economies of scale can still provide advantages to the incumbent operator of bottleneck facilities, so access arrangements of the sort outlined in the WTO



Reference Paper on Telecommunications remain an important regulatory adjunct to free entry arrangements. Those ASEAN members who have not bound the WTO Reference Paper as part of their ASEAN trade commitments need encouragement to do so.

## Healthcare services

### *ASEAN commitments*

Medical and health services can be provided by individual medical professionals, or in a broader institutional setting. Accordingly, the UN Central Product Classification, which is used to classify the different services covered by the GATS, recognises two types of healthcare services:

- the services of medical professionals, including medical and dental professionals and midwives, nurses, physiotherapists and paramedical personnel;
- health services, including hospital services (including psychiatric hospitals), and the services of medical laboratories, ambulances, and residential health care other than hospitals.

Medical professional services can be traded via all four modes of service delivery. Health services are primarily facilities-based services that are traded via mode 3, that is, by the entry and operation of foreign-invested operators. Increasingly, however, hospital and medical laboratory services are traded via mode 1 (e.g. telemedicine or remote diagnostic services). Hospital services are also traded via mode 2 (consumption abroad).

There are significant gaps in the coverage of most country's commitments under AFAS. For example, Cambodia, Indonesia and Malaysia restrict their commitments to specialized services, while Lao PDR limits its commitments for hospitals to modern private hospitals with more than 100 beds. Brunei and Thailand restrict some of their medical commitments to services provided in hospitals, not on a stand-alone basis. Most countries omit some services altogether. For example, Brunei, Cambodia, Indonesia, Lao PDR, Malaysia, Thailand and Vietnam omit laboratory services. Cambodia and Lao PDR omit paramedical (including nursing) services. The Philippines omits medical, dental and paramedical services.

For the services that are covered, the commitments for modes 1 and 2 tend to mirror the commitments made for mode 3, but less closely than for air and maritime transport. In particular, some countries are willing to make mode 3 commitments for some services for which they are not willing to make commitments under modes 1 and 2. This is presumably because they can enforce local quality control standards on mode 3 delivery, but not on delivery through modes 1 and 2.

### *Comparison with actual practice*

Medical and health services are another area where there appears to be gaps between commitments and actual practice. Most countries do allow some entry and foreign direct investment in laboratory services, though most have not made commitments for this service. For services that are committed, at least some foreign equity limits appear to lag actual practice in Indonesia, Lao PDR, Malaysia and Singapore.

Achieving quality objectives in health and medical care will inevitably mean that there will continue to be barriers to the entry and operation of at least some providers — not all regulatory restrictions on market access can be removed. But a well-designed quality control framework should ensure that

the operators who are locked out are the genuinely low-quality ones. It can afford to be relatively neutral in its treatment of domestic and foreign providers.

Similarly, achieving equity objectives in health and medical care on an affordable basis may mean that not all providers or clients can gain access to government subsidies. Governments may choose to deny higher-quality private providers access to subsidies, in order to keep the subsidy scheme affordable, but if the system is to not unduly constrain trade, then this denial of subsidies should be the same for domestically-owned and foreign private providers.

In facilities-based health services, the review of actual practice in Dee (2011) shows that non-discriminatory barriers to entry and operations in ASEAN have already been substantially removed, so removing discrimination against foreign suppliers is the only remaining task. This can be achieved under the current AFAS negotiating structure. In medical professional services, there is also significant scope in the short term to ensure that existing quality assurance regulation does not discriminate against foreign providers, using the current AFAS negotiating structure.

However, the failure to develop satisfactory quality control regimes is preventing some countries from making more extensive trade commitments. There is also work to be done to ensure that current non-discriminatory regulation is no more burdensome than necessary to ensure quality of the service. In the longer term, therefore, frameworks are needed to support the development of quality control regimes that are adequate, but no more burdensome than necessary.

While sometimes the omission of particular services may reflect weaknesses in the domestic quality control regime, in other cases it may reflect the complexity in the domestic regulatory regime. The scheduling format used in AFAS is the same as in the GATS, and its tabular format is not amenable to providing large amounts of regulatory detail. If this has in fact been an impediment to some countries making commitments, then perhaps ASEAN countries could experiment with other scheduling formats.

## **Accounting services**

### ***ASEAN commitments***

The commitments in accountancy services under modes 1 and 2 are generally very liberal. These modes are often free of all limitations, although some countries require auditors to have a commercial presence. In mode 3, it is relatively common for there to be residency requirements for professionals, and/or requirements for joint ventures with a local partner. Lao PDR imposes a nationality requirement on accounting and bookkeeping services. Such nationality requirements are particularly restrictive.

### ***Comparison with actual practice***

There is some evidence that accounting is an area where AFAS commitments have pushed beyond actual most-favoured nation practice. For example, actual practice in Brunei is for the Ministry of Finance, as a condition for renewal of a licence for a foreigner, to require that the firm have a local partner. This condition is not in Brunei's AFAS commitments. Indonesia normally requires accounting firms to be either individual proprietorships or partnerships, but this limitation on legal form is not noted in its AFAS commitments. In Thailand, there are 39 occupations that are restricted to foreigners, and accountancy is one of those restricted occupations. Foreigners are generally allowed

to invest up to 49 per cent in a local accounting company, but need approval from the Director-General of the Commercial Registration Department to invest higher than that. Neither of these restrictions is noted in Thailand's AFAS commitments.

After reviewing actual practice in accountancy, Dee (2011) notes that six ASEAN countries already meet the Blueprint's targets for foreign equity participation — they have no restrictions on foreign equity at all. But restrictions on the movement of individual professionals are more prevalent than restrictions on commercial presence. They contribute to marked discrimination against foreign services suppliers, not all of which can be justified on the grounds of quality assurance. There is scope to remove much of this discrimination, using the current AFAS negotiating structure. There is also scope to review quality control measures to ensure they are no more burdensome than necessary.

## **Banking services**

### ***ASEAN commitments***

The AEC Blueprint noted that commitments in financial services should respect national policy objectives and the level of economic and financial sector development of the individual members. Apparently consistent with this, there is considerable variation in trade commitments across ASEAN countries.

Arguably, the most liberal commitments in banking services have been made by Cambodia. It places no limits on deposit taking, lending or payments and money transmission services, except that deposits from the public must be reinvested in Cambodia (an important restriction on mode 1 trade). For commercial presence, these activities are only permitted through authorized banks. The latter proviso reflects the fact that the UN Central Product Classification used for making trade commitments lists financial services by service provided, whereas most countries these days regulate according to type of institution (commercial bank, investment bank, offshore bank) rather than by service provided. Similar qualifications sometimes appear in the schedules of other countries, in order to span the gap between the UN Central Product Classification and the way in which financial services are regulated in practice.

In contrast to Cambodia, Brunei makes no commitments for mode 1 trade, and for commercial presence, it only commits the acceptance of deposits, subject to approval of the Monetary Authority of Brunei Darussalam and existing laws.

Given this variation in commitments across countries, it is more meaningful to compare the commitments with actual practice, rather than look for patterns in the commitments themselves.

### ***Comparison with actual practice***

For some countries, the commitments lag actual practice by a significant margin. In Brunei, there are apparently no regulatory restrictions on foreign bank entry, and foreign-invested banks can lend as well as take deposits. However, since the Ministry of Finance issued a clarification on lending in 2009, foreign banks can only lend against local capital, not parent capital. Cross-border fund raising and lending is also allowed in Brunei, subject only to prudential restrictions. In Indonesia, foreign ownership in banking is allowed up to 99 per cent, although its trade commitments only allow foreign investment in existing banks up to 51 per cent.

Other countries appear to have made preferential concessions in their trade commitments, relative to actual practice. Lao PDR and Malaysia will allow cross-border lending and deposit taking in their commitments (though in Malaysia's case, subject to additional provisos), whereas this appears to be generally not permitted in these countries. Vietnam also has made commitments on commercial presence that are more liberal than current practice, but this is because in early 2010 it imposed new regulatory requirements on establishment that arguably go beyond purely prudential measures.

While the AEC Blueprint notes that commitments in financial services should respect the level of economic and financial sector development of the individual members, the variation that exists is not entirely explicable either by level of development or by level of regulatory capacity — Lao PDR has made among the most liberal trade commitments, while Brunei has made among the least.

Looking at actual policies reveals that there are instances where barriers to trade in banking services are being retained to compensate for prudential regulation that is inadequate or poorly enforced. The lessons of the global financial crisis for the design of prudential regulation are now relatively clear, and a new set of Basel guidelines has been designed accordingly. Maintaining moratoriums or intrusive regulatory restrictions on new entry is no longer justifiable as a short-term response to the crisis. Frameworks are needed to support the development and enforcement of adequate prudential regulation, but perhaps with time-lines attached, to ensure these moratoriums and intrusive restrictions are lifted.

## **Insurance services**

### ***ASEAN commitments***

Unlike banks, insurance companies generally do not need an extensive network of retail outlets. This makes cross-border trade a viable mode of service delivery. However, most ASEAN countries have retained restrictions on mode 1 trade in at least some insurance products. For mode 3, in those instances where trade in a product is allowed, it is often subject to non-prudential regulatory restrictions instead of, or in some cases as well as, foreign equity limits. Both of these issues can be addressed using the current AFAS negotiating structure.

### ***Comparison with actual practice***

There is some evidence that for some countries, AFAS commitments are less liberal than actual practice for mode 1 trade. For example, Indonesia has made no commitments except for reinsurance services, but in practice the regulatory attitude to cross-border supply has been very flexible if domestic insurance companies are not able to provide satisfactory coverage. Similarly, Brunei has made no mode 1 commitments for life and non-life insurance, although its domestic regulations do not prohibit cross-border supply, but only prevent providers from soliciting.

There is also evidence that for some countries, AFAS commitments for mode 3 have involved the granting of preferences that have gone beyond actual most-favoured nation practice. For Thailand and Vietnam, there appear to be regulatory restrictions on opening branches that are omitted from the AFAS commitments. There is also evidence of implementation lags. For example, Lao PDR has had a de facto ban on new entry since 2008, even though this is not reflected in its AFAS commitments.

## Overall summary

Early assessments of AFAS (eg Stephenson and Nikomborirak 2002) suggested that its trade commitments were particularly weak. The above examination suggests that successive rounds of negotiations have since expanded the scope of the trade commitments significantly, in terms of numbers of sectors and subsectors covered. In some cases, they have also expanded the depth of the trade commitments, by gradually removing qualifications and limitations that were originally made.

In all of the sectors examined here, there is evidence that some commitments still lag actual practice. In some sectors, such as air transport, telecommunications and banking, these gaps are widespread. In other areas, such as accountancy, there is evidence that AFAS has instigated real reform. Table 1 provides selected examples of both phenomena in tabular form.

There are only a few isolated instances of implementation lags — where actual practice lags AFAS commitments. Yet there is a major qualification to this finding. AFAS commitments are supposed to record and liberalize trade barriers rather than domestic regulation, but the distinction between the two is often not clear-cut. Many elements of domestic regulation, while not involving explicit quotas or rights of exclusive supply, may have the same effect. In theory, these should be listed as limitations on market access (WTO 2001). In practice they may not always be. The trade schedules of some ASEAN countries provide relatively detailed accounts of the regulatory limitations that apply in some sectors. The schedules of Indonesia and the Philippines are particularly transparent in this regard. Other countries may simply record that entry is ‘subject to domestic regulation’. This begs the question of whether or not that regulation constitutes a limitation on market access.

Similarly, there may be derogations from national treatment that still apply in practice, but are not recorded in AFAS schedules. AFAS commitments have followed the GATS by excluding taxes and subsidies from their ambit. Yet as WTO (2001) makes clear, the discriminatory application of taxes or subsidies should be recorded as a limitation on national treatment. The schedule of Myanmar provides a great deal of detail about the discriminatory application of taxation to foreign-invested companies and expatriate workers. It is not always clear that the discriminatory application of subsidies has always been recorded by ASEAN countries, particularly in medical and health services.

In general, however, the above findings suggest that there is still scope for future rounds of trade negotiations to simply bind the status quo. This is not a fruitless exercise, as it guards against future policy reversion. But if AFAS is to genuinely improve economic outcomes, real reforms will need to be made. What are the sticking points that might make them difficult to deliver? And how might the AFAS negotiating process be amended to make it easier to address those sticking points? That is the purpose of the next section.

## 4 Next steps

The gains from further services trade reform in ASEAN can be substantial, with real income gains in each economy of between 1.5 and 5.6 per cent of GDP *each year*, after about ten years, or about US\$24 billion (in 2004 dollars) *each year* across the whole region (Dee 2013). These gains will only be reaped if future services trade negotiations can do more than simply bind the status quo — useful though that would be. It will require real reforms.

The above assessment of progress has tried to identify whether the gaps that remain in the services trade commitments are the result of sectoral sensitivities, features of the negotiating framework, or gaps in the broader regulatory environment. If real reforms are to be made, then steps will need to address all three types of problems.

Much useful progress can still be made using the existing AFAS negotiating structure. The 'request and offer' process has sometimes been held responsible for the lack of progress in the Doha Round of trade negotiations. But the AFAS process shows that when negotiations are held repeatedly and frequently, significant progress can still be made. Cross-cutting liberalization formulas have been used elsewhere (eg in the agricultural negotiations in the WTO) in an attempt to speed the liberalization process. The explicit targets and implementation milestones contained in the Blueprint are equivalent to a formula approach, and have similarly assisted the liberalization process under AFAS.

One key next step would be to extend the Blueprint targets for services to include the removal of all limitations on market access and national treatment on mode 3 trade, other than the 70 per cent limits on foreign direct investment. Where mode 3 commitments have been made, a non-trivial proportion of them meet this requirement anyway. The parameters for mode 3 liberalization currently allow one limitation on national treatment per subsector to remain after 2015, as well as the possibility of a rather generous 15 per cent margin of flexibility. It would be a reasonable ambition to remove these remaining qualifications.

Another key step would be to strengthen the process of policy coordination between services trade negotiators and relevant line ministries, and to ensure that it occurred on a continual basis between negotiating rounds. There is scope in some sectors for future negotiations to continue to bind the status quo. But as negotiations move substantially beyond this phase, and as the implementation process demands more real reforms, the need for coordination will be much greater than in the past, and it will need to take place before the commitments are made.

There is scope for the AFAS services trade negotiations to be significantly GATS-plus, not just in commitments, but also in the negotiating framework. These extensions could significantly broaden and deepen the services trade commitments being made.

The first proposal along these lines is for ASEAN countries to explore alternative formats for scheduling trade commitments. The tabular format currently being used mirrors that in the GATS. In this format it is difficult to provide large volumes of regulatory detail as limitations to services trade commitments. Accordingly, there is a tendency for countries to avoid making any commitments in sectors where their own domestic regulatory restrictions on trade are complex. Yet heavily qualified commitments are better than no commitments at all. And documenting the regulatory qualifications as part of the trade commitments would add to regulatory transparency. ASEAN could pioneer this area by exploring alternative formats for making the trade commitments.

The second proposal is for ASEAN to be GATS-plus by relaxing the exclusion of air transport services that involve the exercise of traffic rights. This would allow ASEAN to bind their existing degrees of openness to foreign commercial presence in domestic, international and ground-based services. Negotiating further access in these areas under a well-specified set of milestones could provide further surety to foreign investors and encourage further private investments in infrastructure. In

this way, the services negotiations could contribute substantially to the Master Plan on ASEAN Connectivity.

The third proposal is for ASEAN to be GATS-plus by developing Reference Papers for domestic regulatory frameworks in areas beyond telecommunications. A key prerequisite for competition, including foreign competition, in many network industries is the separation of bottleneck facilities, and the guarantee of access by all competitors to those facilities on non-discriminatory and reasonable terms. This is what the WTO Reference Paper on Telecommunications contains. Some ASEAN members have already taken first steps in other areas. For example, Cambodia and Indonesia have begun the process of vertical separation in rail transport. In Cambodia's case, this has involved the government granting a 30 year concession to Toll Holdings of Australia to operate the railway. Indonesia has gone further, legislating for full vertical separation. Similarly, Indonesia has begun the process of separating the operational and regulatory functions of the incumbent port operator, a critical prior step to developing an access regime for existing port infrastructure.

ASEAN could develop similar reference papers for air transport, covering access to airport facilities and landing slots, for maritime services, governing ship access to port facilities and port operator access to port infrastructure and/or port superstructure, for rail transport, covering operator access to rail track infrastructure, and for energy, governing access to electricity and gas transmission infrastructure. This would also contribute significantly to connectivity and energy security. Commitment to these reference papers could be on an ASEAN-X basis, but in the meantime, those economies having already moved in this direction could provide regulatory guidance and capacity-building to the others.

A fourth proposal is for ASEAN to be GATS-plus by building 'necessity tests' into its Mutual Recognition Agreements in the professions. As noted above, there is scope for ASEAN countries to remove the purely discriminatory elements of their domestic regulatory regimes for professional services such as accounting and the medical professions, using the existing AFAS negotiating structure. But there is also scope for ASEAN countries to ensure that their non-discriminatory regimes are no more burdensome than necessary. One element of this is to review the licensing conditions for entry into the profession, and to ensure the 'equivalence' of entry conditions for individual domestic and foreign professionals. The latter task falls within the scope of Mutual Recognition Agreements.

At the moment, the framework Mutual Recognition Agreements that exist for medical practitioners, dental practitioners, and nurses say that foreign professionals can apply for registration in the host country subject to a number of conditions, including 'being in compliance with any other requirements as may be imposed by the professional body or other relevant authorities in the host country'. Thus whether the Mutual Recognition Agreements have any real impact in liberalizing trade in professional services depends on whether any disciplines are imposed on those 'other requirements'. As argued in Dee (2009), the most trade-liberalizing outcome would be for each economy to ensure that its 'other requirements' were consistent with *minimum acceptable standards*, and thus were not unduly inflated to restrain trade. ASEAN economies could jointly commit to review their 'other requirements' to ensure that they were the minimum acceptable for their own country, on the understanding that these minimum standards did not have to be the same

for each country. That is, Cambodia would not need to have the same standards as Singapore, but both would apply their own *minimum* standards on a non-discriminatory basis.

There are some services sectors that will remain highly sensitive, whatever amendments or extensions are made to the AFAS negotiating framework. These sensitive areas include cabotage restrictions in air and maritime transport. Here work needs to be done in each ASEAN economy to publicize widely what is at stake in the liberalization process. Incumbents will incur adjustment costs, but these are likely to be manageable with healthy underlying rates of economic growth. The gains from reform are considerable. They accrue almost entirely from reforms at home, not reforms in other ASEAN members. The overall boost to economic activity can benefit many sectors, and generate higher real wages for both skilled and unskilled labour. There is no compelling reason for liberalization to be reciprocal. And there are strong reasons to ensure that it is not purely preferential. Evidence for these propositions is available in Dee (2013). ASEAN economies could commit to commissioning *domestic* studies of the *domestic* benefits and costs of reform in these sensitive areas, and to making these studies publicly available.



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**Table 1: Comparing AFAS commitments with actual practice — selective examples**

<i>Commitment</i>	<i>Actual practice more liberal than commitments</i>	<i>Actual most-favoured nation treatment less liberal than commitments</i>
<p><i>Indonesia – air transport – mode 3</i> Up to 49% foreign equity for computer reservation system, repair and maintenance, selling and marketing, rental without crew, air freight forwarding. No commitments for anything else.</p>	<p>49% foreign equity limit in all air transport services, including international and domestic passenger and freight transport</p>	
<p><i>Malaysia – air transport – mode 3</i> No commitments for repair and maintenance, rental without crew. No limits for computer reservation systems, selling and marketing. No commitments except as in horizontal section for rental with crew. No commitments for anything else.</p>	<p>Maximum % foreign ownership limits: 45% for Malaysia Airlines, but the maximum holding by any single foreign entity is limited to 20%. 30% for other airlines. Malaysia's limit was revised from 30% to 45% in 2000. The Government has recently given permission for the foreign shareholdings limit in Malaysia Airlines to be increased from 30% to 45%, easing the way for a foreign carrier to take a strategic stake in the company.</p>	
<p><i>Myanmar – air transport – mode 3</i> For selling and marketing, repair and maintenance, rental with or without crew, computer reservation systems, aircraft catering: 100% FDI or joint venture with minimum 35% FDI permitted. No limits other than horizontal for air freight forwarding. No commitments for anything else.</p>		<p>No private entry in provision of fuel or computer reservation systems. No foreign entry in these and luggage handling. 49% FDI in everything else, except ownership of aircraft repair and selling and marketing determined case by case.</p>
<p><i>Brunei – maritime – mode 3</i> Foreign equity limit of 40% in passenger and freight transport, except energy goods. No commitments for energy goods. Limit of 49% in maritime agency services, cargo handling, storage and warehousing, freight forwarding.</p>	<p>100% foreign ownership allowed in everything except port superstructure</p>	<p>Non-discriminatory limitations on mode 3 entry into port superstructure, storage and warehousing, pilotage and towing. There are no restrictions on storage and warehousing mentioned in the AFAS schedule.</p>
<p><i>Cambodia – maritime – mode 3</i> Foreign equity limit of 49% in international freight and passenger transport and storage and warehousing. No commitments for cabotage.</p>	<p>100% foreign ownership allowed in everything except port superstructure and pilotage</p>	
<p><i>Philippines – maritime – mode 3</i> No limits for international freight and passenger transport (except cabotage and government owned cargoes), maintenance and repair, container yard depot services, agency services, cargo handling, storage and warehousing. Bareboat charter or lease contract subject to approval by MARINA. Up to 40% foreign equity allowed in pushing and towing, port and waterway, other supporting services (other than container yard depot services, agency services, classification societies), domestic freight forwarding. 40% foreign equity allowed in classification societies, but otherwise unbound. Up to 100% foreign equity allowed in international freight forwarding if minimum capital requirements met, otherwise 40%. Secondary permits etc need to be obtained for all freight forwarding. No commitments for pilotage and berthing, vessel salvage. No commitments for inland waterways.</p>		<p>Non-discriminatory restrictions on mode 3 access to port superstructure (one port one operator policy in some ports) and cargo handling (one port one cargo handling operator).</p>
<p><i>Indonesia – telecommunications – mode 3</i> Voice telephone, packet-switched data, circuit-switched data - JV with 49% equity. Telex, telegraph, fax - 51%. Private leased circuits - 49%. Email - 5 new</p>	<p>Foreign equity in mobile and internet up to 65%. Foreign equity in data up to 95%.</p>	

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foreign providers, 51%. Voicemail - 5 new companies. Online info retrieval - 51%. Electronic data interchange - 49%. Enhanced AV fax services - 51%. Code and protocol conversion, online info/data processing - 49%. Local teleconferencing - provided exclusively by PT Telkom and 5 regional JVs with 49%. Long distance and international teleconferencing - 49%. Regional and national paging services - 51%. Internet access - 49%. Computer timesharing, video text services, file transfer services, home metering alarm, entertainment services, management information services - 5 new companies.

*Singapore – telecommunications – mode 3*

Public switched services (including voice, data and fax, local and international), leased circuit services, mobile services (data, voice, paging, radio) - cumulative total of 73.99% foreign shareholding, with 49% direct. Resale basis for the above - no limitations. Value added services (storage and retrieval, storage and forwarding, email, voice mail, on-line info and database retrieval, electronic data interchange, on-line info and data processing) - subject to license from IDA, where required to set up local branch and must not provide basic telecom services.

100% foreign equity allowed.

*Thailand – telecommunications – mode 3*

Public local, long distance and international services - voice, mobile, telegraph, telex, fax, paging - number of licenses limited, requires head office and management in Thailand, max 25% foreign capital. Data base access services - 25%, must use networks operated by licensed suppliers. Email, voice mail, on-line info and database retrieval, online info and data processing - same as for basic services. Telecom terminal equipment leasing services - no limits. Domestic VSAT - 40% for capital and number of shareholders, build-transfer-operate concept, must use public telecom network. Telecom equipment, consulting - no limitations. Dedicated network services - same as for basic telecom services. Videotext, teleconference, domestic leased circuits - 40% equity and number of shareholders, build-transfer-operate concept, must use public telecom network, based on open tender.

Facility-based licensees must be Thai companies: over 50% of the shares owned by Thai. No restrictions for type-1 licensees (covers resale) - can be 100% foreign owned.

*Cambodia –medical services – mode 3*

Specialized medical and dental services allowed through joint venture. For private hospitals, at least one director for technical matters must be Cambodian.

Medical, dental, paramedical services - can have 100% foreign ownership. Medical laboratory, ambulance services, can have 100% foreign ownership.

*Lao PDR –healthcare – mode 3*

For medical and dental (both general and specialized), modern private hospitals with more than 100 beds, foreign equity up to 49% and in accordance with domestic regulations. No commitments for other hospitals, paramedical, ambulance, medical laboratory services.

100% foreign ownership of hospitals, medical labs and ambulance services allowed.

*Singapore – healthcare – mode 3*

No limits on medical professional services other than number of new foreign doctors registered each year depends on overall supply. No limits on dental, residential other than hospital. No commitments for paramedical, hospital, ambulance, laboratory other than foreign ownership up to 49%.

100% foreign ownership allowed throughout.

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*Brunei – accounting services – mode 3*

Sole proprietorship or partnership only, maximum of 20 partners, principle or only place of residency is Brunei. No commitment other than for auditors.

Although there are no Statutory minimum requirements stated in the Companies Act, Cap 39, the Ministry of Finance as a condition for renewal of license for a foreigner, would require that the firm have a local partner.

*Malaysia – accounting services – mode 3*

Only through locally registered partnership with Malaysian accountants or accounting firms - aggregate foreign interests no more than 45%. Qualifying exam will be conducted in English.

Sole proprietorship/partnership for auditing services but no restriction on legal form for only accounting or tax services

12 months or less residency required. The requirement of having to stay a minimum of 285 consecutive days in Malaysia was confirmed by the registration officer in Malaysian Institute of Accountants.

*Thailand – accounting services – mode 3*

No limits.

There are 39 occupations that are restricted to foreigners. Accounting is one of the 39 prohibited occupations, according to the royal decree under the Working of Alien Act 1978. Aliens are generally allowed to join up to 49% in an accounting company but need approval from the Director-General of the Commercial Registration Department (CRD) if invest higher than that.

*Brunei –insurance services – mode 1*

No commitments for life, nonlife, broking. No limits for reinsurance, consultancy, actuarial risk assessment, risk management and maritime loss adjustment.

No limits on cross-border supply of any service, though providers not allowed to solicit.

*Indonesia –insurance services – mode 1*

Reinsurance services suppliers must be rated BBB by Standard and Poors or equivalent. No commitments for other services.

For life and non-life insurance: yes, there can be cross-border supply if domestic insurance companies are not able to provide satisfactory coverage (very flexible). Up to now, no enforcement is taken to those who purchase foreign insurance coverage.

*Vietnam –insurance services – mode 3*

No limits. From 2012, non-life branches of foreign insurance enterprises allowed.

According to Decree 46, the insurance firm could only open a branch after three years of operation given they has not committed a serious breach of the law for a period of three consecutive years up to the year of lodging the application file; and the insurer is not in breach of the regulations on solvency.

*Brunei – banking services – mode 3*

For acceptance of deposits, advisory and information services, AMBD approval required and subject to existing laws. No commitments for other services.

No restriction on foreign bank entry. 100% foreign ownership allowed. Since the Ministry of Finance has issued clarification on lending in 2009, foreign banks can only lend against local capital. Foreign banks can undertake a range of activities (eg securities) but only through subsidiaries.

*Indonesia – banking services – mode 3*

For banking activities, standstill on current ownership. JV banks allowed to establish. Can acquire existing banks up to 51%. Branch offices allowed in certain cities and all other provincial

Foreign ownership of banks allowed up to 99%

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capitals subject to economic needs test. Bound only 2 sub-branches and 2 auxiliary offices for foreign bank branch, similarly for joint venture bank. No limits on sub-branches etc for financial leasing. For securities and advisory services, allowable on a standalone basis through separate broker/underwriter/investment management company. Note that factoring services, credit card services and consumer finance services can be undertaken outside of commercial bank.

*Malaysia – banking services – mode 1*

Acceptance of deposits - soliciting not allowed.  
Lending - must be jointly with local bank of more than certain amount. Similar restrictions for other services.

Cross-border lending and fund raising not permitted.

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