FROM TRADE NEGOTIATIONS TO IMPACTS ANALYSIS OF ALTERNATIVE SERVICES LIBERALIZATION SCENARIOS: A METHODOLOGICAL VIEW

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Objectives

- ESCWA member countries parties to overlapping PTAs, mostly covering trade in goods
- Negotiations on extending the scope to services underway in the context of FTAs with the EU, PAFTA
- Member states need support to:
  - Fully understand the extent of benefits of a more efficient services sector
  - Formulate scenarios in the context of
  - Estimate the impact of various alternatives…
  - …with a view to designing an implementation strategy
Objectives

• Financial services are considered to be a key component
• Financial services liberalization could substantially improve the efficiency and the development of the sector through
  o Greater competition
  o Skill and technology transfer
  o Greater risk management and risk diversification across borders
  o Improved transparency
  o Better information
• In turn, better intermediation of resources between sectors, across countries and over time, as well as greater financial stability
Alternative approaches to estimating the impact of services trade liberalization

Econometric studies

- empirical strategy based on exploiting the specific timing, differential degree of liberalization across countries or industries
  - Mattoo et al. (2001): policy-based openness indicators on financial and telecommunications sectors and their long-run growth effects using cross-country data
  - Eschenbach and Hoekman (2006): growth effects of services trade liberalization taking advantage of large differences across transition economies
  - firm-level data also used increasingly more recently (Arnold et al. 2011; 2016)
Issues with the econometric approach

- often reduced-form rather than structural models
- results perhaps driven by omitted factors
- services trade liberalization undertaken as part of a package: need to disentangle the effects of other reforms
- difficulties associated with differentiating permanent and one-off effects
- possible endogeneity issues
Simulation methods

• typically using calibrated theoretical models, either a partial or general equilibrium model
  • general equilibrium models capture the linkages between different sector and markets
  • partial equilibrium models focus on single markets or narrowly defined products
Alternative approaches to estimating the impact of services trade liberalization

Issues with simulation methods

• conceptual and practical challenges in modelling different modes of supply
• most CGE models to date identify static gains from services trade liberalization
• lack of disaggregated services trade and investment data by industry and partner
• quantities in a model should reasonably match the actual data and restrictions that apply to relevant variables in the model
• a key input to such models is the estimates of AVEs of barriers to services trade
Calculating the tariff equivalent of services trade barriers

**Possible approaches**

- Based on coverage or frequency indices
- Quantity-based approach
- Price-based approach
Calculating the tariff equivalent of barriers to financial services trade

Common approach in the context of financial services

• Mainly price-based approach adopted by the APC researchers and more recently the World Bank
  • with the inclusion of trade restrictiveness indices in the econometric model
  • regulatory barriers differentiated: applying to both domestic and foreign services suppliers, and discriminatory restrictions imposed mainly on foreign services suppliers
Calculating the tariff equivalent of barriers to financial services trade

**Common approach in the context of financial services**

- Following Kalirajan et al. (2000), involves multiple steps
- First, discriminatory restrictions are quantified for financial services, possibly separately for banking and insurance services.
- A two-stage methodology to convert restrictions into tax equivalents
- In the first stage, a model is specified to explain the net interest margins of banks in an economy as a function of the capital and liquidity and non-interest operating expenses of the bank, as well a constant term and country dummies

\[
\ln(NIM_{ij}) = \alpha_0 + \beta_k \ln(K_{ij}) + \beta_L \ln(L_{ij}) + \beta_E \ln(NIE_{ij}) + \sum D_i
\]

- In the second stage, the interest spreads backed out from the first stage are estimated to be a function of the interest rate volatility of banks, market structure and non-prudential restrictions, as measured by the trade restrictiveness index
Calculating the tariff equivalent of barriers to financial services trade

Common approach in the context of financial services

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\[ S_i = \beta_0 + \beta_{IV} IV_i + \beta_{MS} MS_i + \beta_{TRI} TRI_i \]

Where

\[ S_i = \hat{\alpha}_0 + \hat{D}_i \]
Calculating the tariff equivalent of services trade barriers

Common approach in the context of financial services

- The trade restrictiveness indices in the econometric model differentiate between discriminatory and non-discriminatory restrictions.
- The estimated coefficients and trade restrictiveness index are then used to calculate the size of price wedges for individual economies.
Calculating the tariff equivalent of services trade barriers

**Issues with the common approach**

- **Feasibility**
  - availability of data on price-cost margins, trade flows and regulatory barriers for a wide range of Arab countries
  - Poor coverage of banks operating in the Arab region in databases covering detailed financial statements
  - Such data are very costly
- **Methodological issues and possible improvements**
  - are there ways to tailor the approach for the region?
  - are they ways to further improve the approach?
Calculating the tariff equivalent of barriers to financial services trade

**Suggested approach**

A two-stage approach is proposed. In the first stage:
- The main channel through which the benefits of financial services trade liberalization materialize is postulated to be investment
- Financial services trade barriers are mapped to the FDI flows, using an econometric model that explains bilateral FDI flows by sector
- Relevant factors, including macroeconomic environment, capital controls, political risks as well as financial services trade barriers are controlled for in the model
Calculating the tariff equivalent of barriers to financial services trade

Suggested approach

In the second stage:
• Results from the first stage are integrated into a CGE framework to simulate the impact of removing different barriers to trade in financial services on a wide range of outcomes of interest

Advantages of this approach include:
• Tighter association between different policy options and the nature, extent and scope of benefits and adjustment costs
• Possibly allows for a richer and more specific set of scenarios
THANK YOU