Trade Regulations: Implications for the Financing of Trade in Services

G-NEXID Workshop

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Overview of Presentation

- Services, Development and Trade
- Trade in Financial Services
- Trade Finance as a Sub-sector of FS
- UNCTAD Products relating to Services Trade
- Conclusions

Services are Enablers of Development

- Services, including infrastructure services (ISS - transport, energy, financial services, telecom and ICT) play a key role
  - Contribute to output, employment and trade
  - Fundamental inputs to all economic activities, both goods and services
  - Essential to efficient functioning of productive capabilities and a determinant of competitiveness
- Knowledge, technology and innovation services promote diversification, structural transformation and sustained growth and development
- Technology and global value chains (GVC) increase tradability of services and their potential for export diversification and upgrading
- Devising policy, regulatory and institutional frameworks is important to harness benefits of services, but it remains a critical challenge

Services and SDGs

- The achievement of proposed goals and targets relies on universal access to basic & essential services
  - Health (Goal 3), Education (Goad 4) and Water and sanitation (Goal 6), also
  - Ending poverty (Goal 1), Gender equality (Goal 5), Climate change (Goal 13);
  - E.g., Lack of access to FS represents a major impediment for income opportunities of individuals (the poor, women and youth) and for firms (SMEs and micro-enterprises)
  - SDGs of cross-cutting nature presume efficient, environmentally sustainable and equitable functioning of the services sector (e.g., Sustainable tourism, sustainable consumption and production)
- Infrastructure services (ISS) are essential for infrastructure development, industrialization and innovation (Goal 9)
  - Energy (Goal 7) and Transport (Goal 11); the role of ICT in Goal 4 on Education;
  - Access to FS (Goal 1), Hunger and food security (Goal 2);
  - Knowledge, technology and innovation services essential for Goals 1, 2, 5, 8, 9
- Trade in services is expected to play a major role under goal 17 as a "means of implementation"

Services and Exports

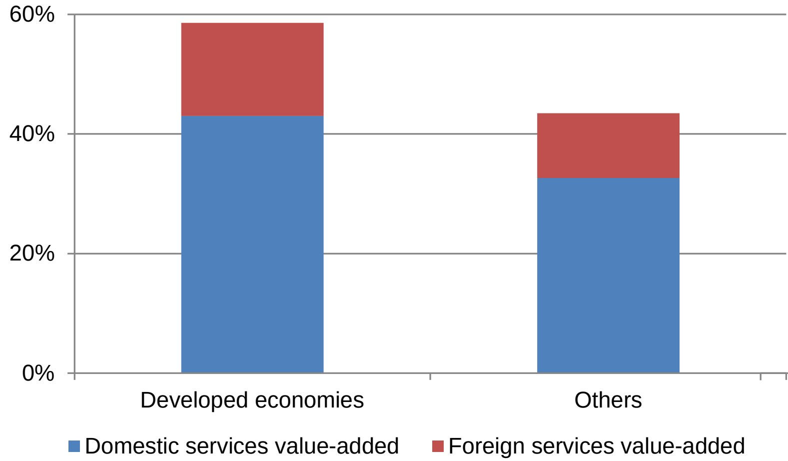
- The importance of services in exports differs between countries:
  - Services in total exports is 25% in developed and 15% in DCs
  - DCs have expanded faster from 2000 to 2013 and their share in world services exports increased from 23% to 30%;
- Different trends according to the mode of supply:
  - Commercial presence through FDI is the major mode of supply
  - FDI in services grew tenfold within 20 years to reach almost $1000 billion in 2010-2012. FDI in services grew faster than primary and manufacturing sectors
  - FDI to financial services amounted to $452 billion in 2010-2012 (16 fold increase since 1990-1992), mainly attributed to developing and transition economies
  - Services exports through the temporary movement of natural persons (Mode 4) is substantial for DCs (based on the growth of migrants and remittances). In 2013, 232 million migrants sent home $542 billion, 80% to developing countries

Services and Exports

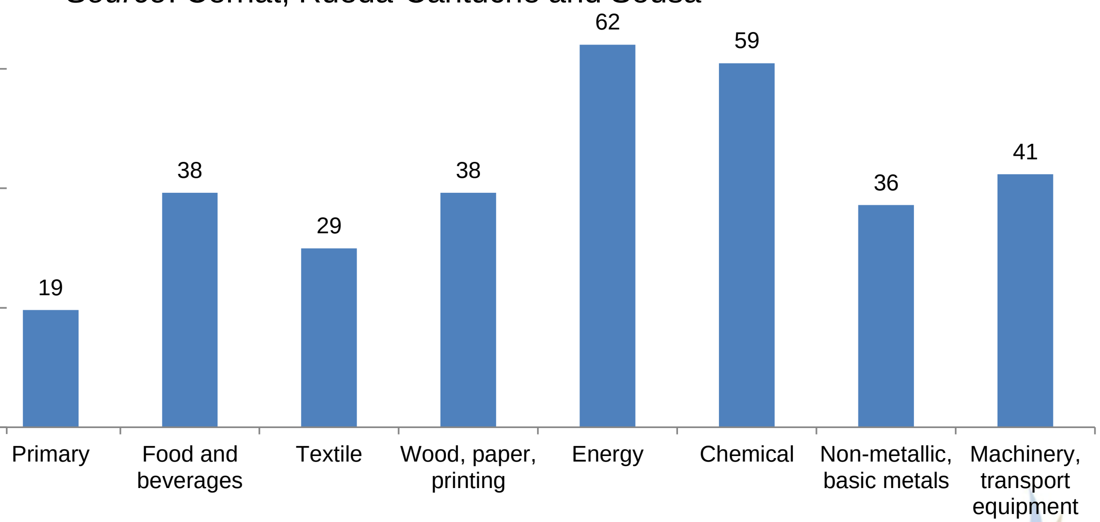
The importance of services in exports is underestimated

- Cross-border services trade data does not capture the significant value-added of services embedded in goods exports:
  - In 2011, services accounted for 59% of gross exports in developed economies and 43% in others, much above their shares of services exports in total exports (see left panel);
  - The value of services embedded in goods tends to be higher in sectors such as energy, chemicals, machinery and transport equipment (see right panel).

Domestic and foreign services value added share of gross exports, 2011 (%)
Source: UNCTAD, based on OECD



Value added of services embedded in exports by sector (%)
Source: Cernat, Rueda-Cantuche and Sousa



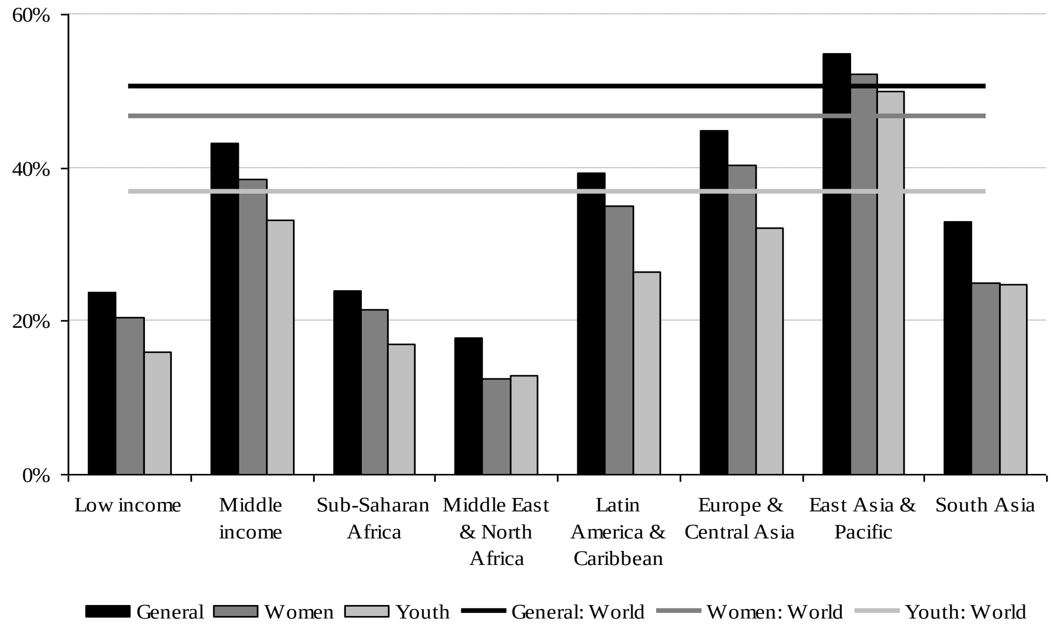
Trends in Financial services

FS can mobilize resources for the real economy

- International transactions become an essential component:
  - Cross-border exports of financial services reached $445 billion in 2013. 80% was accounted by developed countries but the share of developing countries rose;
- Large variation in financial inclusion by income, region, gender, age:
  - In 2011, only 50% of people over 15 years old had a formal bank account;
  - % of adults with bank account in developed countries is more than twice of that in developing countries.

Proportion of people with a formal bank account by income and region, 2011 (%)

Source: UNCTAD computation based on World Bank's Global Findex



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Policy and regulatory trends in Financial Services

Financial stability and financial inclusion

- Regulatory focus on macro-prudential objectives:
  - Recurrent regulatory failures had strong impact on growth, jobs and welfare and it is central to reduce the probability / severity of future financial crisis;
  - Basel III aims to strengthening bank capital, liquidity and other standards;
  - National efforts aim to bring these requirements into national/regional regulations
- Universal access and financial inclusion strategies:
  - New technology (e.g. mobile money), innovative business models (e.g. development banks, correspondent banking for the combined use of bank, telecom, postal and agent networks)
  - Direct measures (e.g. subsidies and mandatory requirements, including universal services obligations), and demand side measures (e.g. increased Gov. use, availability of information, financial literacy, consumer empowerment)
- Increased attention to the regulation of foreign banks:
  - Regulate subsidiaries, rather than branches, not to accept home-country rules

Services under Trade Agreements

- Progressive services liberalization has been pursued at the multilateral level under the Doha Round of the WTO

- Plurilateral negotiations of the Trade in Services Agreement (TISA):
  - Negotiations are under way among 24 members (70% of global services trade)
  - TISA is said to aim for comprehensiveness, subsequent multilateralization, and capturing existing autonomous and preferential liberalization

- Services become a major feature of 21st century RTAs:
  - These RTAs are oriented for deeper and comprehensive integration, with a strong regulatory focus that addresses behind-the-border services measures;
  - 2 mega-regional (Trans-Pacific Partnership Agreement - TPP, and Transatlantic Trade and Investment Partnership - TTIP) place a strong emphasis on regulatory coherence

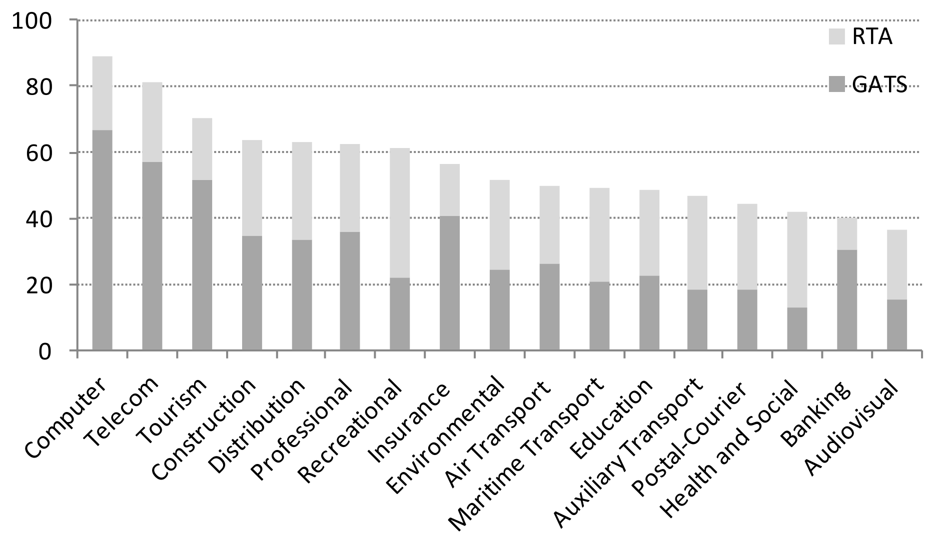
Trade policy and regulatory reform

GATS and RTA commitments vary across sectors and modes:

- Financial services have a relatively high level of GATS commitments but see the least improvements in RTAs (particularly in banking);
- Developing countries have been cautious in banking commitments through mode 1, reflecting the concern that is harder to regulate banks that are not established through commercial presence and fear of opening the capital account as it would be required by mode 1 commitments (cross-border deposit taking and lending);

Average level of GATS and RTA commitments for all countries

Source: UNCTAD based on WTO



Commitments relating to Trade Finance

- Countries can undertake trade agreements which open the domestic financial services market, including trade finance, for foreign service suppliers
- Among the FS sub-sectors, countries can take commitments on “all types of lending” or limit the commitment to “trade finance” more specifically
- Other relevant sub-sectors could include:
  - Other auxiliary financial services, such as advice, intermediation and credit reference analysis
  - Insurance of risks relating to goods being transported
- Expected benefits from the liberalization of this sub-sector are:
  - Predictability of policies
  - Increased access to finance for imports and exports
  - Improved quality of services following the introduction of competition
  - Introduction of new trade finance instruments

Trade policy and regulatory reform

Trade policy and regulatory concerns:

- Trade liberalization efforts need to be coordinated and synchronised with adequate domestic regulation to promote financial inclusion
- Trade liberalization could have bearing on national regulatory efforts including in universal access and financial regulations
- Trade dimension of effective regulation is relevant for financial inclusion, for instance through universal access requirements, particularly when there is substantial presence of foreign banks in domestic financial markets
- The shift in regulatory focus to macro-prudential objectives could also have some bearing in financial inclusion
  - Strengthening bank capital and liquidity standards under Basel III, and isolating essential banking services in retail banking from high-risk investment banking
  - While many developing countries are yet to apply Basel II and Basel III is not mandatory, these could form best practices to follow

Trade policy and regulatory reform

Recent RTAs have moved towards deeper liberalization:

- Commitments may be based on applied levels of market access conditions, including through stand-still requirements that do not allow to decrease the conformity of the measure
- "Ratchet clause" that automatically incorporates further future liberalization measures
- National treatment may be horizontally applied to all sectors/modes
- "(Third-Party) MFN" clause aims that a RTA party obtains best possible preferential treatment available in other RTA partners
- Some of these approaches are being replicated in the plurilateral Trade in Services Agreement (TISA)
- Recent mega-RTA negotiations aimed to address the potential anti-competitive effect of state-owned enterprises (SOEs) by eliminating their possible structural advantages and establishing "competitive neutrality" between SOEs and private companies. Many countries have stressed the importance of SOEs in delivering public policy goals, including access to FS

Services Regulations & Trade Liberalization

Regulatory barriers, divergence and convergence

- Regulation may act as a de jure or de facto barrier to trade:
  - Public ownership and price controls are less trade restrictive than discriminatory measures on ownership limits, nationality and residency requirements for board members, barriers to competition, and transparency in licensing regime
  - In many sectors (e.g. Prof. services), regulation is developed by authorities or associations that may prefer domestic suppliers
- Trade barriers can stem from national regulatory systems' diversity:
  - Suppliers have the cost of adjusting to different regulatory requirements
  - Regulatory cooperation (harmonization, mutual recognition or equivalence) can address divergence if different regulations are pursuing similar objectives
  - Some RTAs seek to reduce regulatory discretion, e.g. by "necessity tests”
- Barrier effects can increase as regulation becomes more important:
  - Integration of products with value-added services and connected to each other
  - Internet and "cloud" connections involve cross-border data flows and require regulation for security, privacy, IP, consumer protection and industrial policy

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How Trade Developments are likely to Impact Trade Finance

- Need to better include the impact of trade finance shortages in the analysis of trends in trade growth
- The 2016 ICC Global Trade Finance survey report shows a majority of small businesses now experience significant problems accessing trade credit (almost 60% of applications for trade finance now rejected by banks)
- Potential for small businesses to create jobs and growth is not being leveraged due to insufficient access to trade finance
- Balance must be sought by policy-makers and regulators between need for prudential regulation post-crisis and the need to support businesses in engaging in international trade
- New trade prospects offered by trade agreements (e.g. TFA, Continental Free Trade Area in Africa, E-commerce) are seen as offering new opportunities for the trade finance industry
- But related challenges should be addressed (e.g. 65% of respondents to the ICC survey feel lack of compliance harmonization between jurisdictions is a great challenge to the trade finance industry)

Source: ICC (2016), Rethinking Trade & Finance

Why Services Sectors Deserve the Attention of the Trade Finance Industry

- Trade finance is a service that can be considered for liberalization but it is also required in support of trade in other services sectors

Services may be a sector or particular interest for trade finance as:

- the coverage of services is extremely broad, and includeBusiness services and professional services, Communication services, Construction and related services, Distribution services, Education services, Energy services, Environmental services, Financial services, Health and social services, Tourism services, and Transport services
- Trade in services tends to be more resilient than trade in goods
- Services trade accounts for 1/5 of global trade volumes and ½ of value-added trade globally
- Services embedded in exports are critical to trade in global value chains

But Challenges Remain…

Example: Challenges to Services Exports in Africa include:

Finance Related Challenges:

- High cost of funds (interest rates);
- Undue delays in cross border fund transfers;
- Liquidity challenges
- Lack of adequate skills in structuring financing for tradable service deals;
- Small size of financial institutions means inability to raise/mobilize sufficient funds to finance services related infrastructure which are capital intensive

Underdeveloped Service Related Infrastructure

- Underdeveloped tourism sites in many African countries;
- Underdeveloped hospitality infrastructure including world-class hotels, resorts etc
- Inefficient service-related facilities in the sphere of ICT, Ports and Marine and Shipping lines etc.

Source: Mbroh (2012), presentation on The Role of Trade Finance in Promoting Services Trade to the UNCTAD Global Services Forum, Doha, Qatar

Hurdles to SME Access to Trade Finance in Development Countries

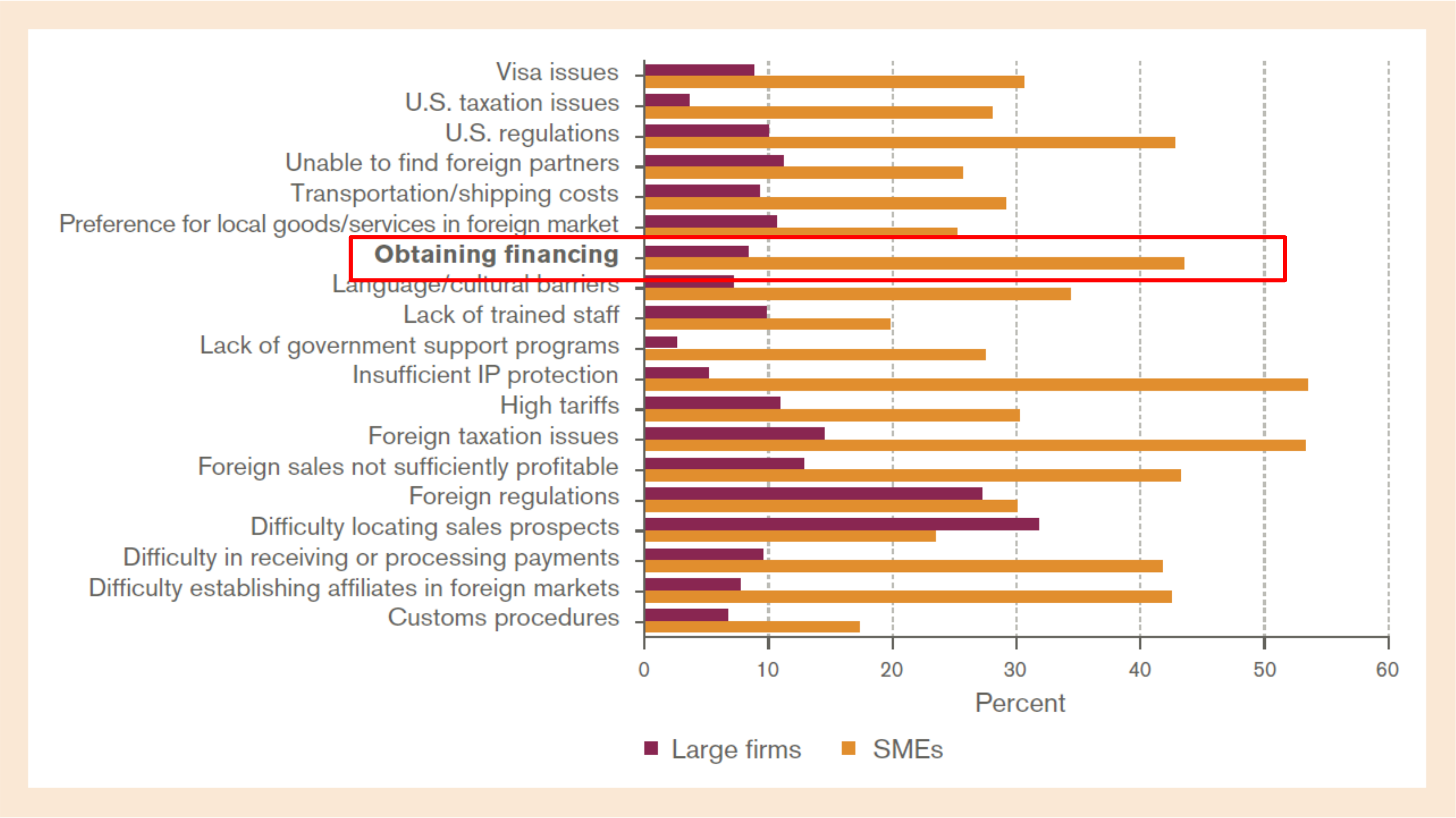
Local banks may have difficulties in supplying supply import- and export related finance due to:

- lack the capacity,
- knowledge,
- regulatory environment,
- international network, and/or
- foreign currency

Challenges also exist the t**raders**' side including lack of awareness of the available products, or of how to use them

Other obstacles, include the perception of **developing countries** as being affected by banking or country risks

Services SMEs Views on Impediments to Engaging in Global Trade (USA)



Source: USITC, cited in WTO (2016), Trade Finance and SMEs, Bridging the gaps in provision

UNCTAD's Products to Enhance Services Regulations and Institutions

Multi-year Expert Meeting on Trade, Services and Development:

- Platform for expert deliberation through an exchange of country experiences and lessons learned to identify best-fit practices on services, trade and development
- Has identified recommendations and areas for deeper research
- Further to MYEM recommendations, UNCTAD conducted surveys of infrastructure regulators and competition authorities (Part I on infrastructure regulation and institutions, Part II on trade of ISS, and Part III (on-going) on policy coherence and cooperation)

Services Policy Reviews:

- Policy, regulatory and institutional frameworks are important to harness benefits of services, but remain a critical challenge, as services are complex and multifaceted in nature
- Identify opportunities, challenges and offer practical recommendations on a best-fit policy mix
- Promote policy coherence and strengthened institutional capacities
- Aim to enhance productive and trade capacity in services, enhance economy-wide competitiveness and meet development objectives

Some Findings of the 2016 MYEM

Coherence is required between services regulation and services trade liberalization

- Necessary to balance benefits from effective market opening with Governments' need to implement regulatory measures in support of public policy objectives:
  - Address trade restrictive effects of domestic regulation measures, including those derived from regulatory divergence across jurisdictions
  - Attend to risks, costs and trade-offs of liberalization for national regulatory autonomy and policy space
- There is case for:
  - "Smart regulations" that are best fit to national circumstances and development needs & minimize inadvertent trade-restrictive effect of regulations
  - Adequate content, pace and sequencing of liberalization so that regulatory and institutional frameworks are built in advance and retain the possibility to adapt to new challenges, including those from liberalized markets
  - Addressing the policy disconnect between national, regional and global trade and liberalization to ensure economic benefits and growth, positive regulatory reforms and capacity-building including for GVCs

Trade-Regulatory Coherence

Common principles for best-fit regulations

- Integrated/consistent with policies, laws, international obligations
- Adoption subject to society's net benefit, beyond particular interests
- Performance-based and not unduly prescriptive
- Accessible, transparent, accountable, clear, stable, concise and communicated effectively
- Reviewed periodically, incl. by regulatory impact assessment, to test continuing relevance

Regulatory design is a major component of ensuring coherence

- Policy makers can draw from the common principles for regulatory coherence and from international standards
- DCs should participate in standard-setting bodies;

Best-fit regulations require an enabling institutional framework

- Independent from political influence and accountable
- National and sub-national cooperation and coordinated approaches:
- Applying principles needs high-level political commitment/resources
- Effective / constant communication, information flows, consultations between sectoral services regulators and Trade Ministry

SPR Methodology

SPR Activities

- Launch of the review process
- Desk-based assessment
- 1st multi-stakeholder consultation
- Field research and follow-up investigations
- 2nd multi-stakeholder consultation for validation
- Dissemination
- Implementation & follow-up

Lessons Learned from SPRs

Cross-cutting lessons

Policy coherence and coordination:

- Refers to horizontal and vertical coordination, not only between sectoral policies but also with trade, investment, competition, industrial, social and other policies
- The overall services strategy should factor in several attributes of each category: value added, sophistication of skills, knowledge and technology intensiveness
- A national agenda formulated in a single policy document may optimise impact

Evidence-based policymaking:

- Need for improved collection, treatment and analysis of services data;
- Example of Brazil's Integrated System of Foreign Trade in Services and Intangibles (SISCOSERV):

Lessons Learned from SPRs

Effective institutions and governance:

- Include national, regional and international levels of multi-stakeholder coordination, strategy definition, and resource allocation
- An inter-institutional coordination mechanism benefits from endorsement at a high political level, a formalised legal mandate, resources and capabilities
- Independent regulators are essential in ensuring neutral, effective and procompetitive regulation. Cooperation between regulatory bodies is important
- Cooperation at regional and international levels is also important given the importance of standard recognition and harmonization

Labour skills development:

- A qualified workforce promotes knowledge and technology intensive services
- This requires a sound education strategy, both at technical and higher levels, that matches labour demand and provided skills. Strong links and interaction between private sector, academia and policymaking bodies facilitates the identification of skills gaps and academic solutions
- Agreements with foreign universities could facilitate academic exchanges and international accreditations

Lessons Learned from SPRs

Enabling productive, technology and business environment:

- The development of productive clusters can promote intensive cooperation and coordination among firms and create economies of scale to reduce operational costs and enhance competitiveness. It may facilitate better integration of higher value added segments of regional and global value chains
- Enhancing a national innovation system is also important to integrate firms in higher value added segments and to promote structural transformation
- Formalizing the economy can create an enabling environment, as informality affects many SMEs and their capacity to establish linkages with the economy
- E.g., the simplification of administrative procedures to grant licences and authorizations facilitates the entry of new operators

Findings of SPRs on Financial Services

Paraguay's SPR on Central Bank's initiatives:

- Setting up a credit bureau to balance information asymmetry and reduce financial spread, and drafting a guarantee fund act
- Cooperating with Secretariat of the Consumer Protection Office for financial education
- Creating basic savings accounts that can be opened without physical presence, do not require minimum amounts or minimum average balances

Nicaragua's SPR - Recommendations:

- Transform the current public bank Produzcamos into a fully fledged development bank, with increased resources, to increase financial depth supporting investments and productive activities

Lesotho's SPR:

- Financial Institutions Act, 2012, aims to revamp fragmented regulation, institutes a new version of reporting system to improve data collection and analysis
- Credit Reporting Regulations, 2013, aims for a central credit repository to promote credit access. A national identification system and financial statements for firms is necessary to demonstrate credit histories
- In collaboration with commercial banks, gov. established a partial guarantee fund to extend credit to SMMEs by assuming and sharing risks associated with non-performing loans

Conclusions

- Pro-development approach to services economy requires coherence between regulatory and trade agendas and effective coordination between regulatory authorities, sectoral ministries and trade ministries
- Multi-stakeholder involvement including private sector & SMEs is instrumental
- National, regional and international coordination and complementarity have also a key role for coherence
- Lessons can be learned from practices and experiences in building coordination and coherence towards mutually supportive regulatory and trade strategies
- UNCTAD assists countries in devising an appropriate policy mix and ensuring coherence to improve services sector regulation and performance, export diversification and structural transformation

Thank you for your attention

More information on services, trade and development:
http://unctad.org/en/Pages/DITC/Trade-in-Services.aspx