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## Working Paper Series on Regional Economic Integration



### The Building Block versus Stumbling Block Debate of Regionalism: From the Perspective of Service Trade Liberalization in Asia

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No. 28 | May 2009

Asian Development Bank





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## Contents

Abstract	1
1. Introduction: Important but Neglected Area in Trade Regionalism—Services	2
2. Principles and Reality of Multilateral Service Arrangements and Negotiations—GATS	3
3. The Achievements of the ASEAN Framework Agreement on Services (AFAS)	4
3.1 The Evolution of AFAS Round Negotiations	5
3.2 Priority Services Sector Liberalization under AFAS: Logistics Sector	11
4. Implications for the “Building Block versus Stumbling Block” Debate	14
5. Policy Proposal: The Amendment of the GATS Article V	16
References	19
ADB Working Paper Series on Regional Economic Integration	20
Tables	
1. GATS and AFAS Packages	6
2. AFAS and WTO Membership of Newer ASEAN Members	6
3. The Evolution of AFAS	7
4. GATS Logistics Negotiation and AFAS Logistics Protocol	12
5. WTO Negotiations on Air and Logistics and ASEAN’s Positions	13
Chart	
1. Regional and Multilateral Commitments	18

## **Abstract**

When debating the pros and cons of economic regionalism, haven't we focused enough on trade in goods at the expense of services? This article argues that regionalism is certainly a building block, not a stumbling block to a multilateral trading system, using the services liberalization scheme of Association of Southeast Asian Nations (ASEAN) as a case study. At the same time, it is critical to set out a proper institutional arrangement to ensure that regional services liberalization initiatives reinforce the global services regime. This paper proposes an amendment of the current GATS Article V to define the appropriate relationship between multilateralism and regionalism in the context of services.

*Keywords:* GATS, AFAS, ASEAN, services, regionalism, free trade, economic integration

*JEL Classification:* F5, F15, O19

## 1. Introduction: Important but Neglected Area in Trade Regionalism—Services

There is general consensus on the growing economic significance of services, recognizing that they are as important as goods. In many countries, more than half of national wealth is created by service industries. One can easily list the essential services of daily life, such as financial or telecommunication services, while services in more “minor” sectors such as environment are also flourishing. Services account for a considerable share of international trade too. And, interestingly, the process of importing and exporting of goods involves services such as transportation and storage; and goods cannot be traded without these services. The recent technological development allows the international transaction of many services through the internet (Mode 1). Moreover, establishing a commercial presence to supply services locally, such as a branch of a commercial bank, is within the scope of trade in services (Mode 3). In addition, the significance of services provided by foreign lawyers and engineers in the domestic territory (Mode 4) and consumption abroad (Mode 2) should not be overlooked, despite accurate measurement of these transactions is extremely difficult.

Nevertheless, as far as economic research is concerned, services have not won serious attention relative to their economic significance. In other words, empirical analysis of trade in services is very limited, unlike trade in goods. This is fundamentally because of the lack of comprehensive data on services. It is difficult to accurately measure the amount of services traded through the internet across borders and services provided by the movement of foreign nationals. A notional difficulty is another reason for the stagnant research output. If a foreign bank opens an overseas branch with minor share participation, should services provided by the branch to local consumers constitute “international” trade in services? Despite these notional and measurement difficulties, however, we can still assess the openness of services sectors qualitatively and draw some policy implications.

Trade economists usually have trade in goods in mind, when examining trade theories, and the studies on trade regionalism are no exception. In particular, a fundamental question of trade regionalism theory—whether or not regionalism contributes to the multilateral trading system—is usually examined from the goods perspective.<sup>1</sup> Theoretical debates relating to regional trade agreements or free trade areas (FTAs) have been dictated by goods-specialists and they hardly capture the nature of trade in services sufficiently. But in reality, the progress of services liberalization at a regional level has been remarkable, even compared with multilateral efforts to liberalize services trade under the General Agreements on Trade in Services (GATS), as we will see in detail later. If we properly take services into consideration, commonplace views on trade regionalism debate will be altered significantly.

This article analyzes regional services liberalization schemes in the Association of Southeast Asian Nations (ASEAN). Although the regional service arrangement in ASEAN—the ASEAN Framework Agreement in Services Trade (AFAS)—has achieved

<sup>1</sup> Kawai and Wignaraja (2008) argue the relations between regionalism and multilateralism from various issues covered by Asian FTAs, not limited to trade in goods.

significant liberalization, it is seldom mentioned in the academic literature. This is in sharp contrast to ASEAN's trade liberalization scheme in goods—the ASEAN Free Trade Area (AFTA)—which has been examined in detail (for example see Menon 2007). Moreover, the majority of studies on AFAS, albeit limited, consider its achievements insignificant in a static comparison with GATS (for the details, see Section IV). But I would argue that ASEAN members “generously” offer GATS commitments comparable to their AFAS commitments: a static comparison between GATS and AFAS has a fundamental problem in assessing regional efforts at liberalizing services. Instead, a dynamic analysis of the evolution of AFAS is needed to understand its real contribution to the world trading system.

The remainder of this paper develops a four-fold discussion. Section II conducts an overview of the principles and reality of multilateral services negotiations. Section III empirically assesses regional services arrangements, using the case of a trade regionalist project in ASEAN. Based on these empirical data, Section IV critically examines commonplace theoretical arguments on trade regionalism, namely “building or stumbling block debates on regionalism” from the perspective of services, and attempts to settle the debates that have not been concluded by studies based on goods. Section V proposes the best institutional framework for integrating regional efforts at services liberalization into the multilateral system. It is critical to properly design the relationship between the two so that regional service arrangements will be able to contribute to global trade in services.

## 2. Principles and Reality of Multilateral Service Arrangements and Negotiations—GATS

Services were negotiated for the first time in the Uruguay Round, and GATS was finally agreed in 1994. The overarching negotiations principles for services liberalization applicable to any World Trade Organization (WTO) round negotiations regarding are laid out in the GATS preface.

*Desiring the early achievement of progressively higher levels of liberalization of trade in services through successive rounds of multilateral negotiations aimed at promoting the interests of all participants on a mutually advantageous basis and at securing an overall balance of rights and obligations, while giving due respect to national policy objectives (GATS preface; underline added).*

Eight years after the conclusion of Uruguay, the Doha Round was launched in 2001, the first to base the formalities and principles stipulated in GATS. In March 2001, WTO members agreed on the “Guidelines and Procedures for the Negotiations on Trade in Services” of the Doha Round, based on Article XIX of GATS. Paragraph 5 of the Guidelines says:

There shall be no a priori exclusion of any service sector or mode of supply. Special attention shall be given to sectors and modes of supply of export interest to developing countries (the Guidelines; underline added).



But the Doha Round faced difficulty in accelerating negotiations in various fields, partly due to its expanded membership and services negotiations were no exception. Many services specialists—including the Chair of the Special Session of the Committee on Trade in Services at the WTO—thought that the then on-going bilateral request-offer approach had led to no-positive indication of submitting commercially meaningful commitments (Committee on Trade in Services, 2005). Trade ministers believed it was necessary for negotiators to identify priority service sectors to facilitate negotiations. The Hong Kong Ministerial Declaration, adopted in December 2005, said:

In addition to bilateral negotiations, we agree that the request-offer negotiations should also be pursued on a plurilateral basis... Any Member or group of Members may present requests or collective requests to other Members in any specific sector or mode of supply, identifying their objectives for the negotiations in that sector or mode of supply (Annex C Paragraph 7).

It was expected that limited negotiating resources would be spent in sectors critical for concluding the Doha Round. But in reality, more than twenty plurilateral negotiations groups, covering almost all sectors and sub-sectors, were established after the Hong Kong ministerial meeting.<sup>2</sup> The sectors included: legal; architecture/engineering; computer related services; postal/courier; telecommunications; audio-visual; construction; distribution; education; environmental; financial; maritime; air; logistics; energy; cross-border services; mode 3; mode 4; MFN exemptions; services related to agriculture; and tourism. The concentration of resources on priority services to achieve a fruitful outcome was unsuccessful and it turned out that *no* sector is prioritized when *all* sectors are prioritized.

The Doha Round was suspended twice (July 2006 and July 2008), and there is no clear prospect of concluding the negotiations in the near future. As a result, no improved overall services commitments have been approved since the Uruguay Round, and progressive liberalization of services has faced a serious problem at the WTO-level. The ambitious attempt to balance *a priori* exclusion and commercially meaningful sector/mode-specific plurilateral group negotiations also seem to have failed. In a nutshell, the grand ideas of services negotiations as laid out in GATS and the Guidelines have not been implemented so far.

### **3. The Achievements of the ASEAN Framework Agreement on Services (AFAS)**

AFAS, ASEAN's own services liberalization project within the region, began in December 1995 at the meeting of the ASEAN Economic Ministers (AEM) in Bangkok, Thailand. Leaders recognized the growing importance of trade in services at a regional level and established AFAS, in adherence to GATS principles, to wit:

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<sup>2</sup> For the development of services negotiations, see Katsuri, 2007.

Reiterating their commitments to the rules and principles of the General Agreement on Trade in Services [GATS] ... and noting that Article V of GATS permits the liberalising of trade in services between or among the parties to an economic integration agreement [.]

In fact, AFAS members make commitments in line with a GATS-style positive-list approach, unlike the negative-list approach of the North American Free Trade Area (NAFTA). AFAS also follows GATS classification of services into 12 categories using the W/120 classification.<sup>3</sup>

This section empirically examines AFAS achievements relevant to the principles of GATS as discussed in the previous section. It first analyzes the evolution of AFAS round negotiations in terms of “progressive liberalization” and “no *a priori* exclusion”, and then assesses the AFAS priority sector liberalization scheme in comparison with the GATS negotiations (under which all sectors are selected as priority sectors).

### 3.1 The Evolution of AFAS Round Negotiations

Six rounds of regional services packages have been concluded under AFAS so far. The analysis below focuses on whether or not *at least* one sub-sector under one sector is covered. Although it may be true that the question of whether or not whole sub-sectors under one sector are covered is critical from a business perspective, the distinction between the perfect exclusion of one whole sector and the situation where “at least one sub-sector is committed” is important from a political perspective. As previously discussed, the *a priori* exclusion of one whole sector is not allowed in the Doha Round negotiation.

**The 1997 package (the first):** Soon after the Bangkok meeting, the first AFAS round of negotiations was launched, and the first overall package was agreed in December 1997 (Table 1). All nine ASEAN members, including the two newest members—Myanmar and the Lao Peoples’ Democratic Republic (Lao PDR)—submitted services schedules, a remarkable achievement given that the two had only become members in July 1997 (Table 2).

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<sup>3</sup> W/120 classification on which GATS commitments are based has twelve sectors. However, the twelfth sector, namely “others” will not be analyzed in this paper. Eleven sectors are listed in Table 3.

**Table 1: GATS and AFAS Packages**

	<b>GATS</b>	<b>AFAS</b>
1994	Uruguay Round Commitments	
1995	...	AFAS Protocol
1996	...	...
1997	...	1st Package
1998	...	2nd Package
1999	...	...
2000	...	...
2001	Doha Round Negotiation started	3rd Package
2002	...	2nd Finance
2003	Doha Round Initial Offer submitted	Amendment of AFAS Protocol
2004	Cambodia Accession	4th Package; Priority Sector Agreement
2005	Doha Round Revised Offer submitted	3rd Finance and 4th Air Transport
2006	Vietnam Accession	5th Package
2007	...	6th Package
2008	Doha Round Suspended	...

Note: ... no data available.

Source: Author's compilation.

**Table 2: AFAS and WTO Membership of Newer ASEAN Members**

	<b>Vietnam</b>	<b>Lao PDR</b>	<b>Myanmar</b>	<b>Cambodia</b>
ASEAN/AFAS Membership	1997	1997	1997	1999
WTO/GATS membership	2006	Under negotiation	Original member of GATT 1947	2004

Source: Author's compilation.

While the 1997 AFAS package was not very ambitious, basically covering only tourism and transport (Table 3), the former included in the schedules of all nine AFAS members. Five out of nine members covered transport. The Philippines also covered business services (audit) and Viet Nam covered some telecommunications services. It is quite remarkable for the ASEAN members to start liberalization in services in the same year when the Asian financial crisis struck.

**Table 3: The Evolution of AFAS**

	Business	Communication	Construction	Distribution	Education	Environment	Financial	Health	Tourism	Recreation	Transport
Brunei	2nd	2nd	2nd				2nd	4th	1st	5th	1st
Cambodia	2nd	3rd	3rd	5th	5th	5th	2nd	5th	2nd	5th	2nd
Indonesia	2nd	2nd	2nd	5th	5th	6th			1st	5th	1st
Lao PDR	2nd	2nd	2nd			6th	2nd		1st		2nd
Malaysia	2nd	3rd	2nd	5th	5th	6th	2nd	5th	1st	5th	1st
Myanmar	2nd	2nd	2nd	2nd		5th	2nd	5th	1st	5th	2nd
Philippines	1st	2nd	2nd	5th		5th	2nd	5th	1st		2nd
Singapore	2nd	2nd	2nd	5th	5th	5th	2nd	4th	1st		1st
Thailand	2nd	2nd	2nd	5th	5th	5th	2nd	5th	1st	5th	1st
Viet Nam	2nd	1st	2nd	6th	6th	6th	2nd	5th	1st	6th	2nd

Source: Author's compilation.  
Shaded portions: no commitment so far.

**The 1998 Package (the second):** There is a marked improvement in the commitments in new and existing sectors. Four new sectors—business, communications, construction, and financial services—appeared in most countries' commitments for the first time. All AFAS members made commitments in business services and, except for two relatively new ASEAN members (Myanmar and Viet Nam<sup>4</sup>), all countries expanded commitments in the communications (telecommunication) sector. Nearly all improved commitments in construction and finance (excepting Indonesia in finance), a marvelous achievement in 1998 given that finance and telecommunication were the most difficult sectors in GATS negotiations.

The scope of commitments in tourism and transport, meanwhile, was significantly broadened. All countries, except Brunei Darussalam,<sup>5</sup> enhanced the coverage of commitments in the transport sector, and most countries advance their commitments in tourism. Interestingly, even countries that had already made transport commitments in 1997 did so again in 1998. This showed that ASEAN members were attempting to balance "marginal" efforts among members in each round of AFAS negotiations.

<sup>4</sup> Viet Nam's 1997 Package had already made goods commitments in telecommunication.

<sup>5</sup> Brunei's 1997 Package had already made good commitments in transportation ranging from air to maritime.

Cambodia—supposedly to join ASEAN in 1997 but postponed due to internal political struggle—immediately submitted its AFAS commitment after accession to ASEAN in 1999. The coverage of its 1999 commitments was limited to four sectors (business, finance, tourism, and transport), but the country gave its best effort, given its level of economic development and the prevailing international environment (for example, Cambodia was not even a WTO member at that time).

**The 2001 Package (the third):** The third package covered almost the same sectors as in 1998; but two important features of this package should be highlighted. First, members significantly deepened commitments in five sectors (business, communication, construction, tourism, and transport). ASEAN paid significant attention to the balance in terms of “marginal” efforts. In fact, all members, including those who had already made commitments in 1998, improved in all five sectors. Cambodia’s communications and construction sectors and Myanmar’s communications sector were first covered in the 2001 package.

Second, members made no commitment in sectors other than the above five.<sup>6</sup> This implies that ASEAN was practical: it carefully avoided liberalization in sectors where political sensitivity lay. Another practical reason for the limited coverage of the 2001 package may have been the launching of the WTO Doha Round. It is understandable if countries have strong hesitation in improving their regional commitments when international negotiations were about to start (the Doha Ministerial meeting was held in November 2001 in Doha).

**The 2004 Package (the fourth):** The Bali Concord II was adopted at the ASEAN Summit in Bali in October 2003, agreeing in two major points: (i) the free flow of services should be achieved by 2020 (as to the priority sectors liberalization timeline, see below); and (ii) the application of the “ASEAN minus X” formula in the implementation of member countries’ services commitments was enabled. Under this formula, a subset of ASEAN members (more than two) that are ready to liberalize a certain services sector on a reciprocal basis may do so without extending concessions to non-participating countries.

Nevertheless, no new sectors were covered in 2004, with improvements limited to the four that were already covered by the 2001 package. It is difficult to provide a definitive answer, but maybe the principal reason for this stagnant outcome would be the then-ongoing Doha Round negotiations. It was also not specified in the protocol how to implement the ASEAN minus X formula, and members did not actually use the formula in making commitments in the 2004 Package.<sup>7</sup>

**The 2006 Package (the fifth):** By 2006, AFAS commitments grew significantly more complicated. To understand the whole picture of a member’s commitment, one should

<sup>6</sup> Excepting Malaysia’s distribution sector; Malaysia’s 2001 schedule included wholesale and retail services.

<sup>7</sup> Moreover, this rule has not been used until now because realizing “ASEAN minus X” entails operational difficulty, although its philosophy is attractive. Accordingly, all commitments so far by all members were on a non-discriminatory basis in terms of the ASEAN minus X approach. The ASEAN minus X method, however, can be said to be politically important, because liberalization among a “coalition of the willing” was supported at the minister level.

refer to the first, second, third, and fourth packages, because only changes in commitments from the previous package were inscribed in their respective overall packages. In addition to past overall packages, one should also refer to independent financial packages and air transport packages. Because the decision on liberalization of some service sectors was highly technical, ministers in charge of specific fields started the negotiations on respective sectors by themselves, rather than through economic ministers. The liberalization of services in the field of finance and air transport falls under this category.<sup>8</sup> In 2002, finance ministers agreed a services package exclusively for financial services.<sup>9</sup> Likewise in 2005, the first independent air transport package was concluded.<sup>10</sup> As a consequence of the above developments, it resulted in too many documents regarding each country's commitments,<sup>11</sup> and monitoring the commitments became very tedious.

The fifth package overcame these problems to a certain degree by consolidating past four schedules. By simply looking at the 2006 package, it is quite understandable the status of commitments in 2006, except for sectors covered by specialized ministers' meetings, such as finance and air transport. The only drawback of this methodological change was that it became difficult to identify the improvement from previous commitments—one should carefully compare old and new commitments to find improvements (and possibly drawbacks as well). The consolidation of past commitments under the fifth package is an excellent example of ASEAN's full support to the GATS approach even at a very technical level.

The 2006 package made a significant improvement in actual commitments as well. All "difficult" sectors that had not been covered in previous packages were included in the 2006 package (distribution, education, environment, and recreation services). For example, liberalization in the distribution sector is politically sensitive in many ASEAN countries because family-run stores would face difficulty from competition with foreign shopping centers. The environment (for example, sewerage) and education are also very difficult to liberalize because they are closely linked to government regulations and governmental services. But by 2006, AFAS achieved comprehensive sector coverage.

At the same time, the 2006 package remains in keeping with ASEAN's "flexibility" principle (though not the ASEAN minus X principle). Half of members did not make commitments in environmental services in 2006, though they eventually did in the later years (discussed in the next section). Flexibility was also extended by other ASEAN members to Viet Nam which allowed Viet Nam not to make commitments in some sectors (distribution, education, and environment) because it was about to complete its accession negotiations with the incumbent WTO members. Had Viet Nam's 2006 AFAS commitments been "too" good, it would have undermined its bargaining position with

<sup>8</sup> Services incidental to manufacturing, fisheries, agriculture, forestry and mining.

<sup>9</sup> This agreement is called "second", because the 1998 overall package covered some financial services, and is regarded as the "first" financial package.

<sup>10</sup> This is usually called the "fourth" air transportation package because, as with financial services, the overall package in 1997, 1998, and 2001 included air transportation.

<sup>11</sup> In particular, the relations between the minus X approach and the MFN Exemption List are unclear. From the GATS perspective, discriminatory treatment among members is prohibited unless the member had registered sectors where such a treatment would be introduced beforehand.

regard to WTO accession.

**The 2007 Package (the sixth):** Viet Nam joined the WTO in December 2006, and its AFAS commitments made significant improvement in 2007. Other ASEAN members also improved, not just free-riding on Viet Nam's new commitments. While Indonesia, Malaysia, and Lao PDR reserved making commitments in environment services in their 2006 schedules, these countries covered some environment sub-sectors in 2007.

The 2007 Package can be said to be "GATS" plus. But because the GATS offers submitted by ASEAN countries in 2006 are basically confidential, it is difficult to compare ASEAN's 2007 AFAS commitments with their GATS commitments thoroughly. Malaysia is the only ASEAN country that made its latest GATS offer submitted in 2006 public.<sup>12</sup> As far as Malaysia is concerned, AFAS 2007 (and 2006) commitments included sectors that are not covered by its latest GATS offer. For example, distribution services, educational services (other than higher education) and health services (other than private hospital) are included in Malaysia's AFAS 2006, while they are not covered in its GATS 2006 offer. Similarly, Malaysia decided to make AFAS commitments in environment sectors in 2007, which it has not offered under GATS.

As a result, the 2007 coverage was significantly more comprehensive. Aside from some limited exceptions, all countries made some commitments in all sectors. As Table 3 shows, the country-sector matrix of making commitments under the AFAS scheme was almost completed by 2007, meaning that the future agenda of AFAS would be upgrading or improving existing commitments in sectors.

In summary, AFAS countries tend to upgrade their commitments every one or two years. No other FTA in the world has liberalized the services sector so quickly: AFAS achieved significant liberalization of the services sectors through consecutive rounds of negotiation with almost all sectors covered by 2007. It is also possible to argue that AFAS has better achieved what GATS attempted to do, namely, "progressive liberalization through round negotiations" and "no *a priori* exclusion".

Furthermore, ASEAN's plans for further liberalizing services is ambitious. During the ASEAN Summit in December 2005, the members agreed to accelerate services liberalization in non-priority sectors by 2015, "with flexibility" (for priority sectors, see below). The target year was moved ahead five years from the Bali Concord II agreed in 2003. The "ASEAN Economic Community Blueprint" adopted at the ASEAN Summit in November 2007 clearly indicate to "remove substantially all restrictions on trade in services for all services sectors [other than priority sectors] by 2015", with some detailed parameters of the services liberalization process.

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<sup>12</sup> Alongside developed countries that are proponents of services liberalization, Malaysia agreed to make its GATS offer available on the website of Coalition of Service Industries. See: <http://www.uscsi.org/wto/>

### 3.2 Priority Services Sector Liberalization under AFAS: Logistics Sector

In November 2004 in Vientiane, Lao PDR, the *ASEAN Framework Agreement for the Integration of Priority Sectors* was agreed to advance efforts at liberalizing priority sectors (otherwise known as the Vientiane Action Plan or VAP). The adoption of the scheme of liberalizing priority sectors *per se* can be said to be GATS plus, in contrast to GATS negotiations, where *all* sectors are regarded as priority. The VAP listed eleven priority sectors<sup>13</sup> of which four of them service sectors (air transport, tourism, E-ASEAN and healthcare). In the case of air transport for example, the Appendix 1—*Roadmap for Integration of the Air Travel Sector*—provides a detailed liberalization schedule. It is indicated in the VAP Appendix 1 that air freight services should be fully liberalized by December 2008 and scheduled passenger services by December 2010 (with no limitations on the first to fifth freedoms of commercial aviation rights).

With regard to the schedule of liberalization in priority sectors, the deadline for the liberalization of priority sectors was set at 2010 under the Bali Concord II. The *Amendment Agreement on Priority Sectors* that elaborated the procedures for designating priority sectors liberalization was adopted in December 2006. It was agreed there that the elimination of all limitations in Mode 1 and 2 should be achieved by the end of 2008. Mode 3 foreign equity participation should be allowed by the end of 2010.

By August 2007 in Cebu, Philippines, the *ASEAN Sectoral Integration Protocol for the Logistics Services Sector* was agreed. The logistics sector was added as the fifth priority service sector. Because of time constraints, ASEAN countries agreed to set a timeline of logistics liberalization separate from other priority sectors, setting the target date at 2013, alongside with the four other priority sectors by 2010.

Logistics services are unique in the context of services negotiations. There is no logistics services category in the W/120 classification, which is used by both GATS and AFAS commitments. This is because logistics services are a cluster of cross-cutting services ranging from transport to communications (for example courier services), which are already included in the W/120. Because of their cross-cutting nature, logistics services are commercially important. If the liberalization of one minor service sector along the logistics services chain is missing, the whole logistics chain may not function well. In other words, merely liberalizing some transport sectors without considering actual flow of goods will result to mismatched business needs. This is the exact reason why the “logistics” plurilateral negotiation group was established in the Doha Round in line with the other twenty plurilateral negotiation groups, such as financial services and telecommunication services.<sup>14</sup>

The GATS logistics plurilateral group classifies logistics services into four categories: (i) core freight logistics services; (ii) freight transport services; (iii) other-related logistics

<sup>13</sup> They are: (i) agro-based products; (ii) air travel; (iii) automotives; (iv) e-ASEAN; (v) electronics; (vi) fisheries; (vii) healthcare; (viii) rubber-based products; (ix) textiles and apparel; (x) tourism; and (xi) wood-based products.

<sup>14</sup> Among over twenty plurilateral negotiation groups, energy does not constitute a “sector” in W/120 alongside logistics.



**Table 4: GATS Logistics Negotiation and AFAS Logistics Protocol**

			GATS	AFAS
Services	Core Freight Logistics Services	Cargo handling	Yes (741)	Yes (741)
		Storage and warehousing	Yes (742)	Yes (742)
		Transport agency	Yes (748)	Yes (748)
		Other auxiliary service	Yes (749)	Yes (749)
	Freight Transport Services	Maritime/internal waterways transport	Yes (7212, 7213, 7214, 7222, 7223)	Yes (7212, 7213)
		Air	Yes (732, 734)	Covered by air priority scheme
		Rail	Yes (7112)	Yes (7112)
		Road	Yes (7123, 7124, 83102)	Yes (7123)
	Other-related Logistics Services	Business services	Yes (8672, 8673, 8676)	No
		Postal/courier	Yes (7512, 7511)	Yes (7512)
		Distribution	Yes (621, 622, 631, 632)	No
	Non-Core Freight Logistics Services	Computer and related services	Yes (84)	No
		Packaging	Yes (876)	Yes (876)
		Management consultation	Yes (865, 866)	No
	Customs clearance services	No	Yes (no CPC)	
	Custom/transportation facilitation etc	Covered by Trade Facilitation	Yes	
	Assistance to logistics services providers etc	No	Yes	
	Human resource etc	No	Yes	
	Infrastructures etc	No	Yes	

Source: Author's compilation.

services; and (iv) non-core freight logistics services. It puts special emphasis on the liberalization of core-logistics services: cargo handling (CPC 741); storage and warehousing (CPC 742); transport agency (CPC 748); and other auxiliary services (CPC 749). The AFAS logistics liberalization scheme covers all core-logistics services included in the GATS plurilateral requests. The deadline for completing full commitments in those services is 2013.<sup>15</sup> Except for a few sub-sectors, most sub-sectors under freight transport services in the GATS logistics plurilateral request are included in the AFAS, with the deadline of either 2008 or 2013. Some sub-sectors in other-related logistics services and non-core freight logistics services in the GATS requests are also covered by AFAS, with the notable exceptions of business services (for example, engineering services: CPC 8672) and computer and related services.<sup>16</sup> Moreover, ASEAN's logistics services liberalization scheme goes far beyond GATS as it includes customs clearance services, which are outside the scope of GATS due to their close link with governmental

<sup>15</sup> The timeline of the logistics service liberalization is not under the constraint of the Amendment Agreement.

<sup>16</sup> From ASEAN's perspective, these may not necessarily be an essential component of logistics services.

authority (Table 4).<sup>17</sup>

**Table 5: WTO Negotiations on Air and Logistics and ASEAN's Positions**

	Requesting members	Requested members
Air	Australia; Chile; EC; New Zealand; Norway; Switzerland	Brazil; Brunei Darussalam; Canada; People's Republic of China (PRC); Egypt; Fiji; Hong Kong, China; India; Japan; Republic of Korea; Malaysia; Mexico; Pakistan; Philippines; Singapore; South Africa; Thailand; Taipei, China; United Arab Emirates; United States (US)
Logistics	Australia; Chile; Hong Kong, China; Japan; New Zealand; Switzerland; Taipei, China	Argentine; Brazil; Brunei; Canada; PRC; Columbia; Egypt; EC; Iceland; India; Indonesia; Korea; Kuwait; Liechtenstein; Malaysia; Mauritius; Mexico; Morocco; Nicaragua; Nigeria; Norway; Pakistan; Panama; Peru; Philippines; Singapore; Qatar; South Africa; Sri Lanka; Thailand; Turkey; United Arab Emirates; US; Uruguay

Note: ASEAN countries are shaded.

Source: Author's compilation.

The ASEAN Logistics Protocol covers various measures that actually facilitate trade. Its Appendix lists 44 issues and the scope of the AFAS logistics scheme is significantly more comprehensive, even in comparison with the GATS logistics negotiations. While GATS logistics negotiations cover only logistics services, the liberalization of logistics services is an important, but not exclusive component of the AFAS logistics scheme. In addition to the liberalization of services relating to logistics (including customs clearance services), ASEAN's Logistics Protocol includes four major components:

- Customs/transportation facilitation, with its main component the adoption of international standards established by organizations such as the WTO and the World Custom Organization (WCO);
- Assistance to logistics service providers in ASEAN, including the support of small- and medium-sized logistics enterprises and the establishment of networks among logistics service providers in the region;
- Human resource development for customs officials and the private sector; and
- Infrastructure and investment, with the development of the ASEAN transport logistics corridor its principal focus.

What is interesting is that ASEAN members are not strong proponents of liberalization of air and logistics services at the GATS (Table 5). Rather, all ASEAN countries are involved in air and/or logistics plurilateral negotiation as *requested* parties: they are required to open their markets by developed WTO members. Thus, it can be said that ASEAN's strategy is first to liberalize the sectors within the region to enhance

<sup>17</sup> Article I (3-c) stipulates: "services" includes any service in any sector except services supplied in the exercise of governmental authority.

competitiveness, and then finally open to global competition. Given that Doha negotiations may take at least a few more years to conclude, ASEAN's liberalization scheme of priority sectors seems to be far advance than GATS.

#### **4. Implications for the “Building Block versus Stumbling Block” Debate**

This section examines the fundamental debate regarding trade regionalism from the standpoint of liberalizing trade in services. The main question is: is the FTA a stumbling block or a building block in the multilateral trading system? The principal concern of the debate is human and capital resource allocation, and thus economic welfare. The variant of this question, however, is related to a more institutional problem: whether or not regional initiatives lead to erosion of the multilateral trading system.

FTA opponents say FTAs will lead to trade diversion, and reduce world-wide economic welfare. Moreover, they emphasize the opportunity costs of scarce negotiating resources for regional negotiations, which otherwise could be used for multilateral negotiations. FTA proponents argue that the trade creation effect is larger than the trade diversion effect, resulting in more efficient resource allocation in a region. According to them, policy reforms are locked-in not only by multilateral arrangements but also by regional arrangements. Increasing the bargaining power of a group in international economic relations is another justification for trade regionalism (ADB, 2008). It is, however, empirical evidence, not a theoretical plausibility, that settles this debate.

As far as services are concerned, trade diversion effects are not critically large. This is mainly because service commitments merely bind an existing liberal regime, without creating new market access. In addition to this, due to the fact that services usually require a high-level of customization, regional trade in services is unlikely to lock out trade emanating from outside a region. In the case of goods, consumers seldom care about the language, beliefs and culture of producers whose labors or services are embodied in products. In contrast, the language, beliefs and culture of a service supplier are critical for consumers. Suppose ASEAN member's made commitments in higher education services, for example: a Thai university or polytechnic could then open an educational center in Cambodia someday. But is it relevant to argue that such a trade in services reduces the business opportunity of Cambridge University? This means that trade creation effect is larger than trade diversion effect in the case of services, because increase in regional service trade is not at the expense of third parties.

A theoretically plausible concern that regional efforts to liberalize services would reduce the enthusiasm for multilateral trade liberalization may not be applicable for trade in services. Some argue critically that regional services arrangements in Asia do not have “GATS plus” commitments by comparing GATS offers and AFAS commitments for example, when new GATS offers are submitted (Rajan 2002; Roy *et al.* 2007). Rather, this is the result of ASEAN members' “generous” GATS commitments which are comparable to their AFAS commitments. ASEAN members are the best students of GATS because they have made a significant effort to “multilateralize” the regional

initiative of services liberalization. In fact, as we have seen, Malaysia's AFAS 2006 and 2007 commitments are much more liberal than its GATS 2006 offer. AFAS leads to better GATS offers of ASEAN members.

Furthermore, ASEAN's effort to improve AFAS commitments even during the Doha Round should not be overlooked. It is misleading to overemphasize the relatively minor outcome of the third overall package in 2001, the year Doha was started. It is very likely that countries' making "too good" offer at regional-level commitments might undermine their bargaining power at the WTO.<sup>18</sup> One should note that AFAS concluded three services packages during the Doha Round (2004, 2006 and 2007), and the ASEAN members' services commitments have been deepened significantly. This means that ASEAN has steadily liberalized services sectors in the region regardless of the progress (or no progress) in multilateral GATS negotiations. Accordingly, it is irrelevant to develop a theoretical argument that AFAS could block multilateral efforts. One important caveat relating to the relationship between AFAS and GATS is that AFAS has not been notified to WTO under GATS Article V. While the question whether the original AFAS in 1997 was consistent to GATS system may be controversial,<sup>19</sup> the AFAS 2007, which has a broad sectoral coverage should be significantly consistent with GATS – and ASEAN's effort to notify AFAS to WTO should be encouraged so that its efforts regarding services liberalization will be widely recognized as WTO compliant.

The effect of regional services arrangements is to internationally bind domestic policy and legislative reforms regarding trade in services. The lock-in effect of regionalism does not seem to be negligible: this is particularly true in AFAS because it is a *multilateral* regional arrangement, not a *bilateral* regional arrangement.<sup>20</sup> This effect is especially critical for ASEAN members that have/had not obtained WTO membership yet. Viet Nam and Lao PDR have submitted AFAS schedules since 1997 and Cambodia since 1999, immediately after obtaining ASEAN membership. Being familiar with how to make services commitments under the AFAS scheme before joining WTO makes their WTO accession negotiations much easier, such as Viet Nam's case (ADB 2008). The experience of making AFAS commitments that inevitably entails domestic policy and legislation reform, will definitely smoothen Lao PDR's (among Asia's least developed countries) WTO entry.

AFAS has even contributed negotiating resources to the multilateral trading system. Certainly, developing countries like Viet Nam face human resource constraints, such as skilled services negotiators. But as far as AFAS is concerned, regional negotiations have contributed to the improvement of developing countries' negotiation skills, because the modalities of AFAS negotiations are almost the same as GATS negotiations.

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<sup>18</sup> The opposite relation also happens. Some countries do not seem to want to offer too much in Doha so as not to undermine their bargaining power in regional/bilateral agreements. In short, nuanced balance between the level of multilateral and regional commitments should be maintained.

<sup>19</sup> In particular, it is uncertain whether AFAS 1997 satisfied GATS V-1a, because its coverage was limited to the tourism sector. For GATS V-1a, see the next section.

<sup>20</sup> Arrangement among too many parties may have a problem associated with monitoring costs. Meanwhile, arrangements consisting of only two parties may be ignored relatively easily by a contracting party compared with agreements among more than two parties. See Ravenhill (2001, 29).

Moreover, AFAS has helped increase the bargaining power of ASEAN as a group and individual ASEAN members at GATS negotiations. ASEAN members do not always speak with one voice at services negotiations at WTO, but it is still regarded as a kind of group in WTO.<sup>21</sup> ASEAN members did not ask Viet Nam to make further improvement of its AFAS commitments on the occasion of the 2006 AFAS package, which could have reduced the country's bargaining power with regard to WTO accession, and strongly supported its WTO membership, as aforementioned. Moreover, ASEAN countries attempt to strengthen less competitive services sectors by opening them up within the region first, before opening to global players at the global level. In fact, ASEAN countries have participated in GATS negotiation groups on air and logistics as “*requested*” members, but they have chosen these sectors as priority sectors for liberalization under the AFAS scheme. This is expected to eventually lead to a change in ASEAN's negotiation positions at the WTO; sooner or later, ASEAN may be able to engage in a GATS negotiation group on logistics and air sectors<sup>22</sup> not as “*requested*” but as “*requesting*” members. The competitiveness of regional single services market in ASEAN may increase in long-term negotiating power of the region.

## 5. Policy Proposal: The Amendment of the GATS Article V

Above all, it is important to recognize the fundamental difference between trade liberalization in goods and services. In the case of goods, the complete elimination of tariffs after a transitional period is implicitly assumed when countries form an FTA. In other words, the event of trade liberalization in goods is one-off. In the case of services, however, progressive liberalization through successive rounds of negotiations is the common practice, though the modality of future services negotiations is still unpredictable.

Because the one-off elimination of tariffs will entail large economic impact on outside parties, some requirements for forming an FTA are stipulated in GATT XXIV. Satisfying these conditions is essential to maximizing the trade creation effect and minimizing the trade diversion effect. They are:

- Duties and other restrictive regulations with respect to substantially all the trade among FTA members should be eliminated (GATT XXIV-8);
- Any interim agreement regarding an FTA should be terminated within a reasonable length of time (GATT XXIV-5c); and
- Duties and other regulations applicable to WTO members other than FTA members should not on the whole be higher or more restrictive than those prior to the formation of the FTA (GATT XXIV-5a).

<sup>21</sup> ASEAN's joint proposal on Emergency Safeguard Mechanism (ESM) in Services is one of examples.

<sup>22</sup> The coverage of air transport services under GATS is very limited because of its Annex on Air Transport Services, which stipulates that GATS is not applicable to any measures affecting traffic rights.

Similar, but not the same conditions need to be satisfied by regional services arrangements are listed in GATS V. They are:

- Service arrangements should have substantial sectoral coverage (GATS V-1a); and
- Substantially all discrimination regarding National Treatment in the sector covered should be eliminated on the basis of a reasonable time-frame (GATS V-1b).<sup>23</sup>

Interestingly, the footnote of the GATS attempts to provide more detailed explanation of the “substantial sectoral coverage”. It should be understood as substantial coverage in terms of the number of sectors, volume of trade affected and modes of supply, and no permission of *a priori* exclusion of any mode of supply. Despite such an elaboration, it is still uncertain what it means exactly. An important point here is that GATS does not simply say “substantially *all* the trade in services”, unlike the case of goods. The way in which “substantial sectoral coverage” is examined is not simple. This is mainly because the concept of services trade and services *per se* is elusive and measuring the amount of trade in services is extremely difficult.

Another interesting point is that the “time-frame” of integration is not a strict requirement in the case of services. It only says “on the basis of a reasonable time-frame”, not “within a reasonable time-frame” like the case of goods. As long as a reasonable plan is presented, such a service integration scheme satisfies this condition. This is exactly the reason why progressive liberalization is possible for regional services arrangements. As a result of these, it is extremely difficult for GATS to prevent the formation of regional service arrangements just on the basis of their inconsistency to GATS V. This in turn means that service arrangements have not been effectively governed by GATS.

What then is the appropriate and practical mechanism for GATS to govern regional services arrangements? The key is the fundamental nature of services liberalization—progressive liberalization. As we have seen, both GATS and AFAS attempt to achieve progressive liberalization, but the latter has been more successful. In the case of goods, the principal concern is to minimize the negative effect of a “one-off” elimination of tariffs in the region by setting requirements for regionalism. But because of the fundamental nature of services liberalization (namely, autonomous and progressive liberalization), the direct control of regional services arrangements by setting requirements is not practically feasible; without discretion in terms of liberalization measures, a regional services arrangement does not become fruitful for members. To a certain extent, reflecting regional-level “progressive liberalization” in multilateral progressive liberalization, with some time-lag, is a better way to cope with regionalism.

The essence of the proposal can be explained by Chart 1. The basic idea is: a particular level of liberalization achieved in regional commitments is expected to be multilateralized at GATS after a reasonable period. If the frequency of WTO round negotiations is as significant as regional round negotiations, the two can be described as two parallel lines

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<sup>23</sup> New or more discriminatory measures are also prohibited by GATS V-1b.

in the chart. In this case, what has been achieved at a regional level should be “copied” into multilateral commitments after a reasonable period. However, the frequency of multilateral negotiations seems to be much lower than regional negotiations. As we have seen, while there have been six packages of AFAS services commitments, no round has been concluded at the multilateral level after the Uruguay Round. Therefore, in reality, the level of liberalization of services commitment at WTO can be described as a stair-shape line in the chart. GATS commitments of services should, after a designated period, at least cover what has been achieved at a regional level.

Accordingly, GATS Article V *ter* is proposed as a new paragraph in the current GATS.

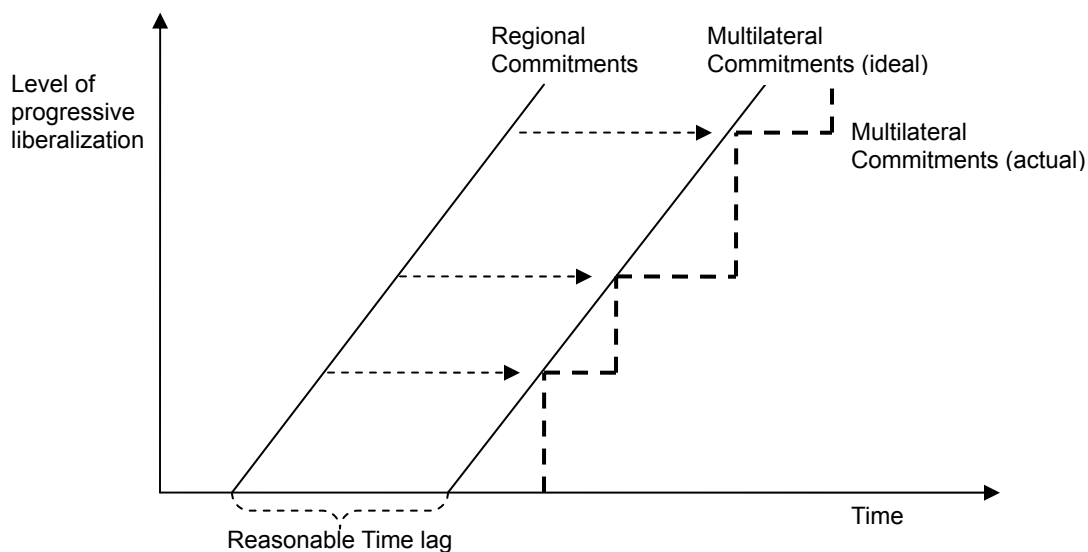
#### GATS V *ter* Regional Integration and GATS

Specific commitments regarding regional integration shall be, to the extent possible, reflected in specific commitments of GATS after a reasonable time-framework.

If this is achieved, there will be no need for WTO services negotiators to engage in *ad-hoc* bargaining in each round of WTO negotiations in order to request other WTO members to realize GATS commitments which are comparable to their regional commitments.

The relationship between regionalism and multilateralism is not just a theoretical academic debate. On the one hand, as long as services agreement is concerned, regionalism is likely to function as a building block of the multilateral trading system. On the other, it is also important to legally ensure that regional service liberalization contributes to a freer multilateral services regime. Policy-makers need to design the relationship between the two to ensure that regionalism reinforces multilateralism in the field of services as well.

**Chart 1: Regional and Multilateral Commitments**



Source: Author's own illustration.

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## **The Building Block versus Stumbling Block Debate of Regionalism: From the Perspective of Service Trade Liberalization in Asia**

Shintaro Hamanaka argues that regionalism is a building block, not a stumbling block to a multilateral trading system, using the services liberalization scheme of ASEAN (AFAS) as a case study. To define the appropriate relationship between multilateralism and regionalism in the context of services, he also proposes an amendment of the current GATS Article V.

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