

# services sector liberalisation

Literature review

TRADE AND INDUSTRIAL POLICY STRATEGIES (TIPS)   
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## Trade and Industrial Policy Strategies (TIPS)

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# 1. Introduction


Trade in goods has often been the focus for academics and policy-makers. In domestic economies, however, services usually make up more than 50% of the gross domestic product (GDP). In South Africa's (SA's) case, this rises to 70% of value added. For the past two decades, world trade in services has grown faster than world trade in goods. One of the reasons for the focus on trade in goods is that trade in services is so much more complicated. In fact, widespread trade in services has only become feasible in recent decades due to advances in technology.

Trade in services offers an important opportunity for developing countries. Over half of all foreign direct investment (FDI) flows is linked to services. Developing countries have also been more successful at trading services than they have at trading goods. Nine of the 25 top services trading countries are developing countries.

The importance of services in the domestic economy can also not be overestimated. For instance, key producer services such as telecommunications and financial services have been shown to be closely linked with economic growth. The role of services as inputs to many production processes means that a country with an efficient services sector is likely to gain more from goods liberalisation.

In this report we focus on the dynamics underlying services trade and the literature around the concept of services trade liberalisation.

A second report surveys the literature around services trade within and by SACU countries in particular. In addition, primary research on the current competitive position of SACU's transport services industry aims to fill some of the information and capacity gaps in the economic analyses of these sectors. Enabling a better understanding of the costs and benefits of transport services liberalisation, the report aims to assist in upcoming trade negotiations.



## 2. Understanding trade in services

The World Trade Organisation (WTO) categorises services according to four modes of delivery. Not all services can be delivered through all four modes but it is important that this classification is understood because the implications of liberalisation differ according to the delivery mode. The restrictions on trade also vary according to how the service is traded.

### 2.1 The four modes of supply

#### Mode one: cross-border supply

This mode of delivery is the most similar to trade in goods in that the service is supplied from abroad. Examples of cross-border trade would include distance education. In this case, production takes place somewhere other than where the consumer is located. This also means that the factors of production do not have to move to meet the consumer.

Technology has had a major impact on cross-border supply of services. Using the example of distance education again, in earlier times this service could only be supplied through the postal network. Now the same service is available, but much faster and more effectively, through the Internet.

In cases such as banking services and education, advances in technology have made cross-border supply of services easier. In other cases, it has made cross-border supply possible where it was not viable before. In countries with fast Internet connections, it is no longer necessary for a surgeon to be in the same room as the patient. On the other hand, new technology also makes it harder to regulate cross-border supply, as the service – embodied in a postal envelope in earlier days – no longer needs to cross a national border (Brown and Stern, 2000).

The main barriers to trade in services are regulations. Most industries face regulation of some sort, even in the local market. Regulations perform a number of roles but their primary task is to correct for market failure. An important issue in services sector liberalisation is to balance the need for deregulation with the need to correct the market failure (Hoekman & Mattoo, 1999). McGuire (2002) classifies regulations according to whether or not they discriminate against foreign providers.

For example, banks are generally required to have a minimum level of reserves on account with a country's central bank. This is not discriminatory. However, in SA, subsidiary branches of foreign banks may not count the reserves of their parents towards their reserve requirements. This raises the costs of entry for foreign banks and is thus a discriminatory regulation.

Barriers to trade for cross-border supply relate mostly to the transmission of funds. For example, exchange controls in SA prevent foreign banks from supplying their services to South Africans through the Internet. In some cases, governments attempt to regulate radio or television broadcasts from outside their borders, but this is not always successful.

### Mode two: consumption abroad

The second mode of service provision is called consumption abroad. In this instance, consumers move to the service providers. This has important implications for the production of the service and the location of the factors of production. Examples of this mode of service provision include the education of students in countries other than their home country, or tourism. Not many services employ this mode of provision. The main restrictions on consumption abroad are controls on the movement of currency and people, for example, limits on the amount of currency allowed to cross borders and visas required for students or tourists.

### Mode three: commercial presence

The most important method of service provision is commercial presence. In this case, foreign service providers establish a local branch and supply to the local market from within the country's borders. Once again this means that the factors of production come into contact with the consumers, which does not have to occur in the market for goods. Examples of commercial presence include banking, catering and accommodation, transport and insurance, amongst others.

Because commercial presence requires the foreign firm to own the local branch, mode 3 trade generates FDI. Such FDI may take the form of either greenfields (newly establishing a local company and the branch offices) or brownfields (acquiring a local company) investment. In either case, the influx of investment and technology accompanying the investment should result in benefits for the host country.

The spectre of foreign corporations owning local assets often brings about protective policies, usually realised as restrictions on FDI. Brown and Stern (2000) identify three main categories of barriers to FDI – restrictions on market access, ownership and control restrictions and operational restrictions. Examples of market access restrictions include outright bans on FDI (as evidenced in Korea in certain strategic sectors during the 1960s), restrictions on the legal form of entry, minimum capital requirements, screening and approval, and conditions on location and further investment. Restrictions on ownership include the need for a local partner (or a BEE<sup>1</sup> partner in the SA context), mandatory transfer of ownership to locals after a specific period, and government-appointed board members. Governments may also put restrictions on the operations of foreign-owned companies by requiring them to export a certain percentage of output, meet local content and training quotas, and restrict the repatriation of profits.

### Mode four: movement of natural persons

The last mode of service provision is related to the input of foreign workers, rather than the production itself. It is referred to as the movement of natural persons. In this mode the service is provided through workers moving between countries and using their skills in foreign countries. In this case, countries can usually only determine the level of such service imports through regulations restricting the entry of foreigners. Similar regulations in foreign countries will determine their levels of exports. The benefit to the originating country will only be felt if the workers remit a portion of their wages.

The statistics on this mode of supply are not comprehensive but they suggest that developing countries are exporting much more through the movement of natural persons than developed countries. The important point to note is that remittances often do not occur, so it is not always true that developing countries benefit from this trade. 'Brain drain' seems to be ubiquitous amongst African countries.

In terms of imports, most countries protect their local market from this mode of supply, at least to some extent. The motives vary. In developed countries, governments want to avoid 'mass immigration' from the third world, as this could overwhelm their social grants systems. Generally developed countries are open to immigration, temporary or permanent, of skilled workers. The same is true to an extent of the developing world. Developed countries often have high unemployment rates, especially amongst unskilled workers, thus there are often extensive immigration controls to ensure that unskilled workers do not gain entry.

The main barrier to this form of trade is immigration regulations but McGuire (2002) argues that there are other methods that governments use to prevent entry. For example, countries may refuse to recognise the qualifications of foreign service suppliers. This will limit the scope of work such service suppliers can carry out. Membership of or registration with professional bodies may also be required. For example, Botswana requires all doctors practising in that country to register with the Botswana Medical Council. Some countries only allow foreign workers to enter on condition that their employing firm establishes a commercial presence in the country. In some cases countries may limit certain work only to local citizens and place restrictions on the ability of foreigners to become citizens.

In some cases, the regulatory obstacles placed in the way of the movement of natural persons may mean that workers prefer to stay in their home country and export their service embodied in a good. Copeland (2001) gives the example of a Canadian woodworker who could choose between working in the US or working on wood in Canada and exporting the finished product to the US instead. This is not always possible as services are not always embodied in goods (for example, medical services).

The question that we must attempt to answer is, given these differences between trade in goods and trade in services, does trade theory explain trade in services? Also, does trade theory predict that free trade is the first, best option?

## 2.2 The theory of trade in services

Copeland (2001) argues that the theoretical literature falls into 4 categories. The largest category is the comparative advantage models, which are very similar to the models for trade in goods. Monopolistic competition models follow the framework set out by Paul Krugman for his models of goods trade. Economic geography models include a spatial element. The last category is models that focus on special issues such as transportation or investment.

Burgess (1995) is an example of the comparative advantage type study. The model specified argues that the factors of service production are mobile internationally but the goods themselves are not. In other words, the model is mainly concerned with commercial presence mode. Burgess notes that under these circumstances, trade theory would only predict the equalisation of the returns to the mobile factor, not the price of the good because it cannot be traded. Instead, the price of the good is determined by local conditions of demand and supply. In this scenario, it is beneficial for a small country to liberalise trade in services and remove any barriers to the movement of the services factors. This is an ideal world. In reality, there are many barriers to the movement of factors, including taxation of the income of skilled workers. The country can benefit under certain circumstances, even if skilled labour income is taxed. The

host country will benefit, not only from the provision of cheaper services but also from cheaper and greater production of goods because services are an input in the production of goods. In an extension of the model to include mode 1 provision, it is shown that benefits from service factor liberalisation are higher than those for just liberalising the service goods market.

The other comparative advantage models, all predict results that are very similar to that for goods trade. The benefits to liberalisation accrue to consumers of imports through cheaper services and to the producers of services exports, if they have a comparative advantage in the production of the service. In the case where goods service liberalisation results in the equalisation of factor income, there will be no gains from the liberalisation of services as services will be traded by being embodied in goods. Should factor equalisation not occur (the more likely case given differences in technology and domestic policy), then the gains from trade would be similar to that for trade in goods. These models also predict that the gains from goods liberalisation will be larger if it is accompanied by services liberalisation. An obvious example of this is where a country does not have the skills necessary to exploit a natural resource or where local transport services are sub-standard. In scenarios like these, where local and foreign factors are complements, trade liberalisation results in increased productivity and demand for local factors. This may imply that small country can gain significantly from services liberalisation because of their limited domestic markets. The benefits from trade liberalisation are higher if trade in intermediate inputs, including services, is liberalised too (Copeland, 2001).

In models of imperfect competition, trade does not take place due to comparative advantage. In fact, trade may create differences between countries. In the initial phase, every country will produce every service. Once autarky ends, increasing returns to scale mean that different services agglomerate in different countries. In Helpman and Krugman (1985, quoted in Copeland, 2001), specialisation occurs at the firm level. Firms cater for consumer needs by developing niches. In the event of trade, consumers gain through increased access to variety, as well as the usual gains from increased efficiency. Firms also gain through increased access to cheaper intermediate goods. These models do not model trade in services as distinct from trade in goods so the benefits should apply equally. These models can also apply to foreign direct investment. Markusen (1984, quoted in Copeland, 2001) shows that FDI will take place if transport costs are too high or if trade barriers make supply from abroad not feasible. This is common sense when one thinks of a service like the fast food industry. Markusen (1989, quoted in Copeland, 2001) specifies a model where foreign producer services are substitutes for their local counterparts but national welfare is still improved through services liberalisation. The benefits from improved productivity in producer services allows goods production to expand. In fact, the productivity improvement is large enough to increase the demand for local skilled workers. In other words, foreign and domestic producer services are partial equilibrium substitutes but general equilibrium complements. In some cases, the productivity boost is large enough for the country to develop a comparative advantage in some goods which faced a comparative disadvantage before.

The economic geography approach builds on the imperfect competition models by adding a spatial dimension. Krugman and Venables (1995, quoted in Copeland, 2001) show that in the presence of transport costs, small countries in the periphery may lose from partial liberalisation as producers will accumulate in the core area. Other studies have tentatively shown that if trading and transport costs are low, multinational corporations are not allowed and factors of production are not mobile, then all production will agglomerate in one country. If multinational corporations are allowed then agglomeration will not occur. This could mean that liberalising services without liberalising market access could result in agglomeration and a welfare loss for small countries.





The dynamic gains from trade liberalisation are generally assumed to be higher than the static gains, although there is little theoretical and no empirical research to back up these claims. The dynamic case is based on the theory that when local firms are no longer protected from international markets by tariffs, they have to maintain a position on the technology frontier in order to be competitive. Thus, the dynamic gains from trade should include higher investment and greater gains in productivity. Unfortunately, this result has not proved forthcoming in the empirical studies that have been done. Or rather, the studies that have found gains from trade, have been shown to have serious methodological problems, to such an extent that their results have to be discounted completely. The research does not differentiate between trade in goods and trade in services.

## 2.3 Empirical studies of trade in services

One problem that the trade and growth literature has had has been defining the measuring the level of protection. This is complicated in goods trade by the presence of non-tariff barriers and subsidies but barriers in services trade are even more complex and difficult to pin down. There have been a number of different approaches. Hoekman (1995, quoted in Deardoff and Stern, 2003) pioneered the frequency method where protection is measured by the number of commitments made by countries in GATS. This assumes that each commitment is equal which is clearly not correct but it is a useful first approximation. Another approach that has been taken is to construct indices of liberalisation based on the regulations applicable to each industry (Chen & Schembri, 2002). As we shall see below, this has implications for the interpretation of the results of the study.

Quantity-based measures try to imply levels of protection through estimating gravity models and thus computing how much trade should be taking place. If actual trade is less than the expected trade, then this is assumed to be a result of trade barriers and the greater the difference, the larger the barrier is assumed to be. Price-based measures attempt to quantify the wedge between world and local prices and hence the barriers to trade. For example, Kalijaran et al. (2000, quoted in IFS, 2003) found that restrictions on entry of foreign banks raised the net interest rate spread by between 5% and 60%. Non-discriminatory restrictions were found to have a much smaller effect. All of the papers below use one of these techniques to quantify the barriers to trade caused by restrictions and regulations.

In the absence of real world empirical proof, the best alternative that we have is CGE-type models. One such paper is Dee and Hanslow (2000), which uses an FTAP model. They find that the global gains from free trade would be US\$ 260 bn. Only half of the gains would come from agricultural and manufacturing liberalisation. In other words, services liberalisation would generate as much wealth as liberalisation of the other sectors combined. The United States, the European Union, Canada, Singapore and Taiwan would all lose from services liberalisation. This mainly occurs because the relaxation of barriers to trade means that FDI flows out of these countries. Developing countries gain from services liberalisation but the majority of the gains accrue to China, to the order of US\$ 100 bn. This is because the services sector in China faces large barriers and because China will receive much of the FDI from the developed world.

These finding echo those of McGuire (2002) who summarises the results of other papers in three main points. Firstly, the income gains from services liberalisation are large. Secondly, developing countries will gain more than the developed countries because their barriers to trade are higher generally. Thirdly, gains from services liberalisation will result in gains for the agricultural and manufacturing sectors through intersectoral linkages, mainly as inputs. Because barriers to trade raise costs and results in

less efficient production, Mattoo, Rathindran and Subramanian (2001) argue that any barriers to services, which are often inputs into other production, will raise costs and be a de facto tax on production.

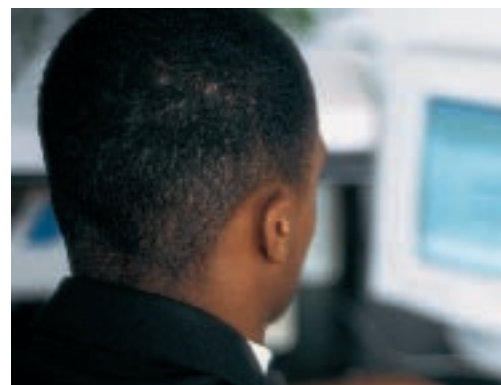
Brown & Stern (2000) also use an international CGE model to estimate the benefits from services trade liberalisation. Seven scenarios are modelled with varying levels of liberalisation and capital mobility. In the scenario with complete capital mobility, a fixed capital stock and total liberalisation, Brown & Stern (2000) also find that China will benefit significantly but not nearly to the same extent as in Dee and Hanslow (2000). Brown & Stern (2000) and Dee and Hanslow (2000) use very similar models except for the fact that demand is modelled differently, which would explain the different results. Once again, the US and the EU lose from liberalisation. An important difference from the results from Dee and Hanslow (2000) is that the Cairns group loses from liberalisation when the opposite is the case in Dee and Hanslow (2000). If the capital stock is allowed to grow, then the results are almost diametrically opposite. The EU and the US gain significantly while China's gains are quite small. In the event of there being a risk premium being applied to FDI decisions, China, the EU and the US lose from liberalisation and Japan is a significant winner. The results are useful but it difficult to decide what to make of all the different scenarios and to decide which is most appropriate. In addition, one faces the usual concerns about CGE modelling, namely the large number of assumptions made.

Findlay (2002) argues that the above studies show that full liberalisation is preferable to partial liberalisation. The reason for this is that the major constraints on the growth of the services sectors are actually non-discriminatory regulations. Allowing foreign competition without addressing the problem of non-discriminatory regulation will only mean that local firms will lose market share in a more competitive market. If non-discriminatory regulations are liberalised too then local producers may actually increase their output (though not their market share) at the same time as the usual benefits to consumers and downstream producers accrue.

Konan & Mascus (2004) use a CGE model to determine the effects of trade liberalisation on the Tunisian economy. Barriers to services trade are measured using price wedges. Once again a number of scenarios are modelled. What makes this study interesting is that it includes separate scenarios for goods and services liberalisation. The results seem to reflect some of the findings from the theoretical literature. Goods liberalisation leads to an increase in income of 1.5%, quite small compared to 5.3% for services. Gains from liberalising financial and transport services account for most of the increase. In the case of goods liberalisation, labour benefits more than capital but the opposite is true. Total liberalisation only leads to income gains of 6.7%, less than the sum of the individual sectors but the returns to factors is a lot more even.

Mattoo, Rathindran and Subramanian (2001) examine the impact of services liberalisation, especially in the financial sector and in telecommunications, on income growth. The authors construct an index of openness and then use this index as an independent variable in a regression on GNP growth. The standard cross-country growth regression independent variables, such as inflation, GNP in year 0, political stability proxies and regional dummies, are included. The regression is run with a sample consisting of the 1990s. The coefficients on the restrictiveness indices are found to be positive (as expected) and significant, though the coefficient for the telecommunications index is only significant at the 10% level. Restricting the sample to only developing countries makes the coefficients higher but the significance drops.

This could suggest that the benefits from liberalisation could be higher for developing countries but this finding is not robust. These results are important in that they show a clear link between the change in growth and openness. In other words, the gains are







not a once-off gain but rather an increase the rate of growth. The gains could be as much as 1.5% per annum.

Three major criticisms suggest themselves. Firstly, there may be some element of feedback between the indices and dependent variable. In other words, only countries that were growing quickly during this period may have felt secure enough to attempt financial and telecommunications liberalisation. This may influence the results. Secondly, many of the studies purported to show the benefits of liberalisation were crucially dependent for their results on the influence of China and India. It would be interesting to see the results with these two countries omitted. Thirdly, these studies were also crucially dependent on the construction of an index. Weaknesses in this index, for example in Sachs and Warner (1995), rendered their results meaningless. Mattoo, Rathindran and Subramanian (2001) may still face such a challenge.

One must be clear in interpreting what the findings of the study mean. The key lies in analysing the construction of the indices. Three criteria are used, namely competition, foreign ownership and regulation but competition is the prime determinant. Thus, the results may suggest not so much that trade in these sectors is important but rather that the absence of monopolies is. This finding would not surprise any first year economics student. Another important finding is that the financial and telecommunications industries have enormous effects upon the growth of an economy as a whole. The importance of these sectors is underscored in McGuire (2002) which finds that higher levels of service sector restrictiveness is associated with lower GDP. Once again, this does not deal with the problem of causality.

Hodge and Nordas (2001) look at services liberalisation from the perspective of developing countries and ask what they have to gain from liberalising their services. The authors point out that all countries have some comparative advantage. The developing countries, particularly African countries, will most likely have a comparative advantage in labour-intensive industries and services, given their very low levels of capital. In general, the skilled labour-intensive services such as financial and business services, engineering and telecommunications can be performed via the first mode of supply, cross-border. However, the pattern witnessed so far is that the multinational corporations supplying these services prefer to do so via mode 3, commercial presence. This has important implications because it means that the potential losses from liberalisation are lower and that increased services trade will result in other benefits such as FDI and skills transfers. It is argued that the gains from liberalising producer services are threefold:

- Reallocation of resources to the sector in which they are most efficient;
- Improved productivity in the sectors with economies of scale; and
- Improvement in productivity throughout the economy due to lower cost, better quality services inputs with more variety.

Markusen (1989, quoted in Hodge and Nordas, 2001) argues that the benefits from liberalising services will be larger than that for goods because goods liberalisation can only provide the first two benefits. Hodge and Nordas (2001) note that the extent to which consumers benefit from lower input costs depends to a large degree on the structure of retail markets. If, as is the case in many African countries, the downstream markets are captured by monopolies, then the lower input costs will simply accrue to the monopolist as higher margins.

Hodge and Nordas (2001) also provide information on the patterns of services trade for South Africa and Namibia. This information is useful even though it is now rather out of date.

South Africa has a slight trade surplus in services while Namibia has quite significant deficit. South Africa is a net exporter of tourism, financial services and government services. South Africa is a big importer of transport services though these services are also exported in large quantities. Namibia exhibits the typical pattern of a developing country


Table 1: Cross-border trade in services for South Africa and Namibia

	South Africa		Namibia	
	Imports	Exports	Imports	Exports
Services	5,942	5,975	473	242
Utilities	5	44	0	0
Construction	25	9	20	1
Tourism	1,563	2,224	54	208
Transport services	2,656	1,998	189	0
Communication services	272	208	0	8
Financial services	319	686	33	3
Business services	386	323	133	4
Government services	45	113	12	13

Source: Hodge and Nordas (2001)

where services are traded on a comparative advantage basis, rather than through intra-industry trade. Namibia imports construction, transport, financial and business services and exports very little of these services. Tourism is the main export service. Although Namibia is a middle-income country, its population means that it is unlikely to produce the whole range of producer services, unless it is closely integrated with its neighbours (Hodge and Nordas, 2001).

It should be clear by now that developing countries face significant obstacles to export led growth and one of these barriers is the lack of efficient producer services. This is illustrated by Hodge and Nordas (2001) by examining the spread between lending and borrowing rates at local banks. The US has a quite efficient banking system with liberalised operations so that is used as a benchmark. Spreads in the US are 3 % points, in South Africa it is 4.7% points, in Namibia 7.2% points and in Tanzania 20.6% points. Clearly the burden on investors is significantly higher in Namibia and Tanzania than it is in the more developed markets. This will reduce the amount of investment and hence, economic growth. The obvious solution is for developing countries to liberalise their financial sectors in order to pass on the benefits to the rest of their economy, with due regard to complicated issues such as sequencing and the effect of the macro-economy on the sector.



## 3. Services trade in SACU

So far this report has mainly focussed on the general literature about service liberalisation. In this second section, we shift the focus to the services sectors in SACU. The context of most of this work has been, how should countries respond to requests to open up their services sectors in GATS negotiations? GATS, the General Agreement on Trade in Services, was added to the multilateral trading system as part of the Uruguay Round. The core principles of GATS are as follows:

### 3.1 The GATS framework

#### 3.1.1 Article II – most-favoured nation (MFN) treatment

Countries may not discriminate between member states of the WTO. Thus, if a country has granted a concession to one member state, it has effectively granted this concession to all the other members. The exception to this principle is preferential treatment provided through free-trade areas.

#### 3.1.2 Article III – transparency

Members must list all relevant legislation and regulations pertaining to a particular service sector. This is required, even if no commitments are made for that service. The Council on Trade in Services must be notified of any new regulations and contact points must be established for other members to enquire about regulations.

#### 3.1.3 Article VI – domestic regulation

This article only applies to services where commitments have been made. It stipulates that all regulations should be applied fairly, reasonably and objectively. Members should have access to an appeals process in the event that a dispute occurs. The standards of the relevant world body will be used as a basis for what is a reasonable standard. Licensing requirements should not be a constraint on supply.

#### 3.1.4 Article VIII – monopolies and exclusive service suppliers

Member states are required to ensure that any local monopoly does not violate the most favoured nation principle, or breach any commitment made under the GATS. Members also need to ensure that the monopoly does not use its market power to capture other markets, if there are scheduled commitments in those markets.

#### 3.1.5 Article IX – business practices

This article requires member states to enter into discussions with other members if business practises are leading to restrictions on trade between the two partners. Members also need to provide any information required on such practises, provided they do not infringe on the right to privacy of local firms.

During the negotiations, members provide offers of any liberalisation that they are willing to make. The offers are organised by the four modes of supply and according to the principles of market access and national treatment, which holds that foreign firms should be treated as equal to local firms. Countries may make offers for individual serv-

ice sectors (e.g. architectural services) or they may make horizontal commitments that apply to all services. For example, South Africa tabled two horizontal commitments. The first is on mode 4 which limits the length of time that certain workers may spend in South Africa. On mode 3 market access, foreign firms are limited as to the amount that they may borrow from local banks. After a country has made an offer, other members respond by making requests. The differences between the offers and the requests are resolved through bilateral negotiations. The results of the possibly increased access are then extended to all WTO member states through the most favoured nation principle.

## 3.2 SACU and GATS

Virtually all of the work done relating to SACU and the GATS has been about South Africa. This shortcoming was corrected with the publication of Ndulo et al. (2005) by NEPRU. This study is quite comprehensive, especially when one considers the fact that it so little has gone before it. Although the focus of Ndulo et al. (2005) is SADC, I will confine my discussion of the paper to SACU. Services grew quicker than the rest of the economy during the 1990s in all of the SACU countries with the exception of Swaziland. The contribution of the sector to GDP in the 1990s ranged from 44% in Lesotho to 65% in South Africa. Information is scanty but the sector seems to contribute a similar share to employment. When the informal sector is included, this figure rises as the majority of informal activities are services. Services are not generally that important in SACU's trade. The exception to this is Lesotho which exported twice the value of services as goods. According to the 1997 World Bank African Development Indicators, only Lesotho has a trade surplus. This obviously contradicts the data seen in Hodge and Nordas (2001).

Ndulo et al. (2005) argue that there are few restrictions to cross border supply of services in SACU as most countries have few or no exchange controls. The only exception is South Africa, which is quite surprising how much more developed it is than its SACU partners. Botswana was the only SADC country to make horizontal commitments on the cross-border mode of supply but this was only on market access. The same is true of consumption abroad.

The barriers to mode 2 consumption abroad mostly relate to the movement of people between countries. This is generally not a problem within SACU as citizen of SACU member states do not need a visa to visit other SACU countries. Exchange controls can also be a restriction on this form of trade (Ndulo et al., 2005).

Swaziland was the only SACU country not to make a horizontal commitment to the most favoured nation principle for commercial presence. Botswana and South Africa placed restrictions on national treatment. For example, in the event of a foreign firm selling a stake in a Botswanan company, Botswanan law allows local companies the priority to purchase the company (Ndulo et al., 2005). South Africa limits the amount that companies more than 75% foreign owned may borrow from domestic banks. The limit is set by a formula included factors such as the percentage of foreign ownership and the firm's debt: equity ratio. The limit was raised in 2004 but the EU has still requested South Africa to do away with this limit.



Botswana has also set some restrictions on market access. For example, medical services can only be practised by a natural person. Foreign-owned hospitals or clinics are encouraged to enter into joint ventures with local hospitals and clinics. Lesotho tabled some restrictions on the provision of broadcasting services. The plans for large buildings may not be drawn up by foreign architects.

Ndulo et al. (2005) argue that the openness to commercial presence can be inferred from the legislative environment for investment, exchange controls and double-taxation treaties. South Africa and Swaziland are the only two countries in SADC which do not have a law relating specifically to foreign direct investment. In terms of investment treaties, South Africa is the leader in SADC with 17 signed. All of the SACU countries have signed at least 2 with developed countries being the preferred partners. Double taxation treaties enable commercial presence because they ensure that firm's profits do not get taxed twice. South Africa has signed 54 treaties (2005). The other SACU countries have signed between 4 and 7 (1999). Horizontal restrictions to FDI are virtually non-existent across all the SACU members. There are no exchange controls, except in South Africa. There are no limits on the repatriation of profits and only Botswana has limits on the size of investment.

Commitment to encouraging investment can also be gauged by whether a country has signed one of the multilateral investment treaties which set up enabling institutions. These treaties are designed to encourage investment by making dispute resolution easier and to provide some guarantees to overcome the problem of political risk. There are four multilateral investment treaties, the Multilateral Investment Guarantee Agency (MIGA), International Centre for Settlement of Investment Disputes (ICSID), the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (CREFAA) and the World Intellectual Property Organisation (WIPO). Botswana and Lesotho are members of all of these organisations. Namibia has not signed the ICSID or CREFAA. South Africa is not a member of ICSID while Swaziland has not signed CREFAA.

Ndulo et al. (2005) contend that the mix of different trade agreements within the region (SACU, SADC, COMESA) is itself a barrier to FDI. Red tape is one of the largest barriers to investment in Africa and the multiplicity of trade agreements only increases the amount of bureaucracy that investors face. Furthermore, the number of different regimes makes trade facilitation more difficult and this has a negative effect on FDI as investors often look to supply the local market and export to the region.

There has been very little movement in terms of liberalising mode 4 supply, movement of natural people. The main reason for this is that it is difficult to prevent temporary migration of people from becoming permanent. The SACU countries, with high unemployment rates, are quite receptive to this argument, especially in South Africa. It is felt that if jobs are available, they should be taken by local workers first. Most countries only fill a position if there is no local worker who could conceivably do the job. The horizontal commitments by the SACU countries are listed in Table 2 below. It is clear that the commitments are nothing like the level offered for the other modes of supply.

The commitments have clearly been made with a protectionist view in mind. All of the SACU countries suffer from a lack of skills in certain categories, especially highly skilled workers. The economic evidence is quite clear that the introduction of foreign

Table 2: Horizontal commitment on Presence of Natural Persons mode of supply

Countries	Limitations to market access	Limits to national treatment
Botswana	ABC	DE
Lesotho	ABC	None
Namibia	AB	No commitment
South Africa	ABE	D
Swaziland	No commitment	No commitment

A = limited access to highly skilled persons only; B = limited to employees of companies operating in the country; C = development of locals required; D = no discrimination for those permitted to enter under market access commitment only; E = professionals need to be domestically registered.

Source: Ndulo et al. (2005)

skilled workers leads to the creation of further jobs and faster economic growth. Thus, the protectionist mindset may appear to save jobs for local workers in the short term but in the long term it is harmful.

Ndulo et al. (2005) argue that SACU should liberalise this mode of supply in the context of WTO negotiations as temporary migration may be a substitute for permanent migration. Thus, in order to stop the permanent migration of SACU's skilled labour, SACU should bargain for the relaxation of barriers to temporary migration in the developing countries so that SACU workers do come back to their home country. It is argued that this liberalisation should take place in the multilateral context because the region as a whole lacks skills and this would give it the opportunity to make up for this deficit.

I am not sure that this argument makes much sense. SACU loses its skilled workers because they can earn much higher salaries in the developed world than they can at home. Easing restrictions on working in the developed world will not solve this problem. Nevertheless, the argument for allowing easier temporary migration of skilled workers is still strong.

Judging by the extent of their commitments and other proxies, it is clear that the SACU countries are quite open to trade in services so long as this trade occurs through modes 1 to 3. Mode 4 trade is quite restricted, often leading to the SACU countries not benefiting from the movement of skilled workers.

One of the sectors that is hampered by a shortage of skilled labour is financial services, despite the fact that it is acknowledged the liberalisation of this sector could contribute the most to economic growth (Ndulo et al., 2005). The sector is important because of its two main functions. Firstly, it allocates capital to investors. The more efficiently it does this, the more investment will occur, hopefully in the best opportunities. The second function of the sector is to manage risk, namely currency risk, maturity mismatches and credit risk. The sector also adds value to the economy like any other sector (Butterworth & Malherbe, 1999).

Butterworth & Malherbe (1999) advocate that South Africa should aim to become the financial centre of Africa and that the GATS negotiations are a good means of achieving this. Certainly South Africa's wealth has required that the country has the deepest, most sophisticated financial sector on the continent but it is still some way short of being as important as the authors desire. They argue that the way to build a regional financial centre is to have a deep pool of talent, foreign institutions and high liquidity. These three factors feed off each other in a virtuous cycle of innovation and efficiency.

There are only a few barriers to entry of foreign firm into the financial sector in South Africa but these obstacles are telling. Firstly, foreign banks have to establish a local company to act as their local representative. This is not demanding except for



the fact that the local branch cannot count the reserves of the parent towards its own reserves. This adds costs to foreign banks and prevents entry. One reason is that the lodging of capital in Rands adds exchange rate risk to the parent company's holdings. Butterworth & Malherbe's (1999) argument is that the local branch should be able to rely on the reserves of the parent. The parent firm will not allow the branch to become insolvent because this would affect the reputation of the entire firm, a clearly undesirable outcome (Butterworth & Malherbe, 1999).

The only restriction on national treatment is that the accounts of natural persons (i.e. people as opposed to firms) should always have a balance of greater than R1m. This effectively prevents any foreign entry into the South African retail banking market, despite the fact that the large majority of the sector is dominated by only four firms. The effects of this are quite clear; South Africans pay higher costs and get a lower returns from bank accounts that do savers in the developed world (Butterworth & Malherbe, 1999). Opening up the retail banking market to foreign competition would probably lower costs and enable the poor to enter the banking system. The present high cost market has prevented the poor from entering the formal economy.

As has been mentioned above, exchange controls also limit the operations of banks, both local and foreign. All banks are only allowed to hold 15% of their endowment capital in foreign currencies. This limits their ability to enter the market for forex so foreign banks do all the foreign exchange trading in London. The perverse result of these regulations is that the Rand is more heavily traded in London than in Johannesburg (Butterworth & Malherbe, 1999).

The South African government has only made one offer on banking services on mode 3. This commitment reflects the current situation and does not entail any further liberalisation of financial services. The other modes of supply remain unbound. Botswana, Lesotho and Swaziland have made no commitments in the financial services industry. Only South Africa and Lesotho have made commitments in insurance. Lesotho only allows foreign companies to acquire 25% of a local company before written permission has to be requested from the Registrar of Companies. No information is given as to what criteria are used in deciding whether further ownership can be acquired. South Africa has similar restrictions. In addition, the "executive chairman, public officer and the majority of directors must be resident in South Africa (WTO, 2005)." These restrictions are quite onerous and de facto require that international firms will have little control of their own local branch. All life insurance actuaries have to be resident in South Africa (WTO, 2005). Despite the protected nature of its own insurance industry, South African insurers are dominant throughout Africa. Three-quarters of the insurance market in sub-Saharan Africa is supplied by South African firms (Ndulo et al., 2005).

Although the SADC financial sector is currently quite open to foreign entry and competition, this was not always the case. In fact, the sector has been liberalised quite substantially in the last 20 years. Ultimately these reforms were often unsuccessful, partly because governments backtracked on the politically unpopular structural adjustment programmes under which the reforms occurred. Nevertheless, it is important to learn the lesson from these past experiences, lest the same mistakes get made again. The experience of the East Asian Tigers during the Asian crisis of 1998 is ample reason to be careful about how liberalisation of the financial sector proceeds (Ndulo et al., 2005).

Butterworth & Malherbe (1999) identified some key failures. Reforms were not sequenced correctly. Fiscal deficits need to be low before interest rates are liberalised otherwise, rates became too high and investment was choked off. Reforms were often incomplete with the state still owning some banks. Government also refused to let banks fail leading to poor institutions still dragging down the sector. This also causes

moral hazard problems. Weak regulatory institutions were not strengthened as part of the reform process. Countries also suffered because the reforms did not take place with a wider view towards the region. Most SADC countries are not big enough to have a large financial sector so some cognisance of trends in the region should be taken into account.

The entry of foreign banks into the South African financial sector has had positive effects for the economy but these effects could have been stronger if they were accompanied by reform of the sector's regulations. It would be a false comparison to contrast the results of this process to the process in the rest of SADC as foreign banks entered the South African market after the end of sanctions rather than because of any liberalisation. Foreign bank entry has resulted in more complex financial products, improved regulatory performance and access to foreign capital. Unfortunately, South Africa missed an opportunity to liberalise the sector and open retail banking up to more competition. Thus, the majority of the population has not benefited as costs and interest rates spreads have still remained high (Butterworth & Malherbe, 1999).

Ndulo et al. (2005) argue that the South African retail banking oligopoly has been exported to SACU. Namibia, for instance, has a financial sector dominated by South African banks. Namibia also relies on South African human capital to staff the management positions in the industry. Unfortunately the managers that are sent to Namibia are often extremely conservative and this has an impact on the industry as a whole. Butterworth & Malherbe (1999) state that two-thirds of the foreign banks established in South Africa, use the country as a springboard into the rest of Africa.

The restrictions placed on foreign entry into the South African insurance market are similar to those for banks, or in some cases, are more onerous. Mode 1 supply is illegal for both long and short term insurance, as for banking. The US has requested South Africa to do away with these regulations. Mode 2 supply is limited by exchange controls. Mode 3 is limited by a number of restrictions. Permission has to be sought from the Registrar before a controlling interest can be acquired in an insurance company. As mentioned above, the top managers of an insurance firm in South Africa have to be resident in the country. Branches of foreign companies may not be established in South Africa. Controlling companies' reserves do not count towards their subsidiary's reserve requirement for long term insurers of R 10m (Butterworth & Malherbe, 1999).

These restrictions are for prudential rather than protectionist motives. 1997 saw 38% of premiums for short term insurance being paid to foreign owned firms. Market share in the re-insurance market was nearly 100%. About half of the foreign presence has occurred since 1994. Similarly to banking, foreign entry brought price competition, better quality and newer products. In some cases, the standard of market conduct has been higher because foreign entrants with stricter standards in their home market, adhere to those standards rather than South African standards. As the entrants also source their labour from the local market, demand for skilled insurance workers has increased and so have their salaries (Butterworth & Malherbe, 1999).

If the financial sector is the most important producer service, then there can be little doubt that the second-most important is telecommunications. Both sectors are significant inputs throughout the economy. The telecommunications sector has seen many reforms in the last decade in all the SACU countries. The reforms have usually followed the same pattern, as advocated by the Telecommunications Regulatory Authorities of Southern Africa (TRASA). Initially the monopoly fixed line operator is corporatised by separating it from the government of telecommunications. An exclusivity period usually ensues. During this period, some foreign ownership is encouraged. Value-added services operators are forced to lease their facilities from the monopoly. The monopoly also has to meet some roll-out targets, often to service rural areas. After a suitable exclusiv-





ity period, a second national operator (SNO) is licensed. The SNO is often guaranteed a period of duopoly in the fixed line market, in exchange for universal service obligations. The next step is to allow competition in the resale portion of the market. In terms of cellular licenses, entrants are introduced one at a time in order to allow the new firm time to establish itself. The new firms are often chosen through the beauty pageant method, rather than auctions of licences. Currently Botswana has two mobile operators, Lesotho and Namibia both have one, and South Africa has three (Hodge, 2002).

Hodge (2002) argues that this reform strategy has had two consequences. Firstly, the number of mobile users has grown explosively. Secondly, the number of fixed lines has grown slowly if at all. This is evident in Table 3 below. Hodge (2002) argues that the

Table 3: Line growth in fixed and mobile, 1997-2002.

	Fixed lines 1997	Mobile subscribers 2001	Tele- density 2002	1997	2002	As % of total lines	Fixed 1997	Fixed 2002	Mobile
Botswana	85,592	153,000	142,600	-	85,592	66.10%	5.64	8.64	14.24
Lesotho	20,400	22,200	21,100	1,262	20,400	71.10%	0.96	0.99	2.43
Namibia	92,829	117,400	114,000	12,500	92,829	46.70%	5.76	6	4.32
South Africa	4,645,000	4,969,000	4,925,000	1,600,000	4,645,000	69.10%	10.72	10.95	25

Source: Hodge (2002, 29)

growth in fixed lines would be even less if disconnections were taken into account. Only in Namibia were there more fixed lines than mobile in 2002. Hodge (2002) believed this pattern would only continue until the end of 2002.

Hodge (2002) argues that it is the structure of mobile pricing, rather than the level, that has led to such enormous growth. In comparison with international levels, SACU mobile telephone calls are not cheap. Instead the prepaid model, allowing users to pay only for the cost of their calls without any upfront charges, has been incredibly successful. Over 80% of SADC mobile subscribers use the prepaid option.

Another explanation for the poor performance of the fixed line operators can be found in Table 4 below. Under the monopoly model of telecommunications, residential consumers were cross-subsidised by business consumers because business consumption is more price inelastic. In the face of competition, the incumbents adjusted their prices to do away with this cross-subsidisation to prevent being undercut in the business sector by the new entrants. This resulted in increases in the price of local calls. In South Africa the price of local calls doubled but this was nothing in comparison to Botswana and Lesotho where prices increased by more than six times (Hodge, 2002).

In spite of the efforts at liberalisation, the sector is still quite closed to foreign entry and is highly regulated. Botswana, Namibia and South Africa have limited foreign participation to 49% of any firm. Besides SNO's little new entry is expected (Hodge, 2002).

Table 4: Prices and affordability measures for residential consumers (1997-2002)

	Fixed line access price (US\$)		3 minute local call (US\$)		Fixed line rebalancing (1997-2002 in domestic currency)		
	Installation	Monthly subscription	Fixed line	Mobile	Monthly subscription	Local calls	International/local
Botswana	35.21	2.5	0.11	0.94	4.40%	666.7%	24
Lesotho	29.94	3.0	0.11	Na	57.50%	650.0%	17
Namibia	25.34	4.7	0.08	0.53	18.80%	315.0%	44
South Africa	22.72	6.4	0.06	0.51	36.60%	117.7%	17

Source: Hodge (2002, 31)

Botswana, Namibia and Swaziland have made no commitments for the sector. Lesotho has bound modes 1 and 3 for both market access and national treatment. Mode 4 is unbound subject to horizontal commitments. Mode 2 is unbound. South Africa has committed to a duopoly in the fixed line and the mobile industries for modes 1,2 and 3 in market access. Foreign investment is limited to 30%. In other words, current policy has run ahead of the commitments so there will definitely be some change to the commitments as the WTO process goes ahead, even without further liberalisation. All value-added services have to be purchased from one of the fixed-line duopoly firms (Nepru, 2005; WTO, 2005). Clearly there is still a lot more scope for further liberalisation in the telecommunications industry. Policymakers in SACU are understandably anxious about further liberalisation because the process so far has had many unforeseen results, often to the detriment of consumers.



The last major producer service is transport. Transport can include the ferrying of freight and passengers. In SACU the main method of transport is via the road network with rail, maritime transport and the airlines playing ancillary roles. Transport in SACU is more important than in most customs unions because three of the five members are land-locked and are thus dependent on the other members for international trade. Naudé (1999) argues that because of economies to scale in the transport sector, bilateral and regional liberalisation is more important than multilateral liberalisation. The multilateral process is probably more important in terms of encouraging foreign firms to establish a commercial presence in South Africa. One key constraint is that SADC was essentially founded to help the member states wean themselves off economic dependence on Apartheid South Africa. Thus previous SADC transport plans have been rendered obsolete and even counterproductive by the events of 1994. This is an additional challenge to an integrated regional transport system.

Saasa (1998, quoted in Naudé, 1999) discussed the main problems in the region's transportation networks.

- There is insufficient utilisation of capacity. For example, trains run slower than the scheduled speed because of insufficient signals. There is also poor planning in terms of knowing the location of all rolling stock.
- The rail-harbour nodes are very poor. There are insufficient shunting locomotives, cargo handling equipment and poor information on shipping times all lead to congestion.
- Border formalities are arduous. Estimates of costs range up to US\$ 48m annually. One rather simple solution is longer opening hours.
- The road infrastructure can be poor. Only 15% of SADC's roads are primary roads.

Saasa (1998, quoted in Naudé, 1999) proposes the following:

- Rehabilitation of existing infrastructure including the use of skilled foreign consultants, especially in areas such as "management support, logistics, supply chain management practices and IT systems (Naudé, 1999, 32)." Obviously mode 4 supply has a large role to play in this.
- Better harmonisation and co-ordination amongst the member states, in terms of equipment standardization, transport legislation, customs procedures and ratification of international treaties. Essentially what is being suggested here is complete liberalisation of the SADC market for transport services with significant amounts of trade facilitation too.



- The introduction of competition and privatisation in regional transport networks.
- Planning regional service networks so that they integrate into world transport networks.

Currently South Africa's road transport sector is quite liberalised. In fact, one could argue that the lack of effective policing (especially with regard to load limits per axle) has given road transport an edge over its competitors. Air transport has also been liberalised recently. The outcome has been an increase in the number of flights daily while prices are significantly lower. The national carrier, South African Airways, still has a significant market share. Maritime transport is open to competition but South Africa's small market size means that only one operator has entered and a de facto monopoly exists. The other modes of transport are all dominated by the State. The railway infrastructure, as well as the passenger and freight operators are publicly owned. In the years since road transport services were liberalised in 1983, rail transport has steadily lost market share to the point where 80% of cargo is carried by trucks. The ports are still owned and operated by Portnet, a State-owned enterprise. South African port turnaround times are 5 times slower than their competitors. Plans to liberalise the sector by concessioning port terminals have dragged on for a number of years without any visible action. The possibility certainly exists for further liberalisation. South Africa has only offered commitments on mode 2 (for both market access and national treatment) for freight and passenger transport by road. This reflects the current situation and so does not require any further liberalisation. A commitment has been made to have no restrictions on the repair of motor vehicles through either consumption abroad or commercial presence.

Francois & Wooton (2000) argue that the world maritime services industry is relatively anticompetitive. Cabotage (maritime trade restricted to local waters) is usually protected from local competition while there is no single authority to protect against anticompetitive practices on international routes. In fact, price fixing is quite openly practised by organisations such as the Trans-Atlantic Conference Agreement, which "regulates" trade in the north Atlantic. In many respects, shipping costs have become more significant than tariffs. Francois & Wooton (2000) conclude that global liberalisation of the shipping industry will lead to much greater benefits from normal trade liberalisation. Currently the benefits are accruing to the shipping industry, rather than consumers and exporters. This could be an offensive interest for South African negotiators at the GATS.

Tourism is probably the service sector with the most impact on the SADC economies. Once again there is little work on the sector in SADC or SACU, except for a paper on the South Africa industry. Robertson (2002) finds that there are few direct barriers to tourists, or to foreign firms operating in South Africa. The main barriers apply to the whole economy. These barriers would be difficulties in obtaining work permits and exchange control regulations. Work permits may not apply to tourists directly but foreign workers are often visited by family and friends so barriers to workers will have a negative effect on visitor numbers. Obviously skills transfer is also limited by immigration controls.

Namibia has made full commitments on two subdivisions of tourism services, namely hotels and restaurants, and tour agencies and tour operators. South Africa has made a similar level of commitment, except for mode 4 which is subject to the horizontal restrictions on movement of people. Swaziland is also relatively free of restrictions except for the fact that only skilled personnel may obtain access to Swaziland to work in the country's hotels and restaurants. Lesotho has refused to bind tour operating services but the industry is still relatively free of restrictions. Botswana has some restrictions relating to exchange controls (WTO, 2005). With the exception of Namibia, all the SACU countries can further liberalise their tourism services industry by binding

mode 4 supply. The SADC Tourism Sector Co-ordinating Unit has seemed to have little impact on promoting intra-regional tourism (Ndulo et al., 2005).

One industry that has had widespread trade throughout SADC is the energy industry. Unlike other services, energy is often very difficult to categorise because it has elements of both goods trade and services trade. For instance, electricity itself is considered a good. However, transmission and distribution of electricity is a service, as is consulting in the electricity industry. Most energy trade takes place through commercial presence through foreign-owned subsidiaries (Eberhard, 2003).

Although there are no hard figures, it is clear that South Africa's trade in energy services is already quite large, mainly through Eskom and Sasol. The Southern African Power Pool allows trade in energy throughout Southern Africa. Eskom, which generates more than half of Africa's electricity, obviously dominates this trade. The current members of the pool are Angola, Botswana, the DRC, Lesotho, Malawi, Mozambique, Namibia, South Africa, Swaziland, Tanzania, Zimbabwe and Zambia. South Africa has a clear comparative advantage in the production of cheap electrical power and the export of this power to Africa (Eberhard, 2003).

The following table, reproduced from Eberhard (2003, pg 11) shows that the interests of other South African energy services exporters also lie in Africa.

In terms of defensive interests, South Africa's two largest energy services are petroleum and electricity, both of which are highly regulated. Some liberalisation is being planned in the electricity sector. South Africa is rapidly approaching the limit of her

Table 5: South Africa's offensive interests in energy services.

Energy service category	Examples of SA companies	Potential projects	Mode of supply	Possible request
Exploration and development	Energy Africa PetroSA	10 African countries Elsewhere?	1 & 3	Removal of limitations on market access and national treatment in exploration, drilling and development services in the petroleum sector
Networks, transmission and distribution	Eskom, Sasol, Engen and others	Nearly all African countries Elsewhere?	1 & 3	Removal of limitations on market access and national treatment in services related to transportation, transmission and distribution of electricity, gas and petroleum products
Marketing and supply	Electricity, petroleum and coal companies Nufcor, etc. RMB, MCo	Mainly SADC, but also other African countries and emerging markets for electricity and petroleum products, and industrialized countries for coal and uranium	1 & 3	Removal of limitations on market access and national treatment in the wholesale, retail, marketing, trading and brokering of energy and fuels
End-use	Electricity and energy management companies		1 & 3	Removal of limitations on market access and national treatment in energy audit, energy management, metering and billing
Facilities management	Eskom and Sadelec; Netplan and others	African and other emerging economies	1 & 3	Removal of limitations on market access and national treatment in the management and operation of energy facilities
Other related services, including installation, maintenance and repair	Engineering companies	Mainly African and emerging markets	1 & 3	Removal of limitations on market access and national treatment in engineering, construction and related services

Source: Eberhard (2003, pg 11)



capacity so new investment is needed in generation. This will mostly be undertaken by Eskom but some new entrants, including some foreign firms, moving into the generation market will be encouraged. Transmission and distribution will still remain in the hands of Eskom, or in some cases, that of local government.

The distribution of petrol is also highly regulated. In order to open a petrol station, a licence from the Department of Minerals and Energy is required. In recent years, these licenses have only been granted to firms owned by historically disadvantaged people. The price of petrol is set by government. Petrol may not be sold on credit and self-service is not allowed. The margins of retailers and refineries are set by government (Eberhard, 2003). Currently South Africa has made no commitments in the energy services sector.

By contrast, the construction industry is a relatively liberalised sector. South Africa has made quite strong commitments. On both market access and national treatment, modes 2 and 3 are subject to no restrictions. Mode 1 is unbound due to technical infeasibility. Mode 4 is unbound subject to horizontal commitments. The one major limitation is for modes 1 and 2 of market access for architectural services. This requires that a locally registered architect is used for larger buildings. Despite the liberalised nature of the industry, Teljeur and Stern (2002) argue that construction services are quite difficult to export because most of the regulations concerned are local. Thus, the process for approval of designs and quality standards varies from municipality to municipality. Architectural services are difficult to export via mode 1 because site visits generally have to take place. Most architecture exports that do take place then are for specialist buildings like airports (Teljeur & Stern, 2002).

Consulting engineers find trade slightly easier. In 2002, South African consulting engineering firms earned 13% of their turnover abroad with the expectation that this amount could increase to 30-50% in the medium term. Most trade is taking place through the larger firms in the industry with the smaller firms only focussed on the local market. Some of the larger firms have gone so far as to establish offices in foreign countries, including Europe and the US. As with so many other services, Africa is a major market for construction services, although European, North American and Australian firms have the lead at the moment. South African firms do better in SADC and in projects linked to the mining industry, a source of comparative advantage. South Africa's largest construction management company, E.L. Bateman, is rated the tenth largest user of the US Exim Bank's finance, though the requirements for such finance mean that the firm must use significant amounts of US inputs so it is difficult to determine how much impact this has on local output and employment. South African firms have not been particularly successful in targeting the developed markets. Inroads have been made in the Middle East and the former Soviet republics (Teljeur & Stern, 2002).

Imports into the South African market have not been very successful. One of the larger barriers to entry is the lack of familiarity with local labour legislation and other conditions. The firms that have succeeded in South Africa have done so through joint ventures. Unfortunately Teljeur & Stern (2002) is slightly out of date now. They suggest that the expected upturn in the property market would be beyond the capacity of local suppliers to fulfil alone, thus more foreign entry was expected. It would be interesting to see if these imports did materialise as the property boom certainly did.

Teljeur & Stern (2002) report on a number of barriers to trade in other countries, not all of which can be dealt with in the GATS negotiations. In the more skilled parts of construction services trade, the main barrier appears to be recognition of qualifications. This is especially a problem outside of the Commonwealth. Because this trade usually revolves around mode 4 supply, work permits are often a problem, especially in Namibia, Uganda, Zimbabwe, Botswana and Mozambique. In Africa, firms reported that

the main constraint was corruption. Border delays to imported machinery are a problem too. European Union regulations are wide-ranging and difficult to comply with. Licensing requirements to trade in the former Soviet Union, China and India through mode 3 are extremely onerous. In the Middle East, local partners have to be used which often degenerates into institutionalised corruption. US regulations vary from state to state and litigation is a real threat.

Teljeur & Stern (2002) are convinced that South Africa has a comparative advantage in construction services. The biggest problem in the industry at the moment is a lack of skilled and highly skilled workers. In some cases this results in construction delays and poor quality. Trade may exacerbate this problem as more and more of South Africa's skilled workers work on projects in other countries. Of course, imports of these services and of skilled workers may alleviate the problem to some extent. Cleary & Thomas (2003) argue that trade in health services may also lead to adverse affects on the local market too.

The concerns raised by Cleary & Thomas (2003) relate to current trends in the industry. Since 1994, the health sector has become progressively more inequitable. For example, the amount spent on each private sector patient was 4.7 times of a public sector patient in 1996/7. By 1998/9, this ratio had risen to 5.8. The number of private hospital beds doubled between 1989 and 1998. This had dire effects on the public sector as the supply of doctors and nurses is limited. Rural hospitals have struggled to retain skilled workers as conditions and remuneration in the public sector are much less attractive than in the private sector. Coverage by medical aids had decreased. In addition, during the late-1990s growth in real expenditure on private sector patients was as much as 10% per year.

Cleary & Thomas (2003) argue that these factors point to a skills constraint and increasing inefficiency in the sector. They argue that further trade in the industry will only exacerbate these trends and increase the inequities between the public and private sectors.

One factor that Cleary & Thomas (2003) do not consider is that the private hospital industry is highly concentrated, being dominated by only two firms. This is quite likely to have played a role in the rise in costs. Trade would have a significant effect on this by reducing the firms' market power. It is likely that trade would result in lower costs. The more significant question is the one of skills shortage. The main problem in South Africa has not been that not enough doctors are being produced; rather it is that as many as 40% of doctors choose to work overseas. There are a number of complaints from doctors but the two main problems are conditions and pay. The entry of more private service providers will alleviate conditions slightly. Pay may increase but that would depend on how much emigration is affected.

Supply constraints do not seem to be an issue for the private sector because conditions and pay are so much better than the public sector. Thus allowing trade would probably decrease the cost of private medical care, while leading to South Africa retaining more of her doctors and nurses. The key impact on the public sector could be through impact on the supply of nurses, where a real shortage exists. Government could respond to this by ensuring that medical aids cover a greater proportion of the population and thus shift some of the burden of the public sector onto the private.

One measure that government has used to reduce the inequality between the public and private sector is to disallow foreign doctors from serving in private practise in South Africa. All foreign doctors have to register with the Health Professionals Council before they can practise locally. Foreign doctors are ubiquitous in the public sector, especially in rural areas, making up 24% of doctors in the public service in 2001. Unfortunately, many of those doctors eventually move to urban areas so rural areas remain





underserved. South Africa could probably attract many doctors from other countries in Africa but the Department of Health has taken the high road by proclaiming that it will not employ doctors from developing countries unless some fairly stringent conditions are met. Currently the Health Department can enforce these restrictions as South Africa has taken full commitments on modes 1,2 and 3 of both market access and national treatment for medical services. Mode 4 is unbound subject to the horizontal commitment.

The last question that needs to be asked with regard to trade in services is, would South African exporters prosper in a liberalised environment? Stern (2002) attempts to answer this question by modelling South Africa's predicted services trade. The model Stern (2002) uses is based on the standard neoclassical trade theory, namely the Heckscher-Ohlin model. This argues that factor endowments determine trade. As Stern (2002) points out, this model is only partly successful at predicting trade in goods. It is not mentioned that this model is very poor in predicting South Africa's trade in goods. It is also questionable whether this is the best model to use because it assumes that there are constant returns to scale. Services are generally highly skill-intensive with large learning effects. This means that a trade theory based on increasing returns to scale may have been more appropriate.

Stern (2002) uses either net exports or the ratio of services exports to goods exports as the dependent variable. Three classes of explanatory variables are used, namely resource variables, development variables and resistance variables. The resource variables used are used as instruments for human capital, physical capital, natural resources and technology. Development variables include proxies for economic development, population size and export orientation. The resistance variables consist of measures of language, protection and geography. The instrument for protection is an index of protection applied specifically to services.

Four different regressions are estimated, with only variables with significant coefficients being reported. The regressions can be represented algebraically as follows:

$$(i) \log NE_i = a + b_1 \log E + b_2 \log LW$$

$$(ii) \log SM_i = a + b_1 \log E + b_2 \log LW$$

$$(iii) \log NE_i = a + b_1 \log E + b_2 \log LW + b_3 \log Y + b_4 \log P + b_5 \log T + b_6 \log AW + b_7 \log RY + b_8 \log MY + b_9 \log I + b_{10} \log C + b_{10} \log D$$

$$(iv) \log SM_i = a + b_1 \log E + b_2 \log LW + b_3 \log Y + b_4 \log P + b_5 \log T + b_6 \log AW + b_7 \log RY + b_8 \log MY + b_9 \log I + b_{10} \log C + b_{10} \log D$$

where:

NE = Net exports

SM = Ratio of service exports to merchandise exports

E = Average years of adult schooling

LW = Surface area per adult

Y = Gross National Income (GNI)

P = Population

T = Telephone main lines per 1000 people

AW = Domestic patents registered per adult

RY = Research and development expenditure as a share of GNI

XY = Ratio of merchandise exports to GNI

I = Index of domestic protection

C = Access to international waters

D = English language dummy

In general, model (iv) performs the best so it is used. South Africa is shown to not have a comparative advantage in services. Only tourism is predicted to have trade greater than 1% of merchandise trade, predicted at 4.9% of other trade. Put briefly, South Africa is expected to be a minor exporter of construction services, telecommunication services, insurance, financial services, information technology, maritime services and air transport. These results suggest that South Africa should export goods a lot more than services (Stern, 2002).

I would suggest that these results should be interpreted in context. One shortcoming of the research is that it is difficult to incorporate spatial elements into a regression. For example, it has been clear from the other papers that have been reviewed that South Africa enjoys a large comparative advantage in exporting services to Africa, compared to both other African countries and even the developed economies. Partly this comes from greater familiarity with Africa and partly from less distance. It would seem that the paper does not map onto the reality of South African services exports as they currently stand.







## 4. Conclusions

A number of important conclusions can be drawn from the theoretical literature. Liberalisation of trade in services should provide greater benefits to a country than liberalisation of goods. Liberalisation of services can also change the effects of liberalising goods trade. More efficient services trade can lead to comparative advantages for goods in which a country previously had a disadvantage. In liberalising a services sector, the most important benefits come from introducing competition. Trade can augment this process and provide greater benefits but it cannot do this on its own. Producer services are integrally important to the economy. Telecommunications and financial services seem to have significant impacts on national income.

There are some gaps in the international literature. For example, all of the work seems to be modelling exercises. There are few case studies or attempts to examine how applicable the theory is in practise. Mostly the work is confined to theory. For instance, there is little mention in the literature of the effect of services liberalisation in the context of NAFTA (the North American Free Trade Agreement). All of the work on polarisation is based on modelling, while the real world case-study remains unexamined.

South Africa is the dominant player in the services market in SADC, and in some cases, in Africa. This is especially true in the case of financial services. South Africa has the potential to become the financial centre of Africa but it needs to remove discriminatory regulations. In telecommunications, the SADC countries are all in the process of reforming their industries but this reform process has not always been successful. There are still enormous gains to be had from liberalising SADC's telecommunications and trade can definitely play a role in this.

Transport services are also in need of some liberalisation, especially in some of the more regulated segments, such as harbours and railways. The road infrastructure is also in need of better maintenance. Better policing of road laws concerning load limits per axle should result in more goods being transported via rail or air. South Africa should have a comparative advantage in transport services within the region and in the rest of Africa.

The same could be said of energy services and it appears that this is already being borne out by the large amount of trade between South Africa and the rest of Africa in electricity services. There is still considerable scope for deregulation in South Africa's domestic energy services, especially in the petroleum retail market.

South Africa should have a comparative advantage in construction services. This service has been bound, virtually with full commitments, so there are no defensive interests in construction. South Africa should rather concentrate on offensive interests and it appears that these are significant. Regulations and licensing conditions are barriers to trade in many of South African exporters markets.

Health remains a contentious sector. The local industry in South Africa has seen widening inequalities between the public and private sector while significant number of newly-trained doctors and nurses leave the country to pursue their careers in the developed world. The prudent thing to do would be to hold off on trade while the Department resolves these issues. In fact, trade could be a useful tool to counteract these problems. For instance, entry by foreign firms would reduce market power and hence

reduce profits and prices in the private sector. This would reduce some of the inequality between the private and public sectors. An expanded private sector help to reduce emigration of health professionals and coverage could be expanded to take some pressure off public hospitals.

Stern (2002) suggests that South Africa does not have a comparative advantage in services. We suggest that this finding does not replicate the findings from other studies regarding South Africa's services trade in Africa. One problem could be that South Africa is a middle-income country so comparative advantage will change depending on whether trade is being conducted with a developed country or a developing country.

South Africa has a comparative advantage in most services in trade with Africa. This agenda should be pursued in the GATS negotiations. Other opportunities are in the construction industry, world-wide.



## 5. Future research

Having said this, it is important to recognise that the work this statement is based on is dated and only growing more so. In general, there seemed to be a flurry of activity around the turn of the century but little has been done since. In terms of the region, very little work has been done besides the Nepru study. The other work is all based on South Africa.

Services have often been seen as less important than sectors such as manufacturing, often because it is assumed that services can only follow economic growth, not lead it. This has meant that the sector is relatively under-researched, especially when one compares it with some manufacturing industries. This problem is exacerbated by the fact that there is little data on trade in services, and anecdotal evidence suggests that this data is underreporting anyway. In light of the fact that there is very little data, it is all at very high aggregation and of doubtful accuracy, the only option is to conduct research at the firm level. For example, in SACU there is very little idea of the size of services and their contribution to employment. Ndulo et al (2005) extrapolate some data but the veracity of it needs to be confirmed at the firm level.

The work that has been done on South Africa has mainly been descriptive. Besides Stern (2002) there has been very little econometric work or modelling. The exact role of services could probably be better understood by work such as input-output modelling or some econometrics. This work is only becoming more important over time as services begin to play a larger role in the multilateral trade negotiations at the WTO and also in some bilateral agreements, such as the EPAs.

Also of importance is work on the political economy of services trade. The preliminary work suggests that South Africa dominates this trade to the same, or possibly to a greater, extent that it does trade in goods. This has serious political implications as obviously the SADC countries want to avoid this sort of economic dependence. This could lead to reluctance to negotiate a SADC (and a SACU) protocol on services, allowing the EU which is currently negotiating on services as part of the EPAs, preferential access to the SADC services market. There are also growing concerns in the region about the practise of South African retailers sourcing their produce from South Africa instead of the home country.

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