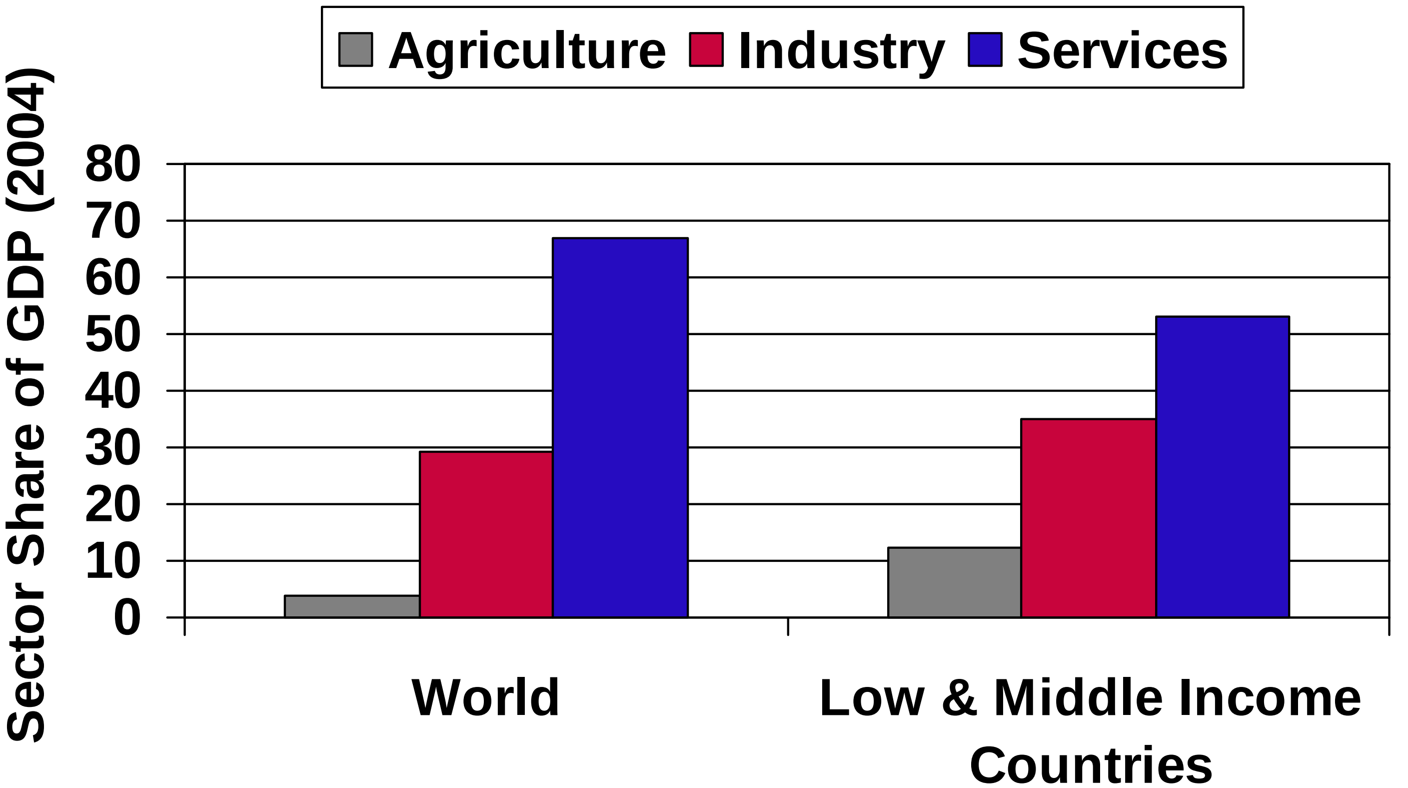
Liberalizing Infrastructure Services: A Key To Economic Growth and Development

Office of the U.S. Trade Representative

Open services markets: a key to achieving growth and development

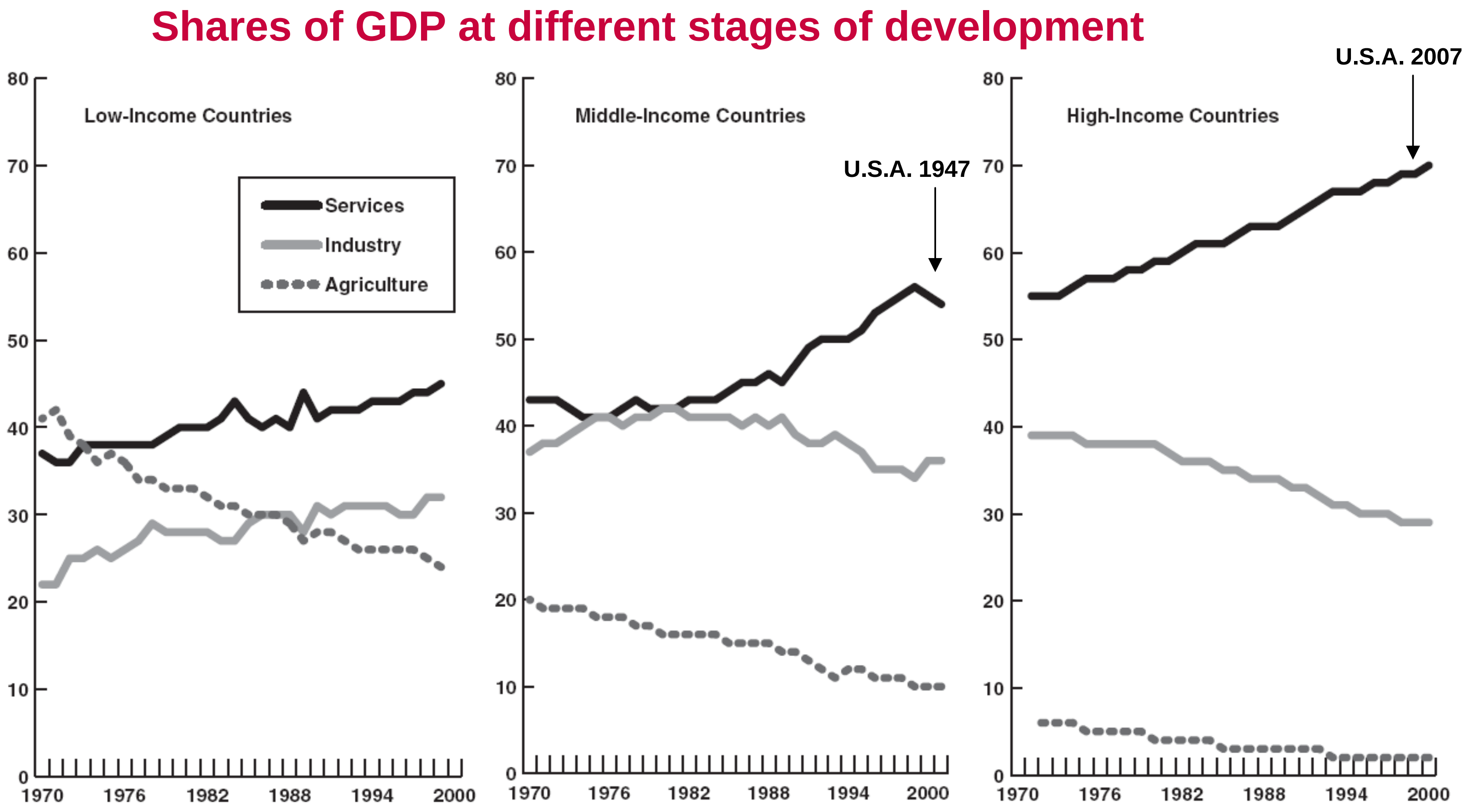
- The largest sector of the global economy
- Greatest source of new jobs and investment in emerging markets
- Vital for the productivity and competitiveness of domestic firms and overall economy

Services is the largest sector of the global economy



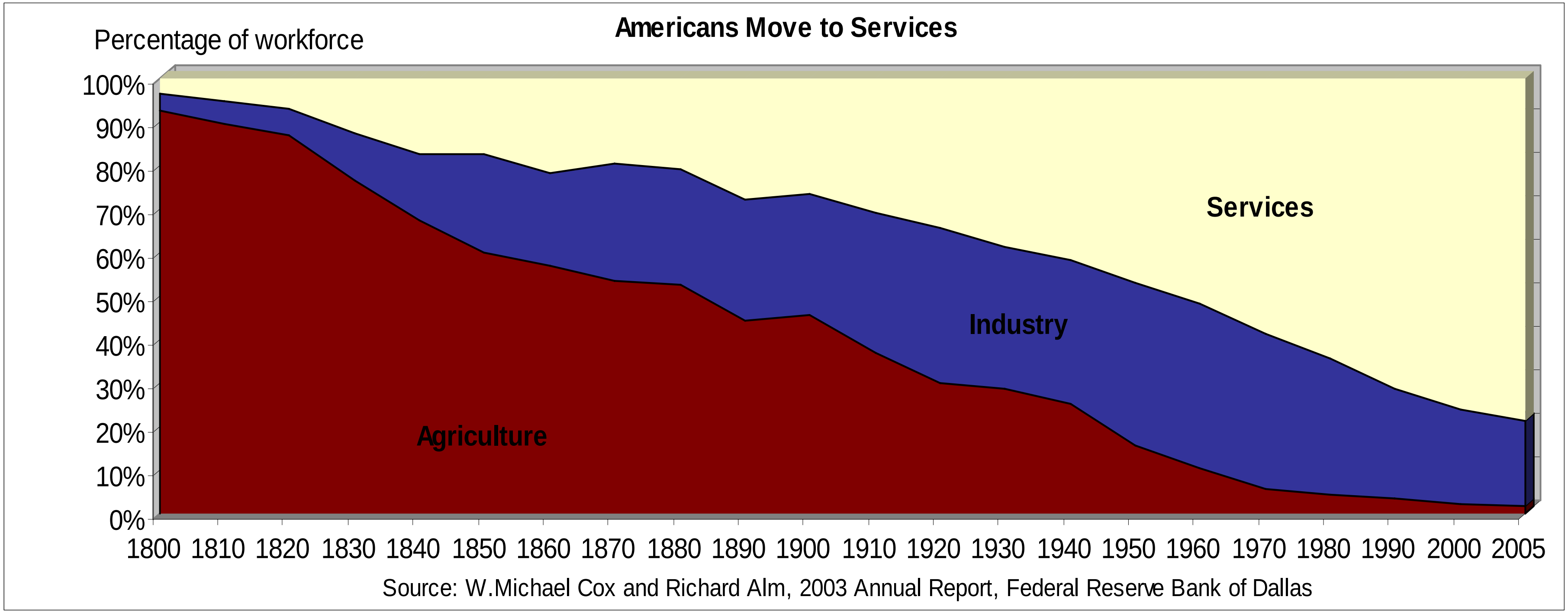
World Bank, World Development Indicators, 2006

Expansion of service sector related to economic development



Jobs follow the same trends

U.S. Employment Since 1800 By Sector



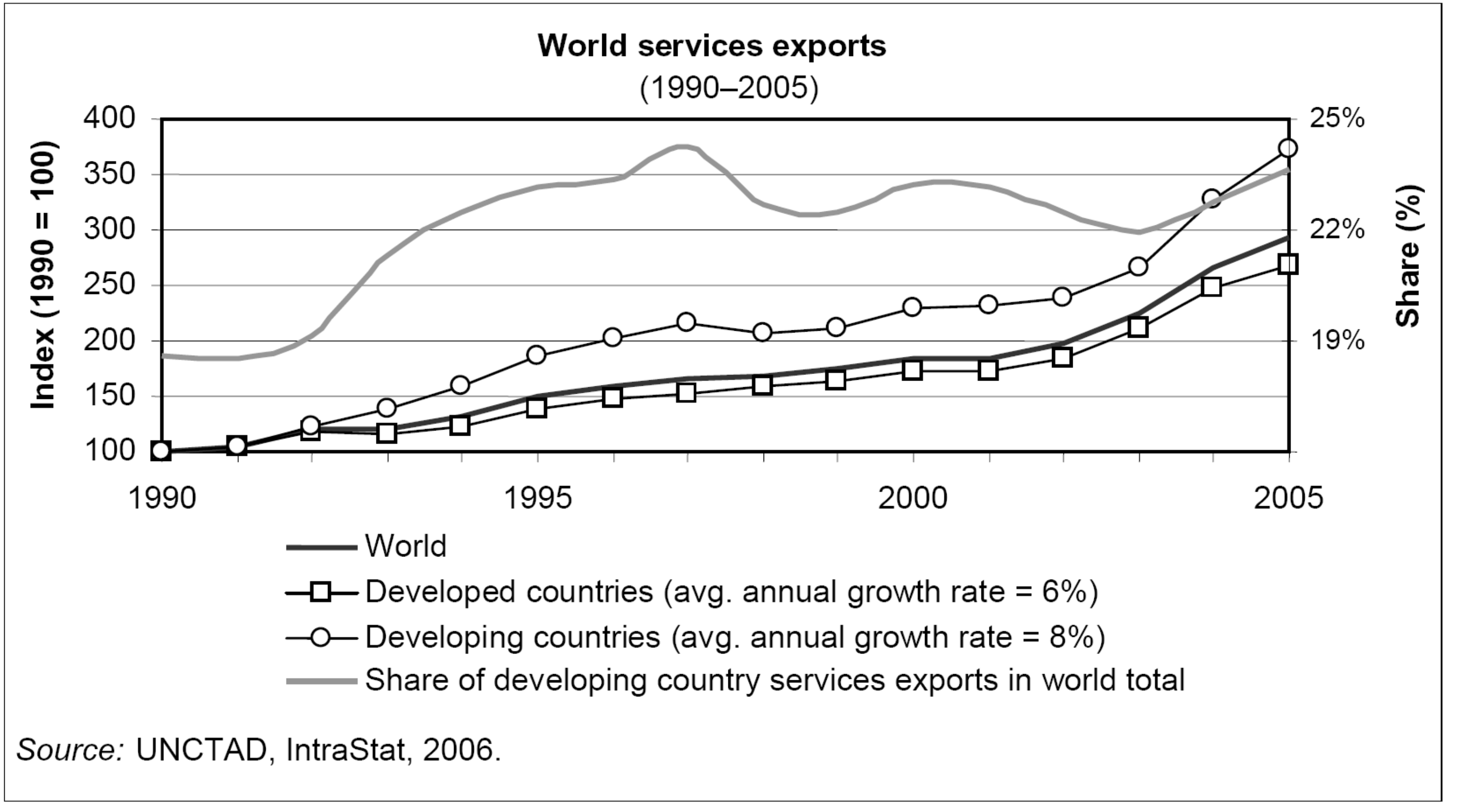
Meeting business and consumer demands for services generates growth and jobs

- Services sectors such as financial, telecom, and distribution services are critical inputs to modern production and integrate economies across sectors—the new “infrastructure” of the modern economy.
- Businesses demand ever-more efficient and sophisticated infrastructure services as essential inputs into their production of goods and other services.
- As incomes grow, consumers traditionally spend an increasing share for services such as such as banking, telecommunications, tourism, and entertainment.

Open services markets allow these demands to be met

- Open markets:
  - Promote innovation and entrepreneurship
  - Generate lower costs and higher quality
  - Enhance performance of downstream activities
  - Provide the discipline of competition and drive resources into more productive activities
  - Increase the pace of technology diffusion
  - Attract more foreign direct investment (FDI)
- Countries that restrict trade in infrastructure services are blocking their own economic growth and global competitiveness.

Since 1990, services exports growing faster from developing countries

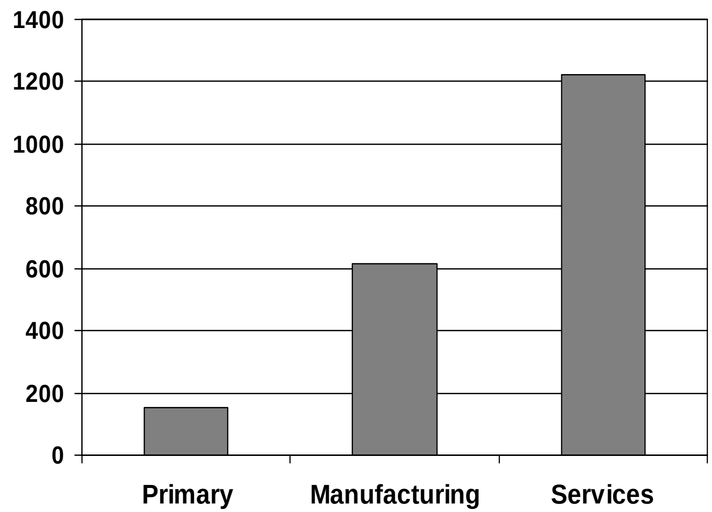


Note: The growth in services exports is indexed to 1990 on the left-hand vertical axis. The share of DCs' exports in total world services exports is plotted along the right-hand vertical axis.

Services attract the most FDI in emerging markets and create new jobs

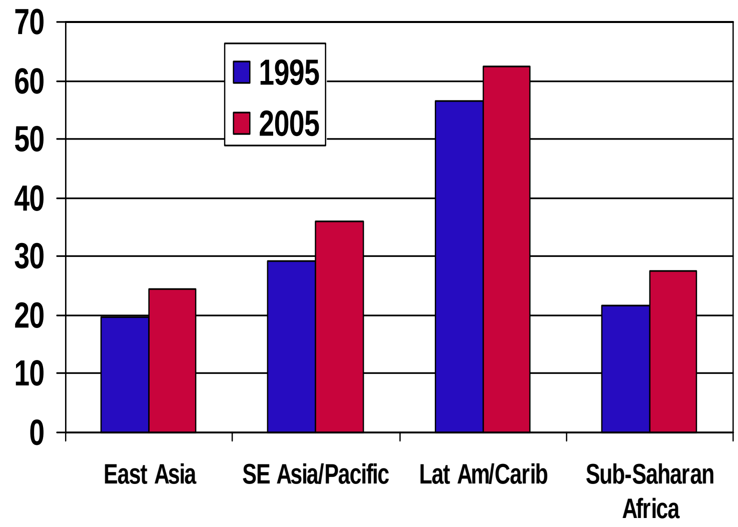
Global FDI stock in developing countries, 2004

(Billion U.S. Dollars)



UNCTAD, *World Investment Report, 2006*

Share of total developing country employment in services



ILO, *Global Employment Trends Brief 2006*

FDI and trade are critical for technology diffusion, a key development component

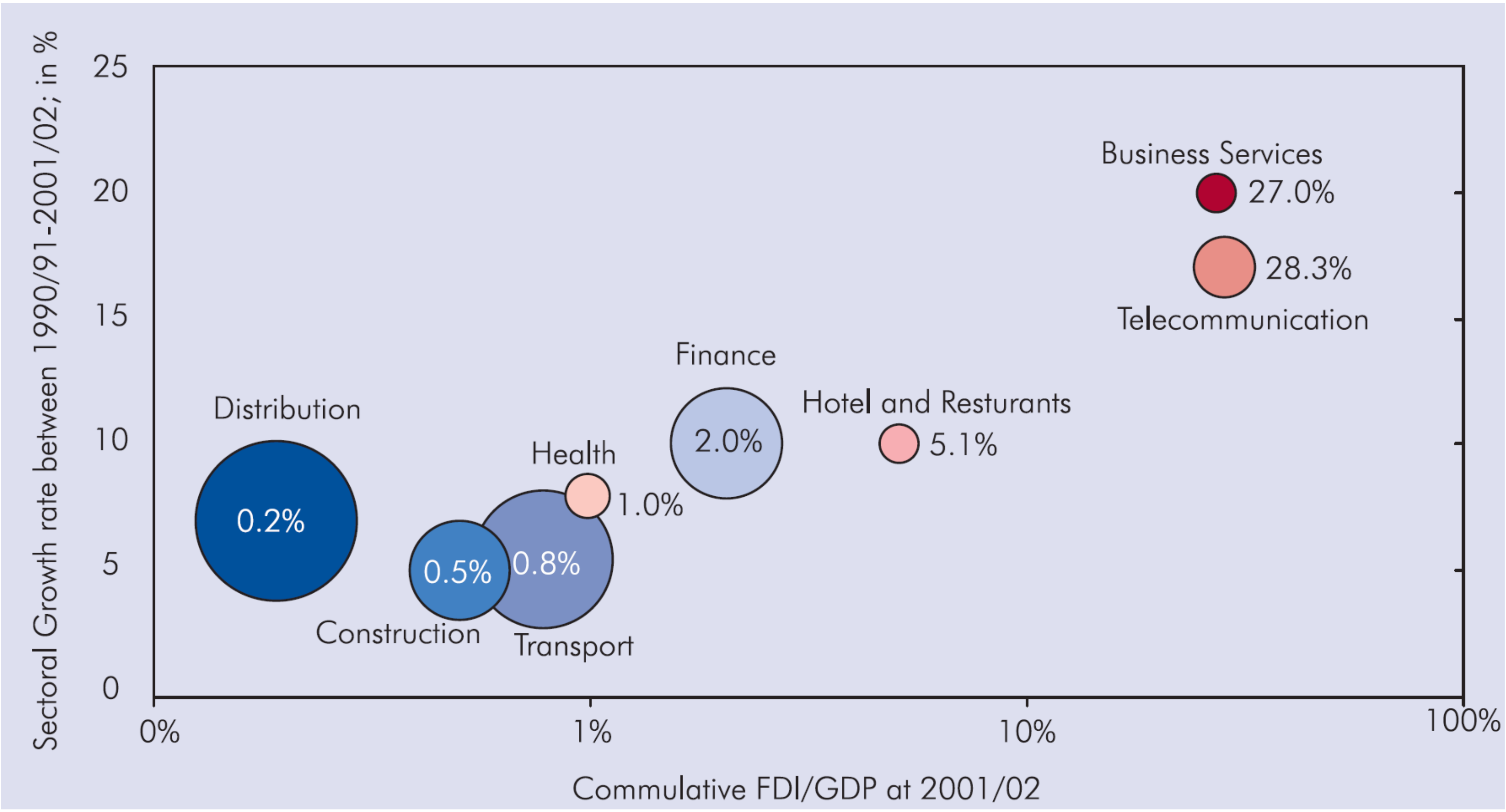
- “As measured by total factor productivity, [technology] explains much of the differences in both the level and rate of growth of incomes across countries.”

- “Increased openness to foreign trade and foreign direct investment (FDI), plus increased investments in human capital, have contributed to substantial improvements in technological achievement in developing countries over the past 15 years.”

- “Foreign firms are making important contributions to the technological capacity of host countries, performing more than 40 percent of the total R&D in some countries. . . . the competition, standards and knowledge of foreign markets that foreign firms bring to the domestic market can have important spillover effects.”

World Bank, *Global Economic Prospects 2008: Technology Diffusion in the Developing World*

Indian sectors receiving more FDI have had the greatest growth



World Bank (2004) *Sustaining India's Services Revolution*

Services key to competitiveness

- “The international competitiveness of traditional sectors of developing economies is heavily dependent on access to services at world prices. The best guarantee that services will be supplied at world prices is to open an economy to the pressures and opportunities of international competition or trade and investment liberalization.”

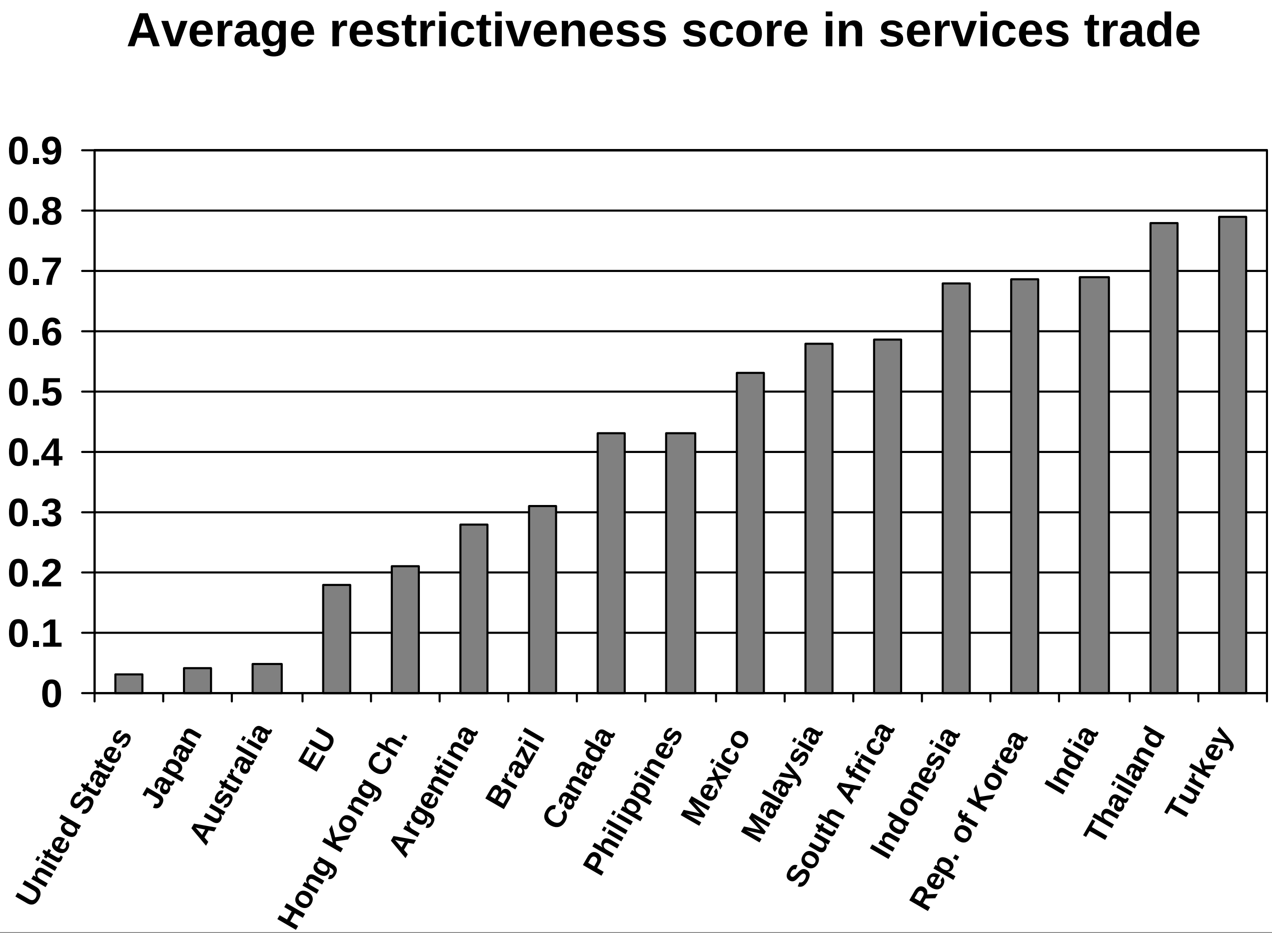
UNCTAD, Study Series No. 19, 2002

Does Services Liberalization Benefit Manufacturing Firms?

- Title of World Bank study, using data from the Czech Republic.
- Answer: Yes
  - *“. . . our findings of a positive relationship between liberalization of services sectors, in particular opening of services sectors to foreign providers, and downstream manufacturing performance are consistent with a productivity-enhancing effect of a reform in services.”*
- Open services sectors critical for overall economic competitiveness.

Arnold, Javorcik, and Mattoo (2007)

Developing countries tend to maintain more restrictions on services



The index scores are the average restrictiveness scores for banking, distribution, maritime, professions and telecommunications. Adapted from McGuire, 2002.

Impediments that prevent growth of infrastructure services

- Foreign equity restrictions
- Excessive and burdensome requirements for market entry (such as high capital and scope-of-business requirements)
- National treatment concerns
- Lack of commercial certainty owing to unpredictable and non-transparent implementation of existing regulations and approval of licenses

Lessons learned: What government policies best address these impediments?

- Transparency and predictability
- Fostering competition
- National treatment (non-discrimination)
- Ease of market entry
- Sound regulatory choices

Examples

- Financial services
- Communication services
- Computer and related services
- Express delivery services
- Distribution services
- Energy services

Financial services in a modern economy

- Banking
- Insurance
- Securities
- Pension fund management
- Asset management
- Financial information services
- Electronic payments systems
- Other financial services

Economic efficiency and stability enhanced by better capital allocation

- Credit flows to growth sectors and competitive firms rather than politically connected state-owned enterprises, resulting in fewer bad loans and accelerated growth.
- Insurance products (such as life, property/casualty, reinsurance) benefit both businesses and consumers by transferring risks and freeing up capital for more productive uses.
- New products (e.g. enterprise annuities) help people hedge against risk (supplementing government efforts to build a social safety net) while giving higher returns on their savings than bank deposits, thereby reducing precautionary savings rates.

Internationally competitive financial services essential for development

- Competitive markets encourage innovation, entrepreneurship, and the diffusion of new technology, which work to lower costs and produce more sophisticated capital markets.
- Financial services a key input for domestic firms in all sectors. Lower costs improve their competitiveness, in both domestic and world markets.

Entry of foreign banks improves access to credit, for businesses of all sizes

- World Bank study of 3,000 enterprises in 36 developing and transition economies, investigating the impact of foreign bank entry on enterprises' access to credit.
  - *"The results strongly support the assertion that foreign bank penetration improves firms' access to credit"*
  - *"The benefits of high levels of foreign bank penetration do not appear to accrue only to large enterprises . . . there is strong evidence that even small enterprises benefit and there is no evidence that they are harmed by foreign bank entry."*

Clarke et al. (2002)

Communications: Critical 21st century infrastructure

- Telecom and information technology (IT) services:
  - underpin a new kind of business reality, both for traditional goods and services industries and new growth areas.
  - are “force multipliers” that increase productivity across all sectors of the economy.
  - create new levels of global integration that generate new trading opportunities and relationships.

Telecom, like financial services, generates economy-wide effects

- Countries that fully liberalize financial services grow, on average, 1.0 percentage point faster than other countries.
- Countries that liberalize both financial services and telecommunications sectors grow even faster: on average, 1.5 percentage points faster than other countries.

(World Bank Policy Research Working Paper No. 2655, 2001)

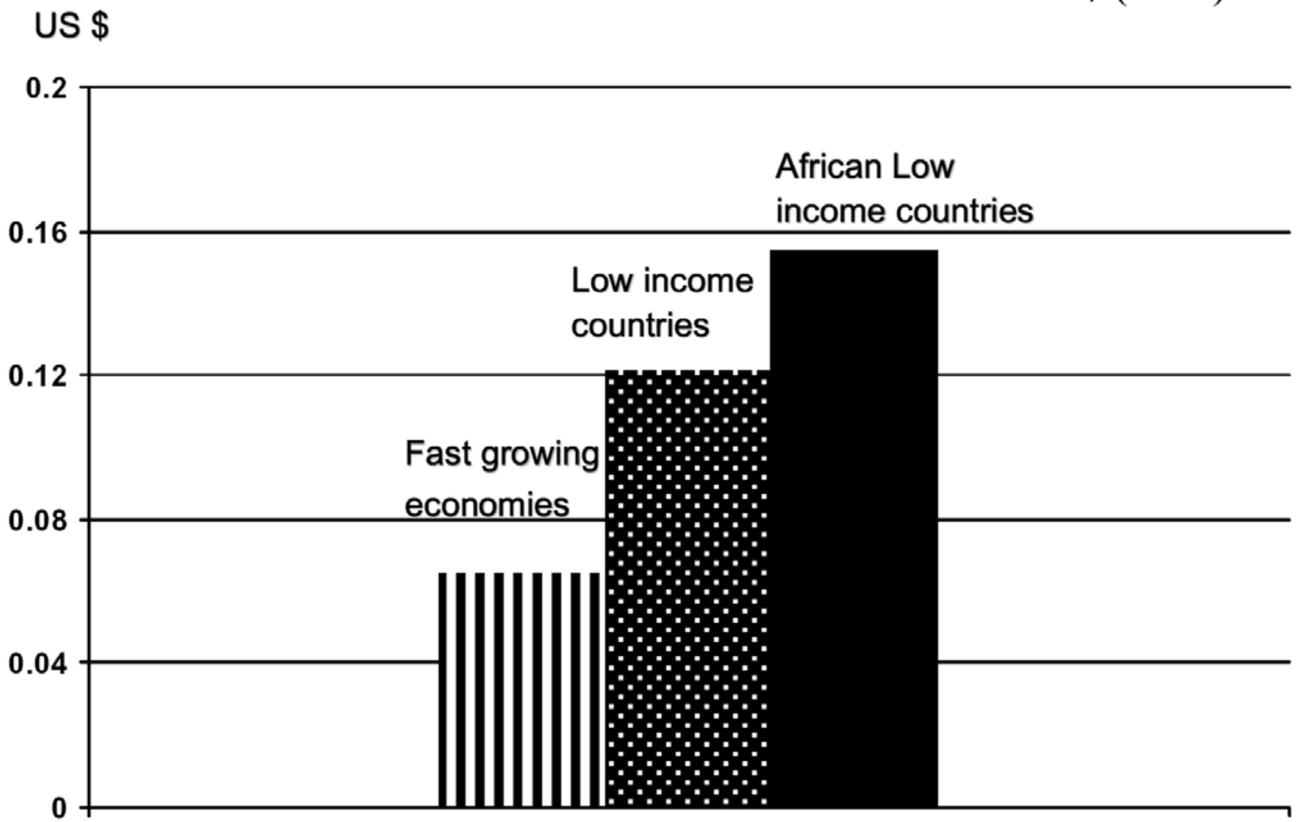
ITC inputs key for firm productivity

- Domestic producers may find it difficult to succeed, even in domestic markets, without access to vital ITC services inputs of competitive quality and prices.
- Evidence from Africa firm-level data shows "significant and positive relationship between firm productivity and service performance . . . Inadequate access to essential producer services hurts African firms by undermining their productivity."[1]
- Same study showed a 13% productivity improvement associated with a shift from average to high telecom performance.

[1](Arnold, Mattoo, and Narciso, 2006)

Telecom efficiency linked to development success

One indication: Cost of three minute local call in US$ (2005)



Source: World bank staff calculation based on data from International Telecommunications Union.

The 16 fastest growing developing countries (1980-1995) had more efficient telecom than other developing countries

Case study: Pakistan

From Pakistan's 2007 Report to the WTO Trade Policy Review:

"Since the last Trade Policy Review, the telecom sector has been totally transformed. In 2003, the new Telecom Deregulation Policy and in 2004 the Cellular Mobile Policy were announced to liberalize this sector. These policies resulted in large investments and new players entering the telecom market. Since July 2003, regulators have handed out more than 900 fixed, mobile, and long-distance licenses to some 50 companies. Already teledensity has increased from 4% to about 45% of the population. The number of mobile subscribers has increased from 8 million in 2003 to over 70 million in 2007. This sector has become a major provider of skilled jobs as its exponential growth has resulted in creation of 80,000 jobs directly and 500,000 jobs indirectly. An unprecedented amount of foreign investment flowed into the sector."

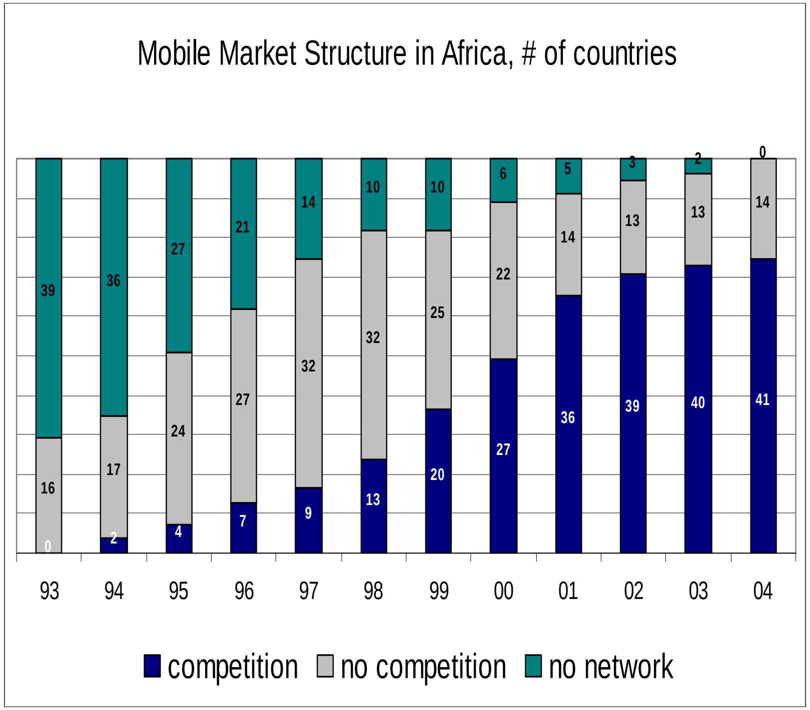
Case study: Brazil

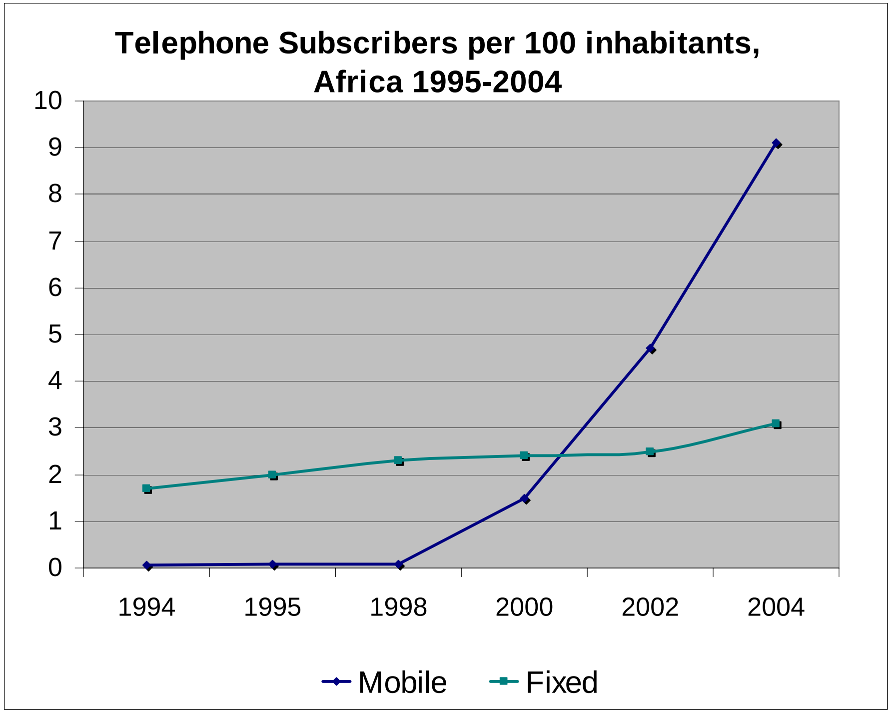
- Liberalized telecom sector in 1997-1998.
- By 2000, telecom attracting 16% of FDI, up from 0.5% in 1990.
- Competition drove down prices by 20%.
- Mobile phone users increased from 15 million in 1997 to 65 million in 2004.

Case study: Nigeria

- Until 2001, Nigeria had one of the lowest tele-density rates in the world.
- In 2001, government awarded three 15-year mobile cellular GSM licenses.
- 400,000 new GSM subscribers in one year, almost equal to the number of fixed-line telephones installed in previous 40 years. Two million subscribers by 2003.
- Once highly concentrated in Lagos, telephone service covered 219 out of 550 local government areas by 2003.

Liberalized telecom markets transforming Africa





Computer & Related Services

- CRS an interesting contrast to model of protecting “national champions” and slowly liberalizing.
- From start, CRS widely liberalized. Not only has growth been explosive, but many developing countries have developed world-class competitiveness.
- Global market for CRS: $US 569 billion (2003) and likely to reach $US 700 billion by 2007.

Transforming India

- Liberalization of IT sectors in 1990’s has led to enormous growth, and demonstrates potential for developing countries to leap digital divide.
- Indian software exports grew from $225 million in 1992-93 to $1.75 billion in 1997-98, an annual growth rate of 50 percent.
- By 2008, the IT sector could account for 35 percent of India’s exports and attract $5 billion of FDI per year.
- A critical part of India’s emerging middle class, which increased 17 percent between 2000 – 2003 and numbers over 250 million.

Importance of express delivery services

- Improves the competitiveness of almost all aspects of companies' operations, including production, sales, logistics and storage, and customer support functions.
- Transports a growing share of world trade, as companies increasingly demand rapid, guaranteed delivery.
- Facilitates this trade by investing in new delivery routes and services.
- Important for many companies based in geographically remote countries or where the domestic transport infrastructure is poor.

The U.S. experience

- Deregulation of air cargo in late 1970's allowed express delivery companies to meet need of companies for time-definite, guaranteed delivery.
- U.S. once consisted of series of isolated regions, many with closer linkages to other countries than among themselves. Express companies linked America with hub and spoke networks.
- Businesses able to locate in regions not close to their market, allowing smaller towns to attract employers, and dispersing economic activity to more regions.
- Just-in-time production systems helped reduce inventory input-output ratio by 20 percent over last 20 years, saving US companies over $25 billion a year.

Distribution Services

- Virtually every good or commodity makes its way to the market through distributors. Wholesalers, retailers, commissioned agents and franchisers provide the domestic infrastructure for moving goods to consumers.
- The value added in the distribution stages can greatly exceed the value added in production; for example, the value created in distribution accounts for 70% of total value for textiles and over 75% for food products (UNCTAD).

Distribution Services

- Frequent barriers include limitations on the purchase of real estate, restrictions on equity holdings, exclusions of products or services due to state monopolies or national interest, nationality quotas, and residency requirements.
- Excess profits enjoyed by uncompetitive distribution firms come at the expense of consumers and producers.
- Delays for imports and exports not only reduce trade volumes, but also reduce the probability that firms will even enter export markets for time-sensitive products.

Benefits of distribution liberalization

- Distributors manage inventories efficiently, minimize spoilage and waste.
- Producers assume lower risk.
- Consumers pay less, have greater choice.
- Liberalization, trade facilitation reform, and domestic regulatory reforms in distribution can be implemented at relatively low cost in low-income countries.
- The gains from these reforms can be substantial.

Case study: Lithuania

- Lithuania's first law on trade, introducing the notion of retail trade and wholesale and provisions on competition, adopted in 1995.
- By 2003 wholesale and retail trade had become the third most important sector in the economy, accounting for 17% of all FDI flows.
- Over the last four years, five domestic chains have emerged as the key players in the distribution sector, accounting for 70 per cent of food retail sales.
- The leading national chain in food and consumer-care products has expanded into regional markets.

Case study: Zambia

- The liberalization of the Zambian distribution sector allowed the inflow of foreign retail companies, which replaced some of the traditional retail sector with modern supermarkets and added both upstream and downstream benefits to the domestic economy.
- Consumers benefited from lower costs; local suppliers learned new production and marketing techniques—sometimes from the retailers themselves—that enabled them to improve the quality, efficiency, and revenues of their operations.
- In the case of a farmers' cooperative that now supplies supermarket outlets, cash income has increased from $2 to $3 a month to $50 to $70 a month, and access to health care and education services has improved.

Services Trade and Development: The Experience of Zambia, 2007

Energy Services

- Services involved in the exploration, development, extraction, production, generation, transportation, transmission, distribution, marketing, consumption, management, and efficiency of energy, energy products, and fuels.

A changing model for energy

- Twenty years ago, industry operated mainly:
  - as state-owned enterprises
  - primarily within home markets
  - as vertically integrated companies with monopoly positions; most functions performed “in-house”.
- Now:
  - Governments and national oil companies increasingly calling on independent oil and gas exploration and production companies
  - Independent service operators bring technology, capital, and project-management expertise to the countries in which they operate.

Lingering barriers

- Restrictions for the entry of the equipment and tools needed to provide the service
- Arbitrary business and licensing requirements
- Regulatory frameworks lack transparency.

Benefits of energy services liberalization

- Energy services can be highly technical and specialized, and often performed in difficult environments.
- Competitive provision of energy services helps ensure that consumers have access to efficiently produced, market-priced, reliable energy, and the latest in environmentally friendly technology.
- Competitiveness in a nation’s energy services markets enhance the competitiveness of domestic energy consumers as well as the incentives for foreign investors to invest in both energy services and energy-consuming sectors.

The Latin American experience

- Before liberalization, the sole participant in the energy business was the government, through agencies with different levels of autonomy.
- Liberalization brought in both foreign and domestic investors, independent power producers, banks, financial advisors, and large customers, who now have a say in their energy supply providers.
- New technology has modernized the marketing and commercialization of energy products, enhanced the performance of power generation equipment (such as combustion turbines), and provided the tools for state-of-the-art management.

The Latin American experience

- Overall access to electricity and gas has increased substantially.
  - Argentina's electricity capacity went from 15,000 MW and 55% availability before liberalization to 22,000 MW and 85% availability.
  - Peru's electrification coefficient reached 75% in 1999 from 47% in 1992.
  - Colombia's thermal electricity capacity increased by 111% between 1992 and 1999.

Myths blocking liberalization

- **Services liberalization is not de facto “deregulation**”
- Liberalization means removing requirements that discriminate against foreign service suppliers and providing transparent regulation.
- Consistent with maintaining the right to regulate and promotes good governance, and creates an attractive business and investment climate.

Myths blocking liberalization

- **Services liberalization should be viewed as part of the solution to economic dislocation rather than a cause of dislocation**.
- Developing country transition from subsistence farming and agriculture to greater reliance on services and manufacturing is essential to produce real increase in living standards.
- Overall GDP and employment growth from services liberalization is key to enabling this transition to occur and to create new jobs and opportunities for those who suffer economic dislocation.

Moving forward

- Pattern is clear: What has been good for manufacturing—trade and investment—is also good for services.
- Emerging-market economies that open up services sectors are enhancing the competitiveness of their manufacturing base and building the strongest foundation for future job and economic growth.