

# ASEAN Economic Integration on Services: An Analysis of Economic Impacts and Implications

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## I. Introduction

ASEAN continues its efforts to liberalize services trade in the region as part of the process of establishing the ASEAN Economic Community (AEC). ASEAN has been increasing the level of regional liberalization through package negotiations of the ASEAN Framework Agreement on Services (AFAS). After signing the 10th AFAS package, the package negotiations were replaced by the ASEAN Trade in Services Agreement (ATISA),<sup>1</sup> which takes a negative list approach and includes regulatory cooperation between member states.

The aims of this service liberalization pursued by ASEAN can be summarized as: (i) eliminating all restrictions on Mode 1 and Mode 2 supply of services; (ii) allowing ASEAN equity participation up to 70%; (iii) significantly eliminating restrictions regarding market access on Mode 3 supply of services; (iv) eliminating restrictions regarding national treatment on Mode

3 except for a maximum of one out of 128 sub-sectors. Meanwhile ASEAN is taking a passive stance on the liberalization of Mode 4 supply of services. This is clearly different from the economic integration in the European Union.

Upon this backdrop, whether such asymmetric liberalization between modes of services supply can lead to an extension of services trade is an important issue. Furthermore, it is necessary to examine whether ASEAN can expect free flow of services as it proceeds with service trade liberalization in the era of Covid-19, where travel and movement are highly restricted.

Therefore, this paper attempts to examine the progress of service market integration within ASEAN and analyze the impact of service liberalization pursued by ASEAN. Based on the analysis results, we also present policy implications to enhance cooperation with ASEAN in the service sectors.

<sup>1</sup> Signed by all member states in October 2020.

## II. The Liberalization of Services Trade in ASEAN

### 1. Progress and Achievements

The ASEAN Framework Agreement on Services (AFAS) was signed in 1995, and the various rounds of negotiations took place under AFAS to liberalize intra-regional services trade. Up to now, ten packages of commitments have been concluded. Financial services and air transport services were previously included in the AFAS negotiations but negotiated separately into independent packages. Since then, the 10<sup>th</sup> package of AFAS, 8<sup>th</sup> package of financial services, and 11<sup>th</sup> package of air transport services have all been integrated into ATISA.

ASEAN has transitioned to a negative list approach in ATISA, which is commonly known to be more open. According to Article 12 of the Agreement, six ASEAN countries (Brunei, Indonesia, Malaysia, the Philippines, Singapore, and Thailand) shall submit their schedule of Non-Conforming Measures within five years after entry into force of the agreement. Vietnam shall submit its schedule within seven years, Myanmar, Cambodia and Laos within 13 years.

The service liberalization in ASEAN aims to eliminate barriers to services trade between member states beyond the level of liberalization

undertaken by the General Agreement on Trade in Services (GATS). In a manner consistent with GATS, AFAS provides commitments covering 128 subsectors out of the 155 subsectors on the GATS W/120 list and follows the definitions of modes of services supply.

GATS defines service trade into four modes of supply, based on the border movements of the services provider and the consumer: Cross-border supply (Mode 1), Consumption abroad (Mode 2), Commercial presence (Mode 3), and Presence of natural person (Mode 4). Services trade is classified as Mode 1 when the service itself crosses the border, classified as Mode 2 when the consumer crosses the border, and classified Mode 3 and Mode 4 when a services supplier crosses the border. Especially when a services supplier provides its services through commercial presence by establishing an affiliate, branch, etc., such service trade is classified as Mode 3.

The specific liberalization targets of AFAS for each mode of supply are summarized in Table 1. Member States have pursued eliminating all restrictions on Mode 1 and 2 except for bona fide regulatory reasons. Regarding Mode 3, ASEAN has been progressively removing market access limitations, and raised minimum foreign equity participation by 70% for all 128 subsectors.

**Table 1. Target of ASEAN Framework Agreement on Services (AFAS)**

	5 <sup>th</sup> /6 <sup>th</sup> Package	7 <sup>th</sup> Package	8 <sup>th</sup> Package	9 <sup>th</sup> Package	10 <sup>th</sup> Package
Completion target	AEM 2006	AEM 2009	AEM 2011	AEM 2013	AEM 2015
Scheduled Subsectors	55	65	80	104	128
Mode 1 (including horizontal)	None	None	None (for all 80 subsectors)	None (for all 104 subsectors)	None (for all 128 subsectors)
Mode 2 (including horizontal)	None	None	None (for all 80 subsectors)	None (for all 104 subsectors)	None (for all 128 subsectors)
Foreign Equity Limitation (including horizontal)	PIS: 49% Construction: 51% Other: 30%	29 PIS: 51% 9 Log: 49% 42 Other: 49%	29 PIS: 70% 9 Log: 51% 42 Other: 51%	29 PIS: 70% 9 Log: 70% 42 Other: 51%	29 PIS: 70% 9 Log: 70% 42 Other: 70%
Mode 3 MA Limitations (including horizontal)	N/A N/A N/A	29 PIS: Max 2 limitations 9 Log: max 3 limitations 27 Other: max 3 limitations	29 PIS: No limitations 9 Log: max 2 limitations 16 Other: max 3 limitations 16 Other: max 2 limitations	29 PIS: No limitations 9 Log: No limitations 26 Other: max 2 limitations 26 Other: max 1 limitations	29 PIS: No limitations 9 Log: No limitations 90 Other: No limitations
Mode 3 NT Limitations (including horizontal)	N/A	N/A	Max 4 Lim /subsector	Max 3 Lim /subsector	Max 1 Lim /subsector
15% flexibility	N/A	N/A	15%*(80*3)=36 modes Max 60% (22 subsectors) in 1 mode	15%*(104*3)=47 modes Max 55% (26 subsectors) in 1 mode	15%*(128*3)=58 modes Max 50% (29 subsectors) in 1 mode

Source: ASEAN Integration Report 2015.

Negotiations for the 10th AFAS package were scheduled for completion by 2015, but actually signed in August 2018. Looking at the depth and scope of liberalization through the 10th AFAS package, we can see that all countries failed to achieve the targets described above. Most member countries have achieved their target level of openness in Priority Integration Sectors (PIS), but failed to meet target levels in other sectors. In particular, Mode 3-related openness is relatively low, and Myanmar, the Philippines and Vietnam remain at a

lower level of openness than other member states.

ASEAN introduced 15% flexibility measures from the 8th package of AFAS, which allowed suspension of opening in 58 modes and up to 29 subsectors in one mode.<sup>2</sup> Under the flexibility rule, all ASEAN countries failed to achieve the target number adopted in 2007, and the flexibility figures of Myanmar, the Philippines, and Vietnam remain above 15%.

In relation to trade in services through Mode

<sup>2</sup> 15%\*(128\*3)

4, the ASEAN Agreement on Movement of Natural People (AAMNP) entered into force in 2016, and Mutual Recognition Arrangements (MRAs) have been signed for eight professional services including engineering, nursing, architectural, surveying qualification, accountancy, medical practitioner, dental practitioner, tourism professionals as of April 2021.

The AAMNP is the first single agreement signed by ASEAN to facilitate the movement of natural persons in the service sector, but it has limitations that the depth and scope of liberalization are low and significantly different among ASEAN member states. According to the schedules of commitment, only business visitors (BV) and intra-corporate transferees (ICT) are allowed to enter and stay, and the degree of openness, the number of conceded sectors, and the period of stay vary greatly from country to country. Above all, certain limitations remain in that it deals only with the movement of skilled workers in ASEAN.

MRAs have currently been implemented for eight areas, but in reality, the cross-border movement of people supplying services is limited due to the national regulations, concerns over job losses, and different education and qualification systems, etc.

## 2. Services Trade in ASEAN

Although service industries are becoming an integral part of ASEAN's production, trade and investment, the share of intra-regional trade seems to be stagnant or rather decreasing despite the liberalizing efforts of ASEAN.

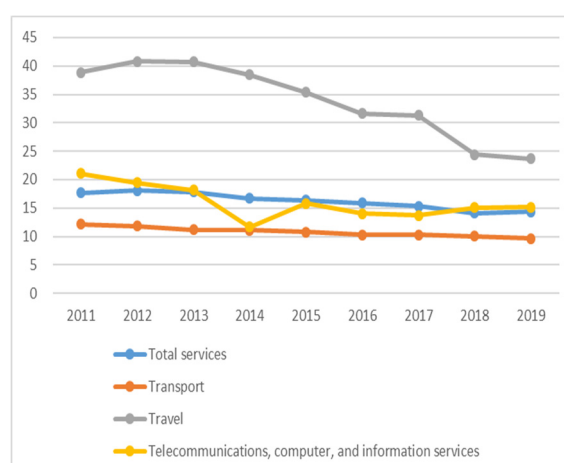
**Figure 1. Share of Intra- and Extra-ASEAN Services/Goods Trade (%)**



Source: ASEAN Stats Data Portal (all accessed on August 28, 2020).

ASEAN has focused its efforts on accelerating integration in Priority Integration Sectors (PIS), including air-travel and tourism, e-ASEAN, healthcare and logistics. Even for such PIS where market opening has been relatively successful, the proportion of regional trade has decreased or stagnated since 2011.

**Figure 2. Share of Intra- and Extra-ASEAN Services Imports in PIS (%)**



Source: ASEAN Stats Data Portal (all accessed on August 28, 2020).

One possible explanation is that services trade with extra-regional countries such as China may have increased due to the relatively rapid economic growth in these countries. Also, market integration in ASEAN may have increased the efficiency of the value chain ASEAN participates in, resulting in increased service trade with extra-regional countries. Another is that Mode 3 trade replaces Mode 1 among ASEAN countries as investment-related regulations are relaxed. Or asymmetric deregulation between modes may have been responsible for the almost unchanged ratio of intra-regional services trade since 2010.

In order to examine the cause of decline in the proportions of intra-regional services trade, service trade data by modes of supply is needed. Since services trade data based on Balance of Payment (BOP) does not include Mode 3 and Mode 4 trade, Foreign Affiliates Statistics (FATS) and FDI statistics are required to accurately measure Mode 3 transactions, and remittance statistics are required for Mode 4 transactions. However, neither ASEAN nor Korea provide this data.

### III. Economic Impacts of Services Liberalization in ASEAN

To analyze the effect of liberalizing service trade, comprehensive information such as industry characteristics, level of liberalization by mode, and comparative advantage of each country is required. For example, in industries that can only be supplied in certain modes due

to their intrinsic attributes, trade can be restricted by limiting trade in certain modes, which can lead to situations where a country with comparative advantage in such industries is excluded from trade. Lowering trade barriers only in some of the modes, such as in the case of service liberalization in ASEAN, has a different effect on trade depending on whether each service sector has inter-modal substitution or complementarity.

When the different modes of supply are complementary, trade barriers in a mode can restrict overall services trade. Meanwhile, when the different modes of supply are in a relationship of substitution, free flows of services can be realized by just opening up one of the modes of service supply. However, barriers for a particular mode can have significantly negative consequences on welfare even if inter-modal substitution exists. If a service provider is able to provide services regardless of modes of supply, the optimal choice can be made in consideration of supply costs and benefits, but if a particular type of supply is not available, the service provider cannot make an optimal choice and consequently the gains from trade decrease.

According to the empirical analysis of this report, the inter-modal relationship varies across industries. In the transportation services, there is a complementary relationship between Mode 1 and Mode 3. In professional services, substitutability exists between Mode 1 and Mode 3, and complementarity exists between Mode 1 and Mode 4. On the other hand, in financial services, there is no significant substitutability or complementarity between Mode 1 and Mode 3.

The empirical analysis uses service trade data during 2007-2009, so it is questionable whether the results are still valid. This is because inter-modal relationships could possibly change over time due to various factors, such as digitalization. However, what can be obtained from the empirical analysis is that inter-modal relationships vary across industries, and analyzing at the aggregate level can produce misleading overall results. Therefore industry-level analysis is required. In the case of ASEAN, however, industry-level analysis is not possible due to the lack of data on services trade. Therefore, this study sought to examine the effectiveness of ASEAN service market integration through a simple theoretical model instead of empirics.

As mentioned earlier, trade barriers in all modes should be lowered in order to enhance services trade when complementarity exists between modes. In this case, the effect of integrating the ASEAN service market, which can be summarized as liberalization of Mode 1 to 3 supply and limited liberalization of Mode 4 supply, is not expected to be significant.

On the other hand, when substitutability exists between modes, the analysis becomes complicated. Based on the simple theoretical model we derive the following results, but more rigorous study is required later. First, eliminating restrictions on Mode 3 supply of services plays a role in preventing the concentration of production into a large country. Second, allowing free movement of labor and capital between countries may result in a concentration of fac-

tors toward larger countries despite the commercial presence of foreign suppliers. In this respect, restricting the services supply through Mode 4 seems to be a reasonable measure in ASEAN, considering the income gap among member states. However, if complementarity exists between modes, restricting movement of service personnel would limit the entire services trade. Therefore, it is necessary to take different liberalization strategies for each industry based on the inter-modal relations.

Meanwhile, relatively smaller countries such as Korea need to lower ASEAN's trade barriers on Mode 1 and Mode 3 to secure competitiveness in the service sector against ASEAN in the process of ASEAN's service market integration. This requires negotiations on upgrading the existing FTA and signing additional bilateral FTAs.

## IV. Conclusions

The services sector accounts for a large portion of the global economy and its importance is increasing. In contrast to the goods sector, however, it is not easy to identify the volume of trade or analyze the impact of liberalization policy. Such areas remain unknown. Therefore, establishment of an appropriate database should be preceded above all. The relevant database will help to identify the effectiveness of trade policies in the service sector, which will also help in policymaking.

For Korea, integration of the ASEAN service

market will be an opportunity and a challenge. As the ASEAN services market grows, Korea may lose its comparative advantage over ASEAN in the services sector, and considerable production of services may move to ASEAN. Therefore, Korea should make efforts to secure competitiveness in the service sector.

At the same time, regulatory cooperation and harmonization must proceed to ensure effectiveness in the liberalization of services trade. This means Korea should not lag behind in discussions on regulatory cooperation between ASEAN and ASEAN+ countries. [KIEP](#)