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Trade in Services in the Pacific: Is it Possible to Use Data to Drive Better Policy?

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Introduction

This issue of *Trade Hot Topic* seeks to examine the available data on services trade and policies for the Pacific countries, and to formulate actionable recommendations for how the situation on the ground can be improved. Services are growing in importance all around the world as sources of economic output, employment, and trade. The four modes of supply under the General Agreement on Trade in Services (GATS) make it possible to trade most commercial services internationally in one way or another. Where trade in services remains limited in a particular sub-sector, it is typically not a result of the impossibility of trade but because trade costs remain very high. Indeed, research work suggests that trade costs in services sector may be around twice as high as in goods, and that technological changes that are widely believed to have resulted in integrated global markets for services, supplied over the internet for example, have in fact only contributed to lowering trade costs in certain sectors (Miroudot et al., 2013).

At the same time, data on trade in value added are widely interpreted as displaying an increasing trend towards servicification of economies. This means that services are frequently embodied (as inputs) into goods that are then traded, or embedded with complementary goods as in the case of apps loaded onto cell phones or tablets, in addition to being traded in the traditional standalone manner (Bamber et al., 2017; Hallward-Driemeier and Nayyar, 2018). As such, the appropriate regulatory stance for countries looking to promote their services sectors and ensure they provide both job opportunities and the potential for productive upgrading is a matter at the top of the regulatory agenda. This is all the more true in a context where services are frequently covered by trade agreements, which means that regulatory measures are in some cases the outcome of negotiations with trading partners. Assessing costs and benefits, including those that accrue across borders, is not a simple exercise, in particular for small economies constrained by the availability of financial and human resources.

Background

As will become clear, a key constraint is data availability: PIF countries are poorly represented in

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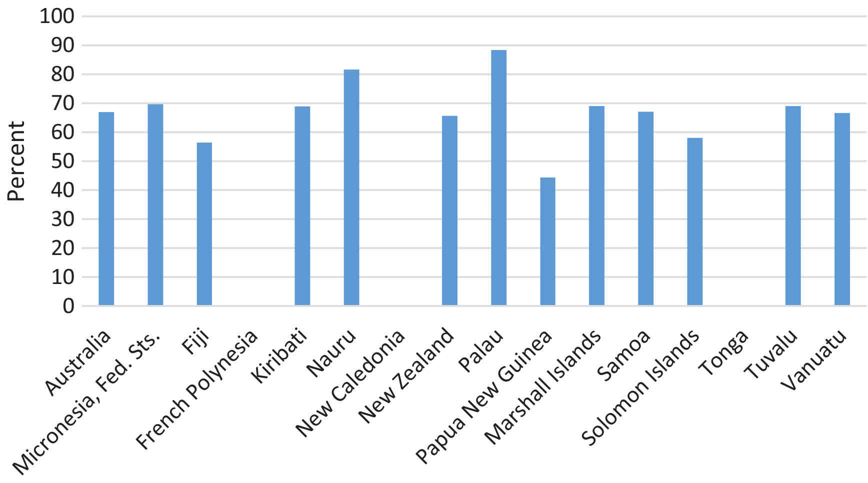
Figure 1: Services as a percentage of GDP, PIF countries, latest available year.



Source: World Development Indicators, and Asian Development Outlook. Note: Missing bars indicate that recent data was not available.

international datasets, and lack some of the basic building blocks needed for understanding and modeling services trade. We present a selection of examples of policies from PIF countries to make the point that in some cases, restrictions exist that impose costs on firms and consumers. The final section concludes with a series of recommendations, focusing on the need to collect data both on services trade flows, and on applied policies.

Services tend to be important for small economies, including the members of the Pacific Islands Forum (PIF). Figure 1 shows that in the PIF countries for which recent data are available, services account for an average of 67% of all economic activity in each case, and over 80% in the case of Nauru and Palau. These figures compare with a low and middle income group average of 54%. As economies with limited domestic markets and stocks of labor, geographically remote from large consumer markets, manufacturing suffers from natural disadvantages in these economies. Services is potentially more appealing, as with appropriate policy settings, it is possible to use information and communication technologies (ICTs) to overcome some of the disadvantages associated with remoteness; this is the corollary of the finding by Borchert et al. (2012) that part of the economic costs associated with being landlocked in fact accrue from illiberal policy settings in key services sectors that could help boost international connectivity.

A similar picture emerges when we move to trade (Figure 2). While numbers vary considerably across the region, we see that services trade is highly significant relative to GDP in all countries, although in some cases it is arguably lower than would be expected given the size of the domestic economy.[1] The average across the PIF countries is 26%, compared with a low and middle income group average of 8%. From a trade policy perspective, services are therefore a vital part of PIF countries' engagement with the world economy, and offer a potential path to diversification away from natural resource based exports, in a context where conditions are not propitious for developing manufacturing.

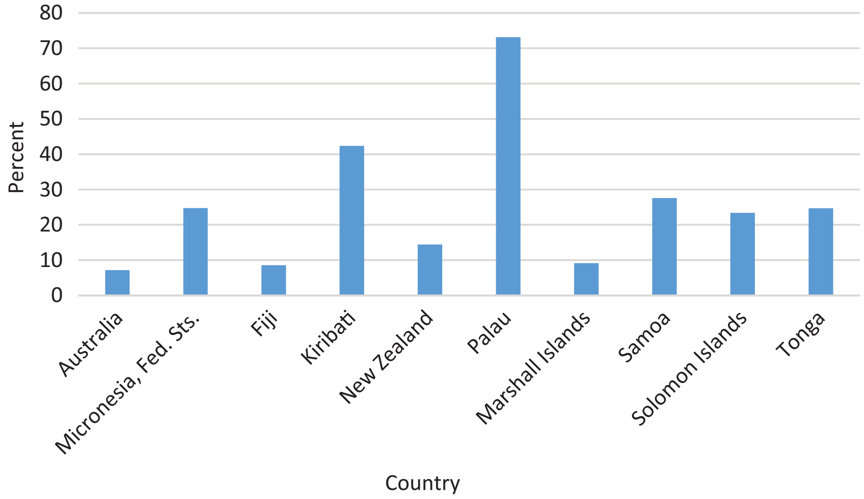
Against this background, it is important to have a clear sense of the regulatory measures and policies within PIF countries that affect the ability of domestic firms—either producers or users of services—to access world markets. Regulations frame the competitive decisions of firms to a greater extent in services than in goods, so there is huge scope for pro-competitive regulations to help support a buoyant services economy that can succeed in world market. On the other hand, illiberal policies, particularly in "connectivity sectors" like ICTs, shipping, air transport, and logistics, can impose economy wide costs that undermine competitiveness and international engagement.

What Do the Data Say about Services Trade in the Pacific?

As discussed above, Figures 1 and 2 show important information on the importance of the services sector in general, and services trade in particular,

1 The data utilized are services trade relative to GDP because it combines BOPs and national accounts, whereas total trade brings in merchandise (typically customs data) and the comparison gets distorted.

Figure 2: Services trade relative to GDP, PIF countries, latest available year.



Source: World Development Indicators. Note: Recent data on other PIF countries not available.

in selected PIF countries. But the most important piece of information for current purposes is the number of countries that are not represented at all: Figure 1 implies that the World Development Indicators and Asian Development Outlook, the two major sources for the region, for 3 countries; the main global source, the WDIs, do not have reported data for 13 countries from Figure 1, while Figure 2 similarly lacks data on eight countries. The importance of not being in this database is that it suggests that the national accounts and balance of payments statistics are either not kept in accordance with international standards, or that they are not reported to the relevant international organizations. In either case, the results are serious: no researcher or policy advisor can provide cogent advice on the services sector in the absence of basic information on its size and degree of international integration.

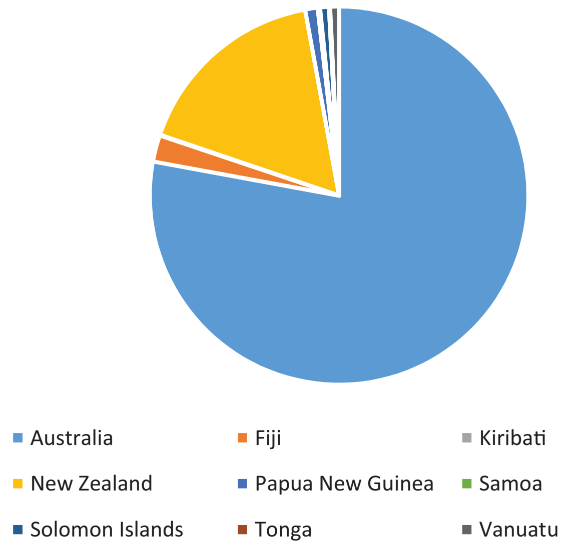
The situation is even more serious in other areas that are likely of particular interest to researchers and policy advisors in the region. According to UN Comtrade, the standard international source, trade in services data are only available for Australia, New Zealand, and the Solomon Islands among PIF countries. And of those, only Australia provides a breakdown by partner country.[2] As a result, it is essentially impossible to run an empirical model to analyze the services trade of PIF countries, as the data either do not exist at all, or are not reported to international sources. This lack of data greatly constrains the ability of local researchers to provide policymakers and civil society with the information needed to make informed decisions not only on trade agreements that cover services, but also on more general regulatory measures that have trade effects.

An experimental OECD-WTO dataset on trade in services (a bilateral trade in services database known as BATIS) attempts to fill in the many holes in the bilateral trade matrix using statistical techniques, ranging from mirror data (use of reported import flows to proxy missing exports) to interpolation and extrapolation, to gravity model estimates. This database contains information on nine PIF countries, but it is important to stress that in the absence of directly reported data in Comtrade, it is essentially statistical estimates. Despite the best efforts of the statisticians, it is impossible to know how closely these data correspond to reality on the ground.

Nonetheless, we can use BATIS to provide some descriptive information. First, Figure 3 shows the regional breakdown of services exports. Unsurprisingly, it is dominated by Australia and New Zealand, although Fiji is also visible. To see the situation of the developing PIF countries better, Figure 4 eliminates Australia and New Zealand. It is now clear that among this sub-group, the dominant exporters are Fiji, Papua New Guinea, the Solomon Islands, and Vanuatu. We focus here on total services trade, but the sectoral breakdown would likely be quite different in each case.[3] The crucial point is that services exports are significant in the regional economy, and in some countries in

2 Note that we are not cataloguing individual country sources, but standardized international databases, like Comtrade.
3 Whilst it is possible to give a sectoral breakdown, such an approach relies more and more on estimated data, and so becomes more and more hypothetical. It has not therefore been pursued in this stage of analysis.

Figure 3: Breakdown of services exports, PIF countries, 2012 (latest available year).

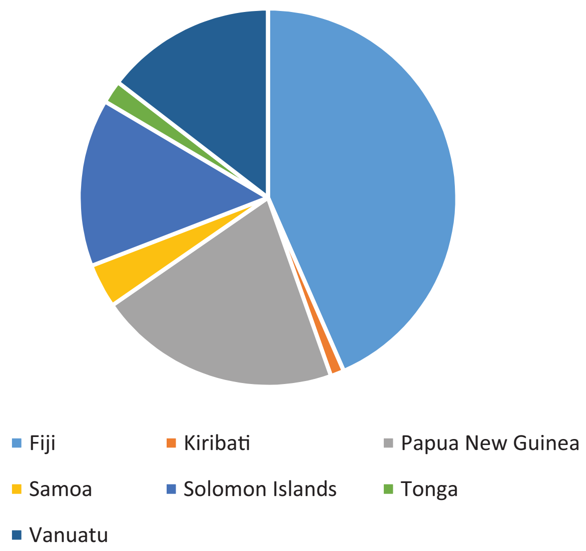


Source: OECD-WTO BATIS.

particular. Nonetheless, the point remains that in the absence of bilateral trade in services data, it is impossible to conduct any detailed modeling of trade flows, whether for analysis or forecasting. So services negotiators from the PIF countries are operating largely in the dark as to the economic consequences of trade agreements that cover services.

A subject that has received considerable attention recently is the rise of Global Value Chains (GVCs) in services sectors. Functions like customer service and back office operations are increasingly being offshored to locations with relatively educated populations with an international language, to take account of differences in prevailing wage rates across countries. International data sources to track value chain activity include the OECD-WTO Trade in Value Added (TiVA) database, and the World Bank's Export Value Added Database (EVAD). TiVA only covers Australia and New Zealand among PIF countries. Although country coverage is much broader in EVAD, it still only includes Australia and New Zealand. The only remaining source is Eora, which has been used in previous Commonwealth Secretariat work. While it is clearly desirable to use these data to the extent possible, it is important to stress that they have not been subjected to the degree of review as for, say, TiVA. There are widely acknowledged problems with the Eora data, in particular at a disaggregated level.[4] As a result, it is difficult for researchers or policymakers in PIF countries to know where they stand in relation to services GVCs in the region, other than through anecdotal evidence.

Figure 4: Breakdown of services exports, PIF countries excluding Australia and New Zealand, 2012 (latest available year).



Source: OECD-WTO BATIS.

A final area where data are crucial is policies. Unlike in goods markets, where data can easily be quantified using average tariffs, services measures are typically regulations that need to be analyzed and quantified using a multi-stage approach. The key methodological approach in this regard is the services trade restrictiveness index (STRI). The OECD and the World Bank both produce STRIs at the sectoral level, but as yet there is no coverage of PIF countries other than Australia and New Zealand. Again, Pacific countries are totally in the dark as to how their applied services policies compare with what is seen elsewhere in the world, and how those policies might be impacting performance and international integration.

Policymaking with Limited Information

Against this background, this section aims to present selected examples of services policies from Pacific countries, to give an indication of the types of measures, and economic effects, that could be studied in greater detail with better data.

Services Regulation in the Pacific

In the regional context, the Pacific countries do not have an overarching consolidated services policy,

4 http://worldmrio.com/comparison/ shows details of how Eora data compare with other sources. There are clear divergences in important metrics, like trade data, in particular for smaller and poorer countries. These problems are magnified at the sectoral level.

however, members of the Pacific Island Forum Secretariat had endorsed the Pacific Plan[5] which includes Trade in Services as an important priority under its economic growth pillar. In addition, some countries in the Pacific have signed onto the Pacific Island Countries Trade Agreement (PICTA) containing the Trade in Services Chapter and have made commitments for the liberalization of services sector under a positive list approach. A similar approach has also been adopted by members in the Pacific Agreement on Closer Economic Relations (PACER Plus) for services. The sectors committed for liberalization are different for each Pacific country based on their level of development. However, the implementation of the PICTA and PACER Plus agreements has not reached fruition.

In the multilateral context, some of the small island states in the Pacific region have also undertaken commitments in selected services sector in the context of obligations under the WTO[6]. Furthermore, at the national level, some of the countries have respective Trade Policy Frameworks but do not have specific national services policies. Given the cross cutting nature of services sector, the services policies are fragmented or have a selective sectoral focus. The portfolio of services regulation at the domestic level are with different ministries within the Government that undertakes the respective regulatory oversight.

Case 1: Telecommunications in Fiji

The Telecommunications sector of Fiji was deregulated in 2008 and was opened to competition. This was made possible through the adoption of the 2008 Telecommunications Promulgations and the successful conclusion of the Deed of Settlement of the Radison Accord. The deregulation in the sector ended the long standing exclusive rights which the three major telecom operators owned with different levels of State ownership. The Telecommunications Promulgation of 2008 established an independent regulator, the Telecommunications Authority of Fiji (TAF). The TAF is responsible for issuing licenses for technical standards, allocating radio spectrum and frequencies, providing telecom policy advice and issuing permits for the import of telecommunications equipment.

As a result of these changes the structure of the Telecommunications market in Fiji has evolved. There are three major players in the Fiji Telecom market since deregulation. These include Vodafone Fiji, Digicel and Telecom Fiji. The total market penetration rate in the telecommunications sector for Fiji has showed an increasing trend with 120.80% growth in 2017[7]. The majority of market penetration was a result of the prepaid services (119.8%) while the remainder was from contract services.

With the deregulation of the sector and increased market penetration rate, the prices of mobile and internet services have decreased substantially in Fiji. The country is now among the most affordable in the Pacific Island Countries with cheapest deals for low-level mobile and data usage.[8]

The deregulation of the Fijian Telecommunications sector also had an effect on the delivery of logistical services thus reducing the cost of doing business. This is evident from the improvement in the LPI rank of Fiji from 136 in 2016 to 133 in 2018, although admittedly a small change in the context of the year on year movements typically seen in that index.[9] The improved telecommunication services in Fiji as a result of deregulation would also have a multiplier effect on other sectors in the economy for example Tourism, Retail and the Financial Sector. Over the years the Tourism sector in particular in Fiji has experienced exponential growth. One of the factors leading to such efficiency would be the competition in the telecom sector and the low rates which the tourism sector benefitted from. Furthermore, the exporters in Fiji have access to low cost telecommunication and internet broadband. As a result, these exporters have also experienced efficient delivery of services with low cost internet penetration. An interesting observation therefore is that for small island economies in relation to the telecommunication market, a small number of players, can provide competitive pressure and efficiency in the small economies.

Case 2: Shipping in Micronesia

The countries of the North Pacific comprising of the Republic of Marshall Islands, Federated States of Micronesia and the Republic of Palau have formed the Micronesian Shipping Commission

5 Note: The Pacific Plan was adopted through the Auckland Declaration in 2004 whereby leaders of the Pacific recognized the need to strengthen regional cooperation amid the challenges faced by the Pacific.
6 These applies to Pacific WTO member countries including Fiji, Samoa, Tonga, Papua New Guinea, Solomon Islands and Vanuatu.
7 Data extracted from https://www.gsmaintelligence.com/
8 For further analyses, see Katafano, R. (2017) A Sustainable Future for Small States: Pacific 2050, Commonwealth Secretariat: London.
9 Source: https://lpi.worldbank.org.

(MSC). The aim of such an arrangement has been to facilitate shipping services within the region ensuring reliable service delivery. The Shipping Services under this arrangement are heavily regulated. The MSC provides shipping license in exchange for a fee to the providers of the services. The licenses are issued for a period of 5 years subject to annual reviews. The heavy regulation of the Shipping Sector therefore manages competition and thus results in high cost of sea freight affecting market access. (RMI Trade Policy, 2012, 140). The MSC allows only a few players in the shipping sector for international maritime in the small island states. As such the cost of sea freight for an estimated 40 foot container from Majuro, Marshall Islands to Valdez, United States is around $8,300 USD. A similar shipment from China to Valdez, United States is estimated around USD$3,600[10]. The increased cost of shipping services with the heavy regulation imposed by the MSC therefore affects the competitiveness of the small and medium enterprises of these small island states.

These countries have a limited export base and with increased shipping costs through heavy regulatory policies, the private sector is affected through the increased cost of doing business. The high shipping cost in the Republic of Marshall Islands as a result has hampered the development of the export sector including the private sector as a whole.[11] The country heavily depends on foreign aid from the United States in the form of budgetary support to sustain its balance of payments.[12] Despite the Republic of Marshall Islands having access to duty free and quota free market access for most of the products into the United States, production for exports in the domestic market is minimal as the high shipping cost and low productive base are impediments. The heavily regulated sector therefore impacts other sectors as well.

Furthermore, the shipping costs adds to the import costs for the private sector and as such the prices of goods and services in the Republic of Marshall Islands are also high.[13] This further results in domestic inflation and thus affecting the low income population that access low value nutritional food as the cost of high quality imported products such as fruits and vegetables are high. Given the climatic and soil conditions in the Republic of Marshall Islands, arable farming land is limited. As such imported fruits and vegetables are required to meet the domestic demand and nutrition of the people. The high cost of shipping burdens the consumers through increased prices of these imported products.

Conclusion: Way Forward

The previous section has shown that an appropriate regulatory stance has great capacity to affect market conditions in a positive way in the Pacific Islands. Whereas liberalization of the telecom sector has led to lower prices, higher quality, and increased service availability, a relatively illiberal approach to shipping has kept prices high and limited the ability of local firms to compete in world markets. For economies that are relatively isolated from large, developed markets—even Australia is some hours of flying time away—the issue of regulating "connectivity services" is a major one, as these two examples show. All other parts of the economy, from agriculture to manufacturing, rely on embodied services inputs like telecom and transport services to move their output to markets. Development of the export sector in goods therefore requires an appropriate regulatory stance in services, to ensure that high cost, low quality services do not inhibit the ability of domestic firms to compete in global markets, to say nothing of the corresponding effects on consumers.

While anecdotal evidence like the two cases discussed above is persuasive in a policy sense, it can never substitute for detailed, representative analysis using hard data. The international community has developed numerous tools that can be of use, from bilateral trade in services data, to trade in value added, to STRIs. But the Pacific Islands are not included in most of these efforts. As a result, local analysts and policy advisors have little to work with when asked to, for instance, evaluate the effects of a proposed trade agreement, or chart a course for regulatory reform that will both safeguard access and promote lower prices and higher quality to the benefit of downstream sectors.

A recent Commonwealth pilot project on Rwanda and Kenya shows that at least part of this data constraint can be loosened through targeted technical assistance. With support from the UK Foreign and Commonwealth Office, the Commonwealth produced an STRI for selected sectors in the two

10 Source: Authors own calculation from http://worldfreightrates.com/freight
11 Trade Policy Framework for Republic of Marshall Islands, 2012.
12 Trade Policy Framework for Republic of Marshall Islands, 2012.
13 Trade Policy Framework, Republic of Marshall Islands, 2012.

countries that is fully compatible with the OECD's approach, thereby allowing for the first time for rigorous international comparisons. The report was validated by the two governments, so there can be a high degree of confidence that it accurately and fairly reflects the policy reality on the ground. With donor support, there is clear scope to replicate this work in the Pacific, as well as in other Commonwealth regions where services are important but data availability poses a major constraint.

Moving forward on the systematic collection of policy data can help governments design regulatory reform programs that prioritize the sectors that are most important for the domestic economy. Doing it across countries means that policymakers can learn from each other's experiences, which facilitates regional cooperation. There is increasing recognition around the Commonwealth, including in the Pacific, that services are important for trade and development. So working together to loosen the data constraint has major benefits for all concerned: policymakers in the countries themselves, but also producers and consumers there, and development partners engaged in trade agreements or talks with them. The resource requirements are minimal in the scope of overall technical assistance budgets, so given the importance of the sector, there is a strong case for prioritizing these kinds of interventions.

Data collation for Pacific countries is additionally critical given that some WTO members are exploring new issues in relation to disciplines on e-commerce and domestic regulations. Without sufficient empirical data on Pacific services sectors, policymakers would not be able to effectively engage in these evolving issues. Secondly, the Commonwealth Connectivity Agenda agreed by Heads of State in April, 2018 prioritizes Physical, Regulatory, Digital, Business to Business, and Supply Chain connectivity. In all the prioritized areas, empirical policy advice is required on the role of services in promoting connectivity. For the Pacific small island states, data on trade in services, as well as information on applied services policies, are thus integral in this regard as well.

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International Trade Policy Section at the Commonwealth Secretariat

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14 November 2018: Commonwealth African Trade Negotiators Network Meeting held in Mahe, Seychelles.

30–31 October 2018: Commonwealth Consultation on Multilateral, Regional and Emerging Trade Issues for the Caribbean held in Georgetown, Guyana in collaboration with the CARICOM Secretariat.

4 October 2018: Sustainable Technology-enabled Trade and a More Inclusive Trading System – Small State, ACP States, LDC and SSA perspective (WTO Public Forum) held in Geneva, Switzerland, in collaboration with ACP Geneva office and DiploFoundation.

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24 May 2018: Presentation of the Commonwealth Trade Review held in Geneva, Switzerland.

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