Book

Tailoring aid for trade for the services economy in low income and least developed countries

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Issue Paper

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LIST OF ABBREVIATION AND ACRONYMS

AfDB	African Development Bank
AfT	Aid for Trade
BPO	business process outsourcing
DTIS	Diagnostic Trade Integration Study
EIF	Enhanced Integrated Framework
FDI	foreign direct investment
GATS	General Agreement on Trade in Services
GDP	gross domestic product
ICT	information and communications technology
ITC	International Trade Centre
LDC	least developed country
LIC	low income country
MFN	most favoured nation
ODA	official development assistance
OECD	Organisation for Economic Co-operation and Development
OSBP	one stop border post
SDG	Sustainable Development Goal
SME	small and medium-sized enterprise
WTO	World Trade Organization

FOREWORD

The fastest growing component of global trade is trade in services. Trade in services represents the fastest growing element of global trade. Coupled with the multi-stranded contribution of services to the achievement of sustainable development outcomes, the building of competitive services sector in the economies of least developed (LDC) and low-income countries (LICs) is of critical importance.

The Aid for Trade (AfT) initiative, first launched at the Hong Kong Ministerial Conference in 2005, has devoted considerable resources to assisting developing countries enhance their ability to take advantage of the opportunities offered by increased integration with the international trading system. While assistance to LDCs and LICs has roughly doubled since the inception of the initiative, the bulk of disbursements targeted towards building productive capacity has been focused on the primary sector rather than on services sectors.

This paper provides an overview of the relationship between the AfT initiative and services, examines potential AfT interventions that could be used to improve both regulatory frameworks as well as the broader policy environment, and lays out the ways in which AfT can be targeted to address service sector-related infrastructure deficits. The paper concludes by providing readers with a series of potential AfT responses which, if implemented, could boost export performance in sectors of economic interest to LDCs and LICs.

This paper, the sixth in a series of publications related to services and Sustainable Development Goals (SDGs), is designed both to expand the body of knowledge in this area and to support positive and innovative service sector policy change in the world's most vulnerable countries. We hope that this paper, as well as the companion pieces in the series, will be useful to policymakers and researchers.

Ricardo Meléndez-Ortiz

EXECUTIVE SUMMARY

Services account for over 70 percent of all economic activity globally and, following decades of above-average growth, they also now contribute more than half of total production in least developed countries (LDCs). The dynamic growth of services has huge potential to help developing countries support sustainable development objectives via a number of channels: by increasing access and affordability of basic welfare-enhancing services, such as education and health; by improving efficiency in key sectors of the overall economy (such as transport or finance); and by generating income in specific services export sectors. More broadly, the development of services-based economies has a key role to play in helping countries meet Sustainable Development Goals (SDGs) in areas from gender equality to climate change.

While many services were previously thought of as "non-tradable," trade in services across borders is now the fastest growing area of global trade. A major factor in this trend has been the advent of new technologies to deliver and supply services alongside new models of competition in sectors that were traditionally dominated by monopolies and enhanced trade liberalization. There is also growing awareness of how services contribute to exports of other non-services sectors, through their input function, within the value chains of agricultural and manufactured goods as well as other services.

However, the contribution of global efforts launched at the WTO in 2005 under the Aid for Trade (AfT) initiative on services has been mixed, despite the likelihood of continued strong growth in trade in services, and it has yet to take full account of the ongoing shifts in global production towards services.

This paper examines the complex relationship between the Aid for Trade initiative and services and finds that AfT has the potential to support the development of services in a number of ways. Firstly, AfT can play a crucial role in assisting countries to put in place properly balanced regulatory and policy frameworks that are essential for ensuring competition, encouraging foreign investment, and allowing services to grow. Secondly, services are dependent on network infrastructure such as roads, ports, energy, and telecommunication networks, which will require continued investment from both AfT and other financing resources. Thirdly, the AfT initiative can assist LDCs and LICs in expanding much-needed finance to firms engaged in the services sector through improvements in domestic financial sector capacity and efficiency.

Finally, AfT can do much more to help LDCs and LICs to fulfil their potential to develop key service sectors of export interest. In each potential export sector, donors and developing countries could improve efforts to develop tailored and comprehensive strategies and responses, improve sector-specific regulatory capacity, and target infrastructural support.

1. INTRODUCTION

Launched more than a decade ago at the WTO Hong Kong Ministerial conference in 2005, the Aid for Trade (AfT) initiative has achieved considerable success in assisting developing countries to integrate into the global trading system. According to the OECD Creditor Reporting System, commitments for AfT reached almost US$54 billion in 2015, up from US$24.6 billion in 2006. Of this figure, some US$19.3 billion went to least developed countries (LDCs) and low income countries (LICs).

However, the last ten years has also seen a changing economic context for many countries. At a global level, economic activity is increasingly driven by services, with most high-value economic activity concentrated in services sectors. New technologies have created new opportunities for trade in services, which have been the most dynamic component of global trade growth in recent years.

Services are important for LDCs and LICs, since they have the potential to reduce poverty in a variety of ways. Overall, the main channels through which services can lead to poverty reduction include:

- Direct improvements in *consumer welfare*: for example, better and cheaper communication services allows for improved and more widespread flows of information, while improved education and health – resulting from enhancements in welfare services – have a direct impact on consumer well-being and productivity.

- *Income generation:* services sectors can support poverty reduction by generating economic growth. In many LDCs, tourism services remain the primary source of revenue generation. The role of services in generating income is particularly and increasingly important for smaller and/or landlocked LDCs that lack the manufacturing scale and physical connectivity to global product markets.

- Contributions to *overall economic efficiency*: many services sectors (such as finance or transport) enable and contribute to the efficiency of activities in other spheres: for example, in the "embedded" services supplied to the agricultural, extractive, or manufacturing sectors. Enhancing international trade, and integration into value chain more specifically, is, to a significant extent, determined by the efficiency of key services inputs (Fessehaie 2017).

Many opportunities have been created for expanded services trade for developing economies via preferential market access agreements (including the LDC Services Waiver), regional trade agreements, as well as multilateral liberalization. However, service sector development in LDCs and LICs is constrained by a number of factors which limit the ability of firms in these countries to export services directly, and, of increasing importance in the era of global and regional value chains, to supply them as key inputs into the production of other goods and services.

This paper provides an overview of the relationship between the AfT initiative and services (section 2) and maps AfT support for services in LDCs and LICs, before exploring some of the most pressing service sector supply-side constraints (section 3) in order to determine what additional AfT interventions are necessary. Section 4 discusses potential AfT interventions in four broad areas: improving regulatory performance, enhancing the overall policy environment, addressing infrastructural deficits, and increasing access to financing for service sector firms. Section 5 provides a more detailed examination of potential AfT interventions in service sectors of specific economic interest to LDCs and LICs, including tourism, information and communications technology (ICT) enabled services, financial services, transport and logistics, and the temporary movement of natural persons.

2. SERVICES AND AID FOR TRADE: CONTEXT AND OVERVIEW

Services have played a dominant role in economic activity in developed countries for more than fifty years. Yet, while goods have been transported across borders for centuries, resulting in the creation of sophisticated global production chains, the exchange of services across borders is, for the most part, a relatively new phenomenon, and one that continues to change with the advent of technologies that create new ways to supply and consume services. Furthermore, recent evidence from the OECD-WTO Trade in Value-Added (TiVA) database shows that nearly half of global trade, when measured on a value-added basis, is accounted for by services. This indicates that services are not only tradeable products in their own right but are also critical inputs into the production of many other goods and services (ICTSD 2016).

This points to a large untapped potential for greater trade in services sectors. There is also a need to enhance understanding, especially by developing countries, of the opportunities in the services economy. Similarly, assisting developing countries, especially LDCs, in harnessing scarce development resources – including those available under the banner of the AfT initiative – to take advantage of new opportunities in the emerging global services economy is of critical importance. This section briefly examines the complicated and overlapping relationships between the creation of competitive services sectors, economic development, international trade, and the role of development assistance under the AfT Initiative.

2.1 The General Context for Trade in Services: How are Services Traded?

In order to address how AfT might be mobilised to support trade in services, it is first important to understand how services are traded across borders, what barriers and impediments exist to prevent trade, and what steps are needed by countries to overcome them.

The relationship between trade and services is complicated; until relatively recently, many services (for example, in the main utilities, health, and education sectors) were dominated in most countries by state monopolies with competition restricted. Many network services, such as energy and telecommunications services, remain closer to "natural monopolies" than to perfectly competitive markets, due to the high barriers to entry in the form of large initial sunk costs (such as network infrastructure). Even where there is competition, the majority of services remain subject to public interest and regulatory concerns that help to limit *de facto* competition and trade.

Nevertheless, in the past couple of decades in particular, a number of factors have made services more tradable, including:

- Technological progress (such as the aforementioned potential for many services to be delivered from anywhere in the world through electronic means);
- A changing political attitude to the provision of services and a resultant wave of regulatory reform (in sectors ranging from telecoms to banking to environmental services);
- The growing importance of foreign investment, including foreign direct investment (FDI);
- The increasing mobility of services consumers (such as tourism, and increasingly in other sectors, such as health) as well as services suppliers (such as contractors and employees of multinationals willing to make temporary movements across borders);
- Rapid expansion of merchandise trade to support greater trade in services, occurring in two waves: firstly, as a result of geographical fragmentation in production

of goods and, secondly, as services themselves were supplied remotely, for example through a process of offshoring.

Services are delivered to markets in a number of different ways. Within the WTO GATS framework, these different delivery mechanisms are formally defined as four separate "Modes" of delivery:

I. **Mode 1: Cross-border supply** covers services flows from the territory of one country into the territory of another (e.g. the provision of financial services to clients overseas via the internet).

II. **Mode 2: Consumption abroad** refers to situations where a services consumer travels temporarily into another country's territory to obtain a service abroad (e.g. tourists travelling abroad and purchasing hotel and restaurant services).

III. **Mode 3: Commercial presence** takes place where a services supplier of one country establishes a local presence, such as ownership or lease of premises, in another country's territory in order to provide a service to that market. This activity is closely related to FDI.

IV. **Mode 4: Movement of natural persons** consists of services providers of one country travelling temporarily to the territory of another country to supply a service (e.g. an engineer hired to work on a construction project overseas for a fixed term).

In light of the large differences between each of the four modes, identifying and targeting barriers to trade in services is complicated. Given that services range from financial services to construction and education, there are also specific barriers established at the sectoral level.

The implication for AfT is that responses and interventions will need to address both "horizontal" issues – the general rules and governing frameworks in areas such as foreign investment or work permit regulations – as well as the multitude of "sector level" issues (such as telecoms operator licenses or building codes in construction) which are unique to each area of services trade.

One critical feature of trade in services is that the actual process of liberalisation of services markets often occurs in a very different way than that for international trade in goods. In goods markets, there are obvious and well-known sets of instruments that are identified as barriers to trade, such as tariffs, SPS regulations, technical standards requirements, and other non-tariff barriers. There is also a set of broader policy-based barriers and distortions in international goods market – such as long-standing systems of trade preferences, newer free trade agreements, and agricultural subsidy and support systems – which create distortions within international markets. Taken together with traditional barriers, this has meant that negotiations over trade in goods tend to take place around clear "defensive" and "offensive" interests. Moreover, for developing countries, in particular, the costs of liberalisation are more easily recognised in the form of lost tariff revenue -a dynamic not as readily apparent for services. Indeed, one of the key rationales for AfT came from a recognition that there was a need to mitigate these short-term losses for developing countries with compensatory and accompanying measures under headings such as "trade adjustment support," or large-scale investment in "productive capacity" to enable countries to reap more benefits from opportunities in the global market.

For services, however, the picture is slightly different. Firstly, and with the notable exception of Mode 4, the "footloose" and internationally mobile nature of services companies makes it difficult to discriminate amongst potential foreign suppliers. It also makes less sense, *in general*, to discriminate: once a sector is opened up to services companies from one country, there is little incentive not to open the sector to all foreign firms, regardless of nationality (unlike for goods where tariffs and other instruments might be used to favour

some supplier countries over others, either for strategic and political reasons, or as part of a mutual liberalisation scheme under a free trade agreement, or to cushion domestic industries against the most competitive suppliers).

Secondly, the motivation for liberalising services sectors tends to be different from the motivators for liberalizing goods. Rather than negotiating with other countries towards mutually beneficial liberalisation (for example, under a free trade agreement, with tariffs on both sides being applied according to carefully balanced negotiations), *as a rule* the motivation for liberalising services tends to focus more on purely domestic concerns. Countries often actively seek to move from inefficient monopoly situations and generally seek greater competition to bring down prices, improve services, and, therefore, boost competitiveness. In this situation, it is more difficult to talk about the costs of liberalisation (even more so since liberalisation tends to be carried out on a unilateral basis, outside of any trade negotiations), although there may be valid arguments around the loss of "policy space" to regulate and put in place some policies at a later date (Cattaneo 2017).

From the perspective of AfT interventions, this means that addressing issues around services requires a different approach that is – in the mind of both donors and recipients – focused less on *quid pro quo* adjustment mechanisms (such as support to producers who will suffer from the erosion of their preferences), or on traditional notions of "building productive capacity." When focusing on services, there should be more attention on how to support liberalisation to improve general levels of competitiveness within developing economies; this also includes also looking beyond the established boundaries of AfT, (for example at the one of the most crucial inputs to services sectors – a skilled workforce).

2.2 Services, Economic Development, and Trade

Services play a crucial role in economic development. Services have long been the dominant source of growth driving high-income economies where, together, they account for an average of slightly less than 75 percent of total GDP. Even in the poorest countries, services have been the fastest growing sector: according to *World Development Indicators*, services contributed roughly half of overall GDP in LDCs in 2015, up from 42 percent in 1990 and 44 percent in 2000.

Available research highlights a number of trends about the close connection between services and development. Overall, there is a strong positive correlation across countries between the size of the services sector and the overall level of economic output. Ghani and Kharas (2010) challenged the long-held notion that industrialisation is the only route to rapid economic development for developing countries, noting the positive relationship between growth in services and overall economic growth and that a stronger correlation may exist between services growth and GDP than is the case for manufacturing growth and GDP. In terms of poverty reduction, the study also finds that growth in the services sector is more closely correlated with poverty reduction than growth in agriculture, and that the channel underlying this relationship is through job creation, particularly for new entrants into the labour force – notably women.

Box 1: Services, LDCs, and the Sustainable Development Goals (SDGs)

On a broad level, a strong case can be made that growth in services in developing countries will have direct and significant impacts on helping developing countries meet a broad range of the post-2015 Sustainable Development Goals (SDGs).[1]

Through the three broad channels outlined above – consumer welfare, income, and improvements to overall economic efficiency – growth in services has the potential to contribute significantly to *SDG 1 – End Poverty in All Its Forms* in developing countries. At the most basic level, clear correlations exist between overall GDP in countries and the size of the services economy. For many LDCs, moving towards a services-based economy can help them overcome disadvantages (such as physical distance from markets) and capitalize on assets, such as young, and increasingly skilled, workforces. For others, developing services is more closely linked to achieving a structural long-term transformation from resource-based economies towards more sustainable, services-based ones. However, much here will still depend on parallel measures to increase LDCs' resilience to frequent natural disasters, including cyclones, flooding, earthquakes, and tsunamis.

Following from this, the experience of developed countries suggests that services might also be expected to play the major role in contributing to achieving *SDG 8 – Promoting Full and Productive Employment and Decent Work for All*. Given that SMEs account for approximately 61 percent of total global private sector employment, they are of particular importance in supporting employment gains in LDCs and LICs (Grater et al. 2017; Ayyagari et al. 2011). Functioning services are also essential elements in building *Resilient Infrastructure* under SDG 9, while access to finance and technology are intimately linked to *Fostering Innovation* under the same goal.

In particular, available research highlights the important role that services may have in *Achieving Gender Equality and Women's Empowerment* under SDG 5. Ghani and Kharas (2010) demonstrate that "female employment goes hand-in-hand with increased services employment," which, in turn, has a special role in reducing poverty. In many LDCs and LICs, there is, however, still considerable scope for such dynamics to play out, given currently low levels of female participation in the labour force. Furthermore, a growing body of evidence suggests that increases in the rate of female employment in the economy can drive productivity and competitiveness (Lipowiecka and Kiriti-Nganga 2016).

At the level of specific services sectors, improvements in services are also directly related to progress on human development objectives, most notably in the education sectors to help achieve *SDG 4 – Ensure Inclusive and Equitable Education and Promote Lifelong Learning Opportunities for All* – and the health sector on *SDG 5 – Ensure Healthy Lives and Promote Well-being for All*. There are also direct links to *Ensuring the Availability and Sustainable Management of Water and Sanitation for All (SDG 6)* and *Ensuring Access to Affordable, Reliable, Sustainable and Clean Energy for All (SDG 7)*.

On a number of SDGs, the appraisal is more nuanced. Inequality is an important issue in developing countries, and policy and improved governance will have important roles to play either in exacerbating or *Reducing Levels of Inequality (SDG 10)*. On the one hand, scarce resources will need to be devoted to support investments in the services sector. On the other hand, services growth can create mechanisms to spread wealth and alleviate inequality: for example, through putting in place systems to ensure the equitable distribution of opportunities.

1 A more comprehensive discussion of the direct and indirect links between services and sustainable development can be found in the ICTSD's framework paper entitled "Services and Sustainable Development: A Conceptual Approach" available at http://www.ictsd.org/themes/development-and-ldcs/research/services-and-sustainable-development-a-conceptual-approach

The WTO (2015) highlights that trade in services is currently "the most dynamic segment of international trade," growing more quickly over the last 20 years than trade in goods, with global trade in services now reaching some US$4.72 trillion. Yet despite this trend, exports of services still represent less than a quarter of global trade, suggesting that there is enormous untapped potential for increased trade in services sectors, especially in light of the fact that together such sectors contribute the majority of global GDP.

Another encouraging trend is that within the growing international market for trade in services, developing economies as a whole have increased their proportion of global trade significantly, with the share doubling over the last two decades to reach 30 percent in 2013. This is still low, however, in proportion to the large populations of developing countries, and ITC (2015) notes that "too few developing countries are taking advantage of new opportunities to specialize in the export of services tasks." While LDCs have also increased their share of world trade, they are still marginal, with less than two percent of global trade in services.

One important caveat to the historical trade data is that the boundaries between trade in goods and services within global value chains are only now being understood and properly accounted for. According to Gereffi (1994), transnational industrial and commercial capital has geographically dispersed and functionally integrated the links in value added chains. These dynamics have been facilitated by revolutions in the transport and communications sectors as well as by trade liberalization, all of which has led to an increased movement of services and industrial activities from the developed world to the developing world.

Many of the links that account for the bulk of value addition are services such as marketing, retailing, and design (Kaplinsky 2005). According to ITC (2015), "when intermediate services tasks are included, services make up nearly half of total global exports." In trying to understand the role of services within trade in other sectors, such as manufactured goods, a number of studies have attempted to highlight and make a distinction between "embodied services" (services that are used in the production of goods) and "embedded services" (downstream services, such as marketing, that help sell the goods) (Drake-Brockman and Stephenson 2012).The overall message is that participation and upgrading in global value chains requires access to critical services inputs – many of which are outsourced. Services create direct export opportunities for developing countries through the various modes of supply and support the export of goods via their input functionality.

2.3 The Aid for Trade Initiative and Services

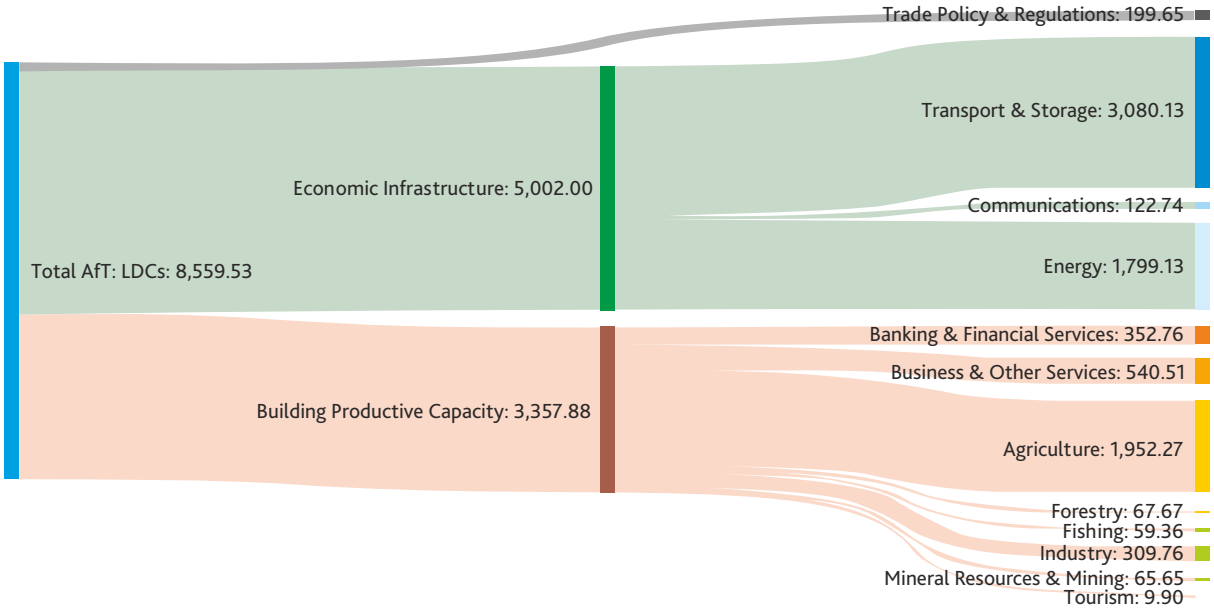
The significance of the initiative was that it represented a general recognition and agreement from WTO members that, in order to take advantage of improved market access, developing countries needed increased investments in infrastructure, improved trade policy, and boosting productivity in key export and related sectors. Arguably these areas had been somewhat neglected during previous years, when donors placed greater priority on achieving goals in areas such as education and health, as reflected in the Millennium Development Declaration and related goals.

A great deal of work was done in the years immediately following the Hong Kong Conference, both in developing the AfT concept and in fulfilling commitments to scale up AfT. With regard to the framework, efforts were made firstly to reach an agreed understanding of "Aid for Trade," in terms of clear definitions and also within the context of the OECD's DAC statistical framework, so that AfT commitments and flows could be better measured and monitored. In terms of substantive progress, the statistics show a significant scaling-up in the levels of official development assistance (ODA, i.e. grants and concessional loans) going to AfT-related activities and sectors since 2005. Flows have shown a continual increase in the years since Hong Kong, with commitments reaching US$39.2 billion in 2010 and US$53.9

billion in 2015, according to the OECD's Creditor Reporting System.

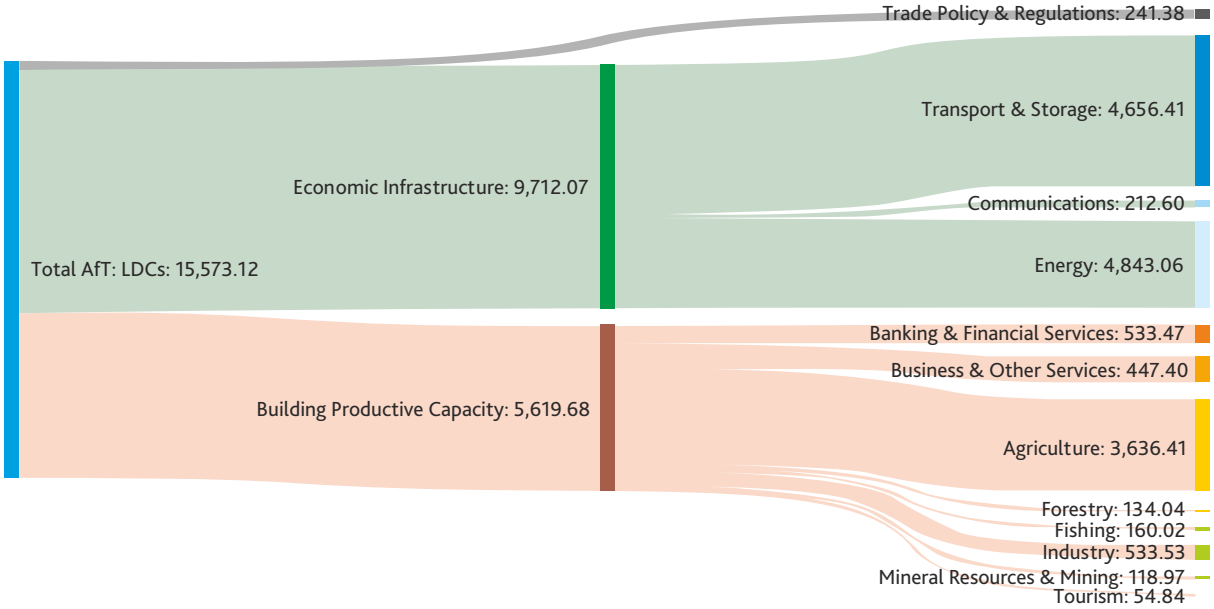
The AfT agenda also emerged not long after the Paris Declaration on Aid Effectiveness, which defined a set of principles for improving aid, including increased ownership and transparency, and a better coordination and division of responsibilities amongst donors. In this context, a great deal of emphasis has been given to improving both the quantity of AfT and its quality.

Figure 1: Aid for Trade to LDCs by Category: Average 2006-2008 (US$ millions, 2015 constant)



Source: Authors calculations using data from the OECD's Creditor Reporting System

Figure 2: Aid for Trade to LDCs by Category: Average 2013-2015 (US$ millions, 2015 constant)



Source: Authors calculations using data from the OECD's Creditor Reporting System

Some important conclusions can be drawn from reported AfT data over the last ten years. Figures 1 and 2 show that AfT commitments to LDCs have nearly doubled since the Initiative's inception. Economic infrastructure has continued to absorb the bulk of AfT commitments and increased in relative importance. Between 2006-2008, economic infrastructure, on average, accounted for approximately 58.4 percent of total AfT commitments for LDCs, while between 2013-2015, infrastructural support represented 62.4 percent. In contrast, while support for building productive capacity and trade policy and regulations has increased in absolute terms, both areas saw decreases in relative terms. Between 2006-2008, support for building productive capacity and trade policy and regulations accounted for, on average, 39.2 percent and 2.3 percent of total AfT support for LDCs respectively; in contrast, between 2013-2015, they represented 36.1 percent and 2.3 percent.

Donor priorities and the needs of potential recipient, in terms of boosting economic infrastructure, have undergone an evolution since the start of the AfT Initiative. Transport and storage, energy, and communications infrastructure increased in terms of absolute commitments. However, only energy infrastructure increased its relative share from 21 percent (2006-2008) to 31.1 percent (2013-2015). The relative average share of transport and storage commitments declined from 36 percent (2006-2008) to 29.9 percent (2013-2015). Support for communications infrastructure maintained its relative share of 1.4 percent during both the 2006-2008 and 2013-2015 periods. Given the importance of sound communications infrastructure in the age of the digital economy and the increasing significance of ecommerce and e-enabled commerce, enhanced levels of support for this vital network service will be necessary.

Donors have increased their commitments to all sectors under the productive capacity category, apart from business services. Worryingly, however, the relative share commitments for banking and financial services declined from 4.1 percent (2006-2008) to 3.4 percent (2013-2015). Banking and financial services serve a critical input function in the production of goods and services, while the lack of access to financial services, in many LDCs and LICs, is cited as one of the most binding constraints (Hallward-Driemeier and Steward 2004). More encouragingly, tourism, often the largest export earner in LDCs and LICs, increased its relative average share of AfT commitments from 0.1 percent (2006-2008) to 0.4 percent (2013-2015). That said, support for tourism services is dwarfed by assistance to agriculture which accounted for, on average, 22.8 percent of total AfT commitments between 2006-2008 and 23.4 percent between 2013-2015.

Commitments for trade policy and regulation increased in absolute terms from US$199.7 million (2006-2008) to US$241.4 million (2013-2015). However, in relative terms, this represented a decrease of approximately 0.7 percent between the two periods. Given the regulation-intensive nature of services (ICTSD 2017), additional support would be needed to support further service sector development in LDCs and LICs that are, in many cases, constrained by a lack of technical, legal, and regulatory capacity.

3. EXPLORING SERVICES CONSTRAINTS IN LDCS AND LICS

The ability of firms within LDCs and LICs not only to export services directly but also to supply services as inputs into global and regional value chains is constrained by three broad factors: regulatory and policy weaknesses, infrastructure deficits, and access to finance. Addressing these constraints will, in combination with flanking measures to increase skills and human capital, support LDCs and LICs in their quest to spur trade-induced growth, enhance consumer welfare, create new opportunities for production and diversification, and increase employment.

3.1 Services Policies in LICs and LDCs

There is a growing body of evidence which suggests that trade openness is highly linked with the performance of services sectors (Amiti and Konings 2009; Duggan et al. 2013). Research also indicates that a robust relationship exists between firm-level total factor productivity and access to communications services, electricity, and financial services (Arnold et al. 2008). Finally, Hoekman and Shepherd (2015) have found that higher barriers to services trade decrease the productivity of domestic manufacturing sectors.

The policy implication of these findings is that restrictions on services trade have a negative impact on exports, on firm productivity in the primary, secondary, and tertiary sectors, and on economic growth more generally. This is borne out in recent empirical work which has found that, if the members of the East African Community (EAC) reduced the level of services restrictions to those of Ghana, which has achieved the lowest services trade restrictiveness index (STRI) score in Africa, exports of non-agricultural products would increase by approximately 20 percent for Kenya, Tanzania, and Uganda and by 13 percent for Ghana (SET 2016).

Services trade policy which increases openness, both regionally and internationally, for LDCs and LICs will enhance competition within the domestic economy and will assist domestic firms in increasing their levels of productivity and international competitiveness. However, far too many LDCs and LICs still lack comprehensive and strategic services policies or the political will to engage in service sector liberalization. This is due to a number of factors including: the fragmented nature of service sector advocacy groups, limited service sector data, a lack of understanding as to the importance of services to the domestic economy, and limited negotiating capacity (Hustler and Primack 2012).

The services sector is composed of approximately 160 subsectors. The diversity of the sector represents a particularly thorny problem when it comes to articulating the sector's interest to government. Similarly, services trade negotiators are unable either to inform the sector of the status of trade negotiations or, more critically, to utilize their input in the formation of negotiating positions and services policy.

Data on services, particularly from LDCs and LICs, is plagued by significant limitations including the scarcity of data on actual policies, incongruities in sectoral classifications, differences in tariff equivalent estimations, as well as basic measurement issues. This lack of data and accurate assessments of impact can create scepticism from policymakers towards the potential benefits of services liberalisation and the formation of effective services policy. In many cases, policymakers in LDCs and LICs focus their policy efforts on the primary and secondary sectors where the dynamics and benefits are more clearly understood. When combined with limited negotiating capacity and challenges in working through the intricate linkages that exist between different subsectors and modes of supply, LDCs and LICs often find themselves at a disadvantage in regional and international trade negotiations.

3.2 Domestic Regulatory Capacity

One of the most important underlying requirements for the development of efficient

services is the creation and maintenance of a proper framework of policies and regulations to govern activity, both at the overall economy-wide level and in the sectors concerned (ICTSD 2017). Most of the time, a change in the regulatory framework is the trigger for the liberalisation of a specific sector, or a dynamic change within it.

In any economy, there are overlapping layers of regulations and policy frameworks that impact service providers by creating compliance burdens. Regulatory systems and policy frameworks need to reflect and balance competing concerns and, as such, need to be designed to achieve multiple objectives, including:

- Fostering and promoting competition amongst services providers;
- Providing a stable and predictable environment for business and investment;
- Supporting innovation and improvements in efficiency;
- Protecting consumers and users of services, for example through price monitoring and ensuring industry-level quality standards;
- Correcting market failures;
- Pursuing broader social objectives, for example through the use of universal service obligations, or by putting in place prudential measures that guard against systemic risk.

Assessments of regulatory frameworks for services in LDCs and other low-income developing countries have tended to highlight two contrasting ways in which the regulatory framework hinders development of services. On the one hand, the existence of regulatory barriers and hurdles prevent or stifle trade in services across the different modes of supply. On the other hand, the *lack* of adequate modern regulations can have the same effect, making it difficult for investors to make decisions about whether to enter specific markets. One reading of the situation is that, in the absence of strong regulatory frameworks at the level of specific sectors, many governments fall back on the option to continue to restrict access to markets using "across the board" measures.

Regulatory barriers and hurdles have constrained the ability of low-income countries to attract flows of investment in their countries and thereby ensure that competition delivers on its promise to lower prices and improve economic efficiency and productivity. Barriers to trade are most easily recognised in "horizontal" or "across-the-board" restrictions, for example on foreign investment and competition.[2] The most obvious cases of regulatory impediments are often found where a monopoly concession has been granted by the government to a single service provider – often a state-owned enterprise – to the exclusion of all others.

Such horizontal legislation can often be outdated. In a similar vein, entry procedures around licensing are often onerous, cumbersome, or opaque. Typically, investment approval decisions are made on a case-by-case basis where there is no clear process for specifying criteria or standards, or where legislation and approval procedures are open to interpretation or exemptions may be applied.

At the sector level, there are often specific sets of regulations that affect trade and investment. Specific reservations may carve out parts of a service sector for domestic companies, while licensing requirements may restrict companies from being able to expand into other areas or provide new types of services to their clients.

2 This section focuses in large part on the most widely discussed area of general regulation, relating to commercial presence and foreign investment under Mode 3. In reality, there are many different "regulatory environments" across the different sectors and modes of supply, many of which are discussed in more detail throughout the paper. For a further analysis of the relationship between the regulatory environment and service sector performance, see "Advancing Sustainable Development through Services Regulation" (ICTSD 2017).

Procedures for approval of investment or operating licences often create additional barriers in themselves. Since legislation has failed to keep up with the pace of development in the services economy of any LDCs and LICs, the applied regimes for investment and licensing may be more flexible in practice. However, this lack of transparency and uncertainty for potential suppliers can lead to reduced investment flows. At the same time, gaps and shortcomings in regulatory systems and policy frameworks, often at the sector-specific level, create uncertainty around the business environment which erodes the confidence of potential operators and investors.

Box 1: Regulatory Reform and Educational Services

The case of educational services in Uganda offers a salutatory lesson in how regulatory change can spur service sector development in LDCs. The Ugandan government adopted a recommendation to break the state monopoly on education and allow private universities access to the educational market in 1992. Increased investment by the private sector in the education sector resulted in the bulk of Uganda's universities being privately operated and the sector has generated approximately US$36 million in export revenue (2010) and is now the sixth-largest sector in the economy (Stephenson and Walusimbi-Mpanga 2015). Moreover, the sector now supplies its services in a more diversified manner across Modes 2, 3, and 4. However, further expansion of the sector, specifically in terms of the ability to deliver content electronically, has been severely limited by the high cost of telecommunications services (African Union 2015).

Unlike for trade in goods, the legislation and institutions dealing with services tend to be highly fragmented. This is partly unavoidable, since regulations governing sectors as varied as financial services, communications, media, and air transportation are often highly technical and require specialist knowledge for their oversight. Nevertheless, this makes it difficult for many developing country governments, especially LDCs and LICs, which have limited regulatory capabilities and may lack the necessary coordination capacity across different departments and institutions involved, to effectively regulate their services sectors.

The advent of new technology means that regulations need to keep up with the pace of technological progress. Even in developed economies, industries such as information and communication technologies (ICT) and financial services often move faster than policymakers are able to legislate and regulators to be trained. Issues such as data collection, privacy, and intellectual property have become areas where regulation precision is required. However, many LDCs and LICs lack requisite legal and financial capacity to adequately regulate these emerging areas. In many cases, regulation requires continual monitoring, enforcement, and active promotion of competition which, in turn, requires high levels of legal and regulatory capacity.

3.3 Expanding Access to Finance

Service sector expansion is predicated on the ability of firms to access capital in order to make productivity and competitiveness enhancing changes. Broadly, firms can tap into two distinct sources of financing: internal capital and external capital, usually in the form of credit, quasi-debt instruments, or third-party equity (Fiestas and Sinha 2011). However, the potential of service sector firms in many developing countries, particularly in LDCs and LICs, is constrained by supply-side factors, such as high transaction costs, physical barriers to finance, and weaknesses in the broader business environment, such as limited enforcement of contracts, which either directly or indirectly limit their ability to access much-needed capital.

The financial sector in many LDCs and LICs is plagued by the weak enforcement of

contractual arrangements (Beck et al. 2006). When enforcing a contractual obligation becomes a costly, risky, and time-consuming effort, due to inadequate legal and policy frameworks and judicial capacity, investors and lenders are disincentivized from extending finance even to firms with good economic fundamentals. Related to this, the lack of adequate bankruptcy laws can hamper lending and increase the costs of financing, as lenders and investors are wary of lending if they cannot, at the very least, recoup a portion of their initial investment.

Information asymmetries are the scourge of financial markets in both developing and developed economies. Lenders and investors, as well as potential borrowers, in LDCs and LICs are particularly impacted by issues associated with information asymmetries as they lack access to critical sources of information, such as audited financial statements, credit reporting systems, and credit profiles, all of which drive up the cost of lending and constrain investment.

Approximately 70-80 percent of firms in low and middle-income countries are required to provide some form of collateral when applying for a loan (Fleisig et al. 2006). Collateral requirements of this nature severely limit the ability of firms to access finance and pose a particular problem for service sector small and medium-sized enterprises (SMEs) that cannot generate sufficient assets to meet such requirements. In a similar vein, service sector SMEs, in particular, are constrained by high borrowing costs that result from information asymmetries, the cost of contract enforcement, and valuation issues. While technological innovation has spurred the development of new methods of financial services delivery, such as mobile and e-banking, the productivity and competitiveness of some firms, particularly SMEs in rural areas, is constrained by distance from lenders and investors.

However, the underdeveloped nature of the financial services sector in many LDCs and LICs can be viewed as advantageous. Policymakers in these countries may have additional policy space to address information asymmetries, expanded access to finance for SMEs, and the enforcement of contracts, as well as financing for infrastructure relative to their counterparts in developed economies where the financial sector is more powerful politically and has a greater capacity to shape policy frameworks (Griffith Jones et al. 2014). Potential policy responses to these constraints are explored in greater detail in section 4.

3.4 Addressing Infrastructural Deficits

Beyond playing a key role in unlocking services reform and creating the general conditions for more competitive services, experience shows that, in terms of the absolute volume of flows, the bulk of AfT resources has been aimed towards directly improving physical infrastructure. Alongside a robust regulatory environment and access to finance, high-quality infrastructure is a crucial enabler for the development of services sectors.

It almost goes without saying that there is a direct relationship between the quality of infrastructure networks as a *sine qua non* for the development of services sectors: cheaper, more efficient services are a channel through which investments in infrastructure are translated into economic growth. For example, transport and logistics services are closely related to storage facilities, efficient customs border control points, roads, and port infrastructure. Much of the success of the tourism sector is either directly or indirectly contingent on the effectiveness of transportation linkages. The development of the digital economy is made possible only with access to IT networks. The existence of infrastructural deficits in communications infrastructure will almost certainly lead to lags in the development of efficient digital industries.

Most assessments of infrastructure needs have tended to be done on a regional basis: in Africa alone, the costs of improving infrastructure networks are immense. Drawing on work carried out by African Development

Bank (AfDB), the *Africa Infrastructure Country Diagnostic* study (Foster and Briceño-Garmendia 2010) estimates that, in general, "infrastructure services in Africa cost twice as much on average as those in other developing regions and […] tariffs are exceptionally high." Overall, the "headline" estimate of the cost of addressing Africa's infrastructure needs is approximatelyUS$93 billion a year, two-thirds of which relates to capital expenditure and the remaining third to operation and maintenance requirements (see table 2).

Table 1: Africa's Annual Infrastructure Needs

Sector	Capital Expenditure (US$bn)	**Operating Cost (US$bn)**	**Total (US$bn)**	**Capital Expenditure (share)**	**Operating Cost (share)**	**Total (share)**
ICT	7.0	2.0	9.0	12%	6%	10%
Irrigation	2.9	0.6	3.4	5%	2%	4%
Power	26.7	14.1	40.8	44%	43%	44%
Transport	8.8	9.4	18.2	15%	28%	20%
Water	14.9	7.0	21.9	25%	21%	23%
Total	60.4	33.0	93.3	100%	100%	100%

Source: Foster and Briceño-Garmendia (2010)

The sheer scale of the investments required for establishing network infrastructure – generally in the form of upfront sunk costs – means that that, in overall terms, most AfT is likely to continue to be in this area. There are clear links between infrastructure investment and improved services, since the former includes air, road, and maritime transport facilities and services, telecommunications networks, and energy infrastructure.

4. POTENTIAL AID FOR TRADE INTERVENTIONS

4.1 Aid for Trade Responses to Advance Services Policy

While regulation is closely related to policy in specific sectors, in order to develop the services sector as a whole in LDCs and LICs, it is useful to identify a range of horizontal AfT interventions that could be implemented at a higher policy level, including:

- Building private sector advocacy around services: one of the key reasons why services are under-represented in policy frameworks is the lack of voice for services industries vis-à-vis other sectors, such as agriculture and manufacturing. Manufacturers still heavily constitute most developing countries' Chambers of Commerce. This reflects in trade negotiations where, combined with the complexity of services negotiations, LDCs and LCs have, until recently, rarely put forward strong positions on market access for services. Donor assistance can help "change the debate" around services, by supporting efforts to build advocacy that is focused on assisting operators to organise effectively in order to affect policy change. For example, Hustler and Primack (2012) offer a comparative analysis of various private sector-led "services coalitions" that have been developed around the world to play such a role, and suggest policy conclusions and a roadmap for developing countries to establish similar organisations in their own countries.

- Support innovations in service delivery: LDC and LIC governments are often well-placed to take a lead in pursuing innovations in services reforms, due to their role as providers of "public good" services, and the scale of their purchasing power as services consumers. AfT can play a key role in encouraging innovative services – often through the procurement of private sector suppliers. Examples of potential AfT interventions include support for electronic payment of taxes and customs clearing, mobile phone information systems, and greater e-learning over the internet in schools.

- Improving data on the services economy and trade in services: data on services is generally weak compared with that available for other sectors of the economy, while data on imports and exports of services lags far behind that available for goods (where, for example, it is possible to see quantities and value of trade at the level of specific goods, and in which markets). This is partly due to the difficulty of measuring services, but AfT could play an important role in helping LDCs and LICs to produce more comprehensive and granular data on key sectors of the economy.

- Supporting regional integration of services markets: Although the focus of many regional integration blocks has been on removing barriers to trade in goods, greater benefits may come from the integration of services markets. While some regional economic communities and blocs have ambitions in this area, most have made limited progress so far in creating integrated services markets with features such as harmonised regulations, free movement of capital, national treatment, and mutual recognition of qualifications.

- Assistance in Building Negotiating Capacity for the Removal of Key Barriers to Trade in Services: negotiations over trade in services are complex and highly technical, given that many restrictions are embedded deep within the domestic regulatory frameworks of trading partners. Until very recently, LDCs and LICs had undertaken very little systematic analysis of potential improvements in market access that they could negotiate at the WTO, although they have now sought targeted commitments from other countries to operationalise the LDC services waiver. Any market-opening commitments need to be evaluated carefully to understand the benefits they

may bring. Before making any commitments of their own, developing countries also need to undertake a review in each sector to ensure that opening their markets will lead to desired benefits, while preserving any policy space they may need in future (Cattaneo 2017). In light of the technical nature of the work that needs to be done, AfT can assist negotiators through training, support for consultation processes, and targeted research inputs.

- Strengthen efforts to export services: beyond making improvements to the regulatory environment, there is a suite of similar measures where AfT can provide more direct support to services exports. Given the wide variation in needs, support will need to be tailor-made to the sector being promoted. For example, in some cases there may be a need for training to deliver services over the internet, while efforts aimed at overseas marketing will be central in others. These issues are explored in greater detail in section 5.

4.2 Aid for Trade Responses to Improve the Regulatory Environment

Given the general lack of technical, legal, and regulatory capacity around services issues in low-income countries, assistance under the AfT initiative has the potential to play a crucial role in improving the policy and regulatory environment. AfT interventions can provide assistance in identifying and reforming outdated regulatory frameworks and plugging gaps. Given the growing importance of services, combined with the fact that LDCs and LICs have very little experience in regulating competitive and quasi-competitive markets for services, the returns to AfT investments are likely to be high in terms of increasing competition and lowering prices. Areas of potential intervention include:

- *Identifying inefficiencies and breaking down barriers:* AfT can create the space for reform through detailed research of sectors at the national level. Diagnostic work can demonstrate the costs imposed by low-quality services and the potential benefits of reform and greater competition. One effective means of doing this is to measure and benchmark the performance of key sectors against both international best practice and developing country peers. Given the need to balance competing economic and social interests, research is often an important first step in identifying and helping policymakers choose between a number of alternative regulatory models or degrees of liberalisation. The newness of services trade means that LDCs and LICs have much to learn from each other's experiences in areas ranging from the liberalisation process to using policies and instruments to develop services sectors and build services export markets.

- *Identifying regulatory and policy gaps:* Due to the complexity involved in regulating services industries, it is often necessary to undertake services regulatory audits to establish how regulations affect trade in services at an overall horizontal level as well as within specific sectors. Mapping the existing regulatory framework is an essential step in identifying barriers and regulatory gaps, and thus in developing a list of potentially beneficial reforms and investments.

- *Improving overall policy around services:* Few LDCs and LICs have dedicated policies that set out strategic goals and priorities for the services economy. Given how closely many services interact with each other to form "clusters" (such as tourism and transport), an overall services policy can have an important role to play in providing strategic direction, prioritisation, and sequencing for services liberalisation and development. AfT has a history of supporting projects providing technical assistance to develop and improve trade policy and, at this point, there is scope to devote more resources to services-specific issues.

- *Improve policy at the sector level:* Beyond overall strategic concerns, sector and

subsector-specific regulatory policy responses are required. Some sectors are more amenable to an open and competitive market approach, while others may be best served through a more managed approach, including network services designed to foster competitive efficiencies. Targeted research can help governments to understand better how they can combine liberalisation with regulations that allow them to meet social objectives, such as maintaining public access to services through subsidisation or through obligations for companies to provide universal services.

- *Updating legislation:* Given the importance of regulatory frameworks for services, many countries will require technical assistance in updating legislation and regulatory frameworks at the horizontal, sector and subsector levels. Most notably, there is scope to learn from other countries, and assistance can help propagate modern legislation and tailor it to different national contexts. This would also need to be accompanied by processes of awareness-raising and training about new legislation; these processes should move beyond regulators and could include businesses and consumer groups (such that they exist) as well as other stakeholders, including the judiciary.

- *Streamlining processes:* Alongside new legislation, there is also scope for AfT to help LDCs and LICs streamline their administrative processes in areas such as the licensing of service providers, approvals for investments, investigation of breaches, and the enforcement of their powers. For example, the creation of investment "one-stop shops," where investors can obtain all of their registration approval documents in one centralised government office, would greatly increase administrative efficiency.

- *Creating and supporting new regulatory institutions:* AfT can be used to help LDCs and LICs to establish regulatory institutions, such as telecoms regulators or general competition authorities. AfT can play an important role in the early phases of liberalisation when markets are transitioning to a more competitive situation and when regulatory authorities are still establishing their position, role, powers, and enforcement capabilities. AfT support is required in building capacity through the training of regulators. Support of major donors at the institutional level can also provide a signalling effect that increases the credibility of the regulator, and safeguards against the threat of 'regulatory capture'. Eventually, however, the need for independence and sustainability requires the establishment of self-financing regulatory models.

4.3 Aid for Trade Responses to Improve Network Infrastructure

4.3.1 Transport Infrastructure and Logistic Networks

Building the transport and logistics infrastructure of LDCs and other developing countries to match the standard in other parts of the world is an enormous task. However, the potential benefits in terms of lower costs, that feed both into cheaper goods and higher export potential, are on a commensurate scale. Foster and Briceño-Garmendia (2010) note that "East Asian firms save close to 70% in transportation costs relative to their African counterparts, while Latin American and South Asian firms save approximately 50%." They cite "creating interconnection between capitals, ports, border crossings and secondary cities with a good quality road network [and] the provision of all-season road access to Africa's high-value agricultural land" as one of the most critical needs for Africa.

Aside from the direct linkage to services, transport is also the sector where better services are most closely associated with improved trade in goods. While the largest share of AfT has been directed to road, rail, and air transport infrastructure over the last ten years, as noted previously, the share of transport-related assistance has declined in relative terms.

Beyond upgrades to physical transport infrastructure, there are, however, a secondary set of required investments around logistical capacity that can increase the level of organisation and efficiency in the supply chain, which, in many cases, determines whether an export industry is viable or not. This includes investment in storage capacity in the form of logistics hubs which can serve as central points for the exchange and onward transport of goods. Such hubs can also be built to act as transit points for multi-modal transport. In terms of overall strategy, it is no coincidence that many of the world's most recognisable services exporters built their successes on the backs of trade and logistic hubs.

AfT interventions also extend to efforts aimed at improving the efficiency of customs clearance and freight services, where improved customs handling and logistics services overlap closely with the trade facilitation agenda. Examples include both additional investment in the physical construction of facilities, such as one stop border posts (OSBPs), through to investment in systems such as national or even regional "single windows" for customs clearance, and systems to identify and resolve non-tariff barriers. Electronic Cargo Tracking Systems are another recent innovation that allow containers to be sealed only once, at their port of entry, and moved across borders without checking, until their final destination elsewhere in a region. These may require additional investments in policy reforms, training and "mindset change" at the level of officials (from border agencies to transport police and road authorities) that can play a large role in ensuring successful change management. Such policy work might also need to extend to improving regulations in the transport and freight sector itself, to achieve levels of competition that translate investments into sustainable results.

4.3.2 Energy

Aside from its social impact, a reliable and inexpensive supply of electricity is an essential input into virtually all forms of economic activity, and is vital for services ranging from IT-enabled services through to tourism. A lack of access to electricity is often cited as one of the most important constraint on economic growth: in sub-Saharan Africa, more than half of the population still do not have any access to electricity (World Bank 2010; Calderón and Servén 2008).

While the sector is too large to cover in this study, in broad terms, the main requirement is increasing capacity for power generation and distribution. Scott (2015) notes that, while African governments have committed in principle to achieving universal access to electricity by 2030, "under business as usual scenarios over 600 million Africans would still lack access to electricity two decades from now." In terms of quantified estimations of this gap, Foster and Briceño-Garmendia's (2010) continent-wide survey estimates that, in Africa, this amounts to "developing an additional 7000 megawatts a year of new power generation capacity and the enabling of regional power trade by laying 22000 megawatts of cross-border transmission lines." Beyond generation and distribution, two other areas where AfT can have positive impacts are in policy and regulation. This includes assistance for the deregulation of energy markets and the facilitation of new forms of power generation; this is in addition to support for the broad goals of promoting renewable sources of power and improving energy efficiency which are linked to discussions on climate change.

Although it is generally outside the scope of trade negotiations, there is also significant opportunity for LDCs in future years to generate foreign exchange revenue by becoming regional exporters of electricity. This is notably the case for some landlocked LDCs that have hydrothermal capacity, such as Lao PDR, Ethiopia, Uganda, and Lesotho, and for countries such as the Democratic Republic of Congo in Southern Africa and Senegal in West Africa, under the West Africa Power Pool. For this to happen will require investment on interconnectivity as well as expanded legal, policy, and regulatory efforts to create regional markets for electricity.

Box 2: Renewable Energy, Aid for Trade and the Sustainable Development Goals

While developing countries currently have large gaps in generating capacity, recent rapid advances in new generating technology, combined with political momentum at the global level towards addressing climate change, create an important opportunity for future investments.

Scott (2015) notes that, while 82 percent of electricity in Africa is currently generated from fossil fuels, the cost of electricity from renewable options is now equal to or lower than the cost of fossil fuel options and is expected to fall further. The emergence of standalone energy systems, primarily solar in nature, are giving populations without access to national energy grids the ability to generate their own electricity and reap all of the associated benefits, including the ability to meet SDG targets related to climate change. Evidence from the World Bank's Rural Electrification and Renewable Energy Project II (RERED II) in Bangladesh suggests that increasing access to electricity led to increased study time for children, an improved sense of security for women, and a decrease in fertility rates due to the increased use of contraceptives resulting from access to awareness campaigns on television (World Bank 2014).

However, the expansion of the standalone power generation, as well as the increased use of mini-grid systems, is constrained in many developing countries by limited access to financing, currency risk due to the global supply chain, and a lack of implementation capacity (PWC 2016). Standalone and non-traditional systems are still neglected in many national energy policies in developing countries; however, AfT interventions could be used to support more integrated approaches to energy policy.

4.3.3 Telecoms and ICT Networks

With regards to other network infrastructures, the two main contributions of AfT in recent years has been in physical infrastructure and regulation, where AfT assistance has arguably had a more important role to play. In terms of the latter, AfT projects have often helped developing countries transition from previous state-owned (or semi-private) telecoms monopolies towards an appropriately regulated and competitive market. This has often involved a series of sequenced interventions:

- making the case, through research, into the costs of services (including using international benchmarking);
- technical assistance to examine the legal consequences of breaking up existing concession agreements;
- assistance on drafting and putting in place a new regulatory regime for telecoms;
- in many cases, supporting the establishment of an independent regulatory authority.

With respect to physical infrastructure, the key investment has been in providing finance for the completion of the intraregional fibre-optic backbone networks, including submarine cables. Given that telecoms, in general, have strong commercial viability, infrastructure development and the subsequent roll-out of services has been driven primarily by the private sector with AfT interventions mainly taking the form of project financing.

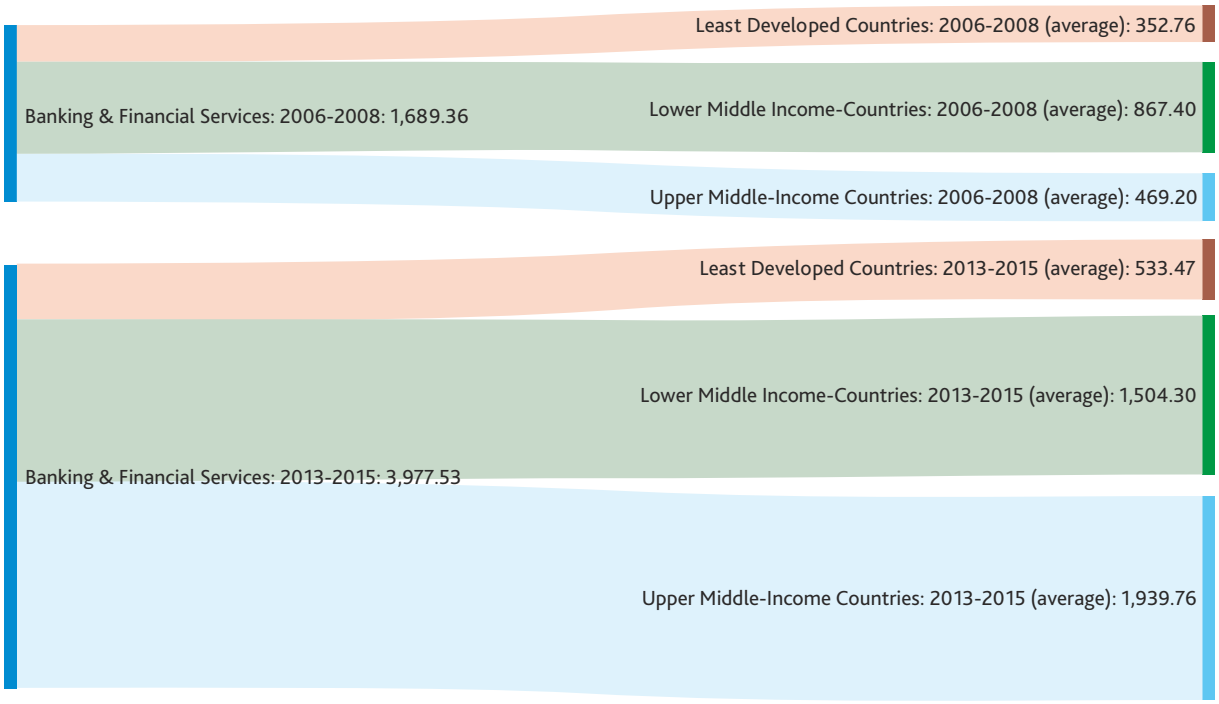
Despite significant investment in recent years, existing networks still need to be complemented in future years to increase connectivity, create competition amongst cable operators and bandwidth sellers, and thus improve the resilience and latency in networks and to cope with increasing demand. This is especially the case for those countries looking to compete in IT-related services that rely on the speed and reliability of data connections. However, as mentioned previously, the relative share of AfT support for communications infrastructure has remained stable between 2006-2008 and 2013-2015. Additional injections of support targeted at ICT infrastructure will be needed in order to

allow LDCs and LICs to take advantage of the digital dividend.

4.4 Aid for Trade Responses to Improve Access to Finance

AfT has a critical role in helping to address government and market failures that inhibit the ability of service sector firms in LDCs and LICs, particularly SMEs, to access finance. According to the OECD's DAC database, banking and financial services accounted for approximately 3.4 percent of total AfT commitments, on average, between 2013-2015. However, while the absolute commitments channelled towards banking and financial services increased from the 2006-2008 period, this actually represents a relative decrease as the share of total AfT commitments from the same period stood at 4.1 percent.

Figure 3: AfT Commitments for Banking and Financial Services (US$ millions, 2015 constant)



Source: Authors calculations using data from the OECD's Creditor Reporting System

As noted previously, the efficacy of the banking and financial services sector in directing much-needed capital to other sectors of the economy, including services sectors, is inhibited by the weak enforcement of contracts. Additional support to strengthen legal and judicial frameworks, especially those relating to commercial transactions, would help to mitigate lending and investment risk and would allow lenders and investors to expand investments and lending without fear of contractual breaches. Similarly, AfT interventions which increase the effectiveness of bankruptcy laws could increase levels of lending and help to decrease the costs of financing. For example, Visaria's 2009 study found that improvements in the efficacy of the insolvency regime in India led to decreases in interest rates by as much as 2 percent.

AfT could also play a role in helping to combat those information asymmetries within the financial sectors of LDCs and LICs that limit lending. Credit bureaus can help to reduce information asymmetries, even in the face of weak judicial and legal systems, and to increase lending. Furthermore, there is evidence to suggest that credit bureaus and registries have a greater impact in countries at a lower level of economic development than in more affluent economies (Djankov et al 2007).

Addressing the grave issues of weak property rights and collateral requirements would be another way for the AfT Initiative to support economic development, and service sector growth more specifically, in LDCs and LICs. Policies which strengthen property rights has been found to increase capital flows to small firms relative to larger firms as the policies improve the firms' ability to tap into bank financing; what is perhaps even more critical, such policies make entrepreneurs more likely to reinvest profits in their own enterprises (Claessens 2006; Johnson et al 2002).

Finally, expanded AfT support for innovative lending solutions, as well as support for policy initiatives which support these solutions (such as Kenya's M-PESA mobile money service), can help businesses and entrepreneurs overcome geographical barriers which have traditionally limited their access to finance. Financial innovations of this nature, which both tap into unbanked populations and extend services and credit to existing customers, can help to increase transactions and to reduce financing costs for businesses and entrepreneurs in rural areas.

5. TARGETING SERVICES EXPORTS: POTENTIAL, NEEDS AND AID FOR TRADE RESPONSES IN SELECTED SERVICES SECTORS

In order to understand how LDCs can build successful services export industries (and how AfT can support these efforts), it is necessary to assess where their export potential lies. A major study by the World Bank (Saez et al. 2015) outlines a comprehensive framework for measuring services export potential based on factors such as the degree to which sectors are most tradable and the level of factor endowments (such as IT penetration and workforce skill levels).

As yet, there has been little specific analysis of LDCs and LICs. Nevertheless, for LDCs and LICs it is reasonable to suggest that the main potential sectors that are either currently being exported or where there is believed to be potential are:

- sectors that are tradable, while noting that services are not only directly tradable in their own right, but also serve as critical inputs into the production processes of other goods and services;
- sectors where LDCs have an existing comparative advantage, based on their factor endowments;
- modes of supply that also suit their factor endowments: for example, this may mean that LDCs might target exports under Modes 1, 2, and 4, rather than the more dominant Mode 3;
- areas where there is an existing export base and areas of dynamic growth.

Based on existing exports, the tourism sector accounts for almost 40 percent of LDCs' total services export revenue, which is far greater than for other sectors (See Figure 4). Transport is the next biggest sector, accounting for 19 percent of total services export revenue, although some of this may also be related to transport for tourism purposes (such as air passenger transport) alongside other personal and business travel. A proportion of this figure will also relate to freight, haulage, and shipping services. After transport, the next biggest service export is government services, followed by other business services and communications.

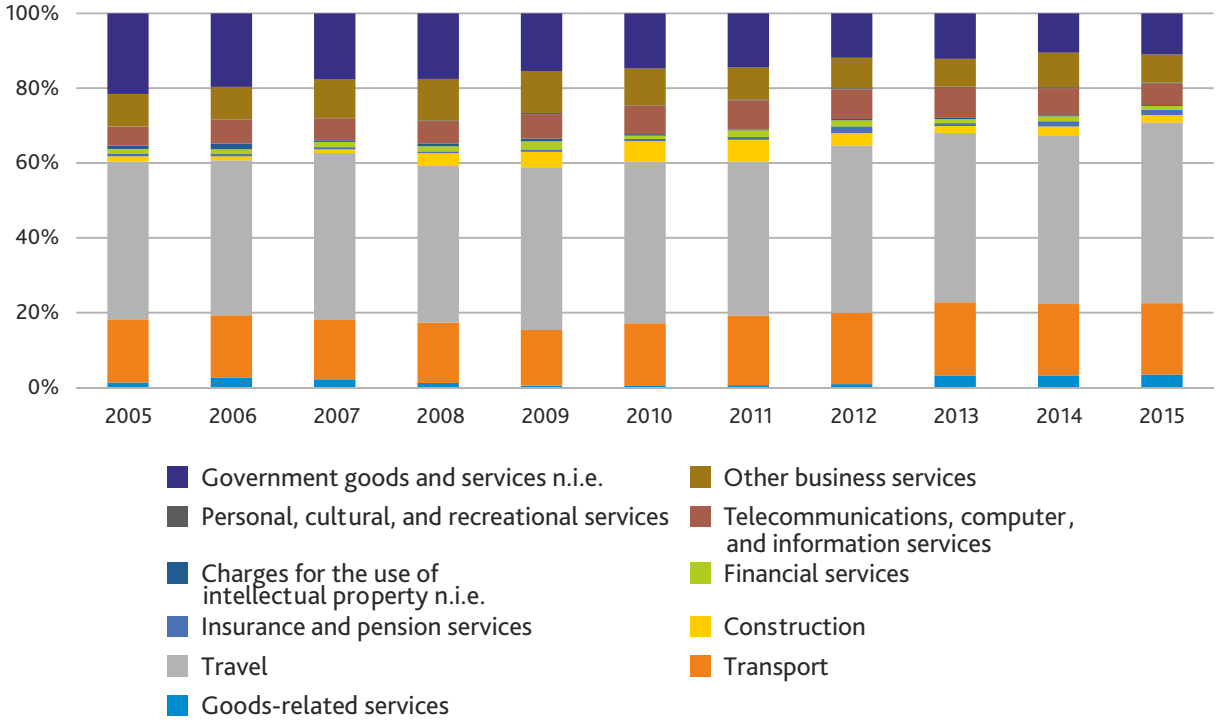
In terms of the most dynamic sectors within overall global services trade, WTO (2015) highlights, in particular, the computer and information sector. It points out that "from 1995 to 2014, world exports of computer and information services expanded much more rapidly than any other services sector, recording as much as 18 percent growth on average annually" to reach an estimated US$302 billion in 2014."' In addition, the report notes the importance of communications services, which "have expanded by 8 percent on average annually over the last 20 years, outpacing the total growth for the services sector and demonstrating more resilience to market turmoil than many other services categories" to reach US$115 billion in 2014.

The rest of this section focuses on five important sectors or areas of services trade where LDCs are likely to have some export potential going forward and where AfT intervention may be most needed. These include: tourism, IT-related services including business process outsourcing (BPO), and the temporary movement of natural persons, or Mode 4 (across different sectors). These might be considered priority sectors for LDC services exports, alongside others that have already been indicated by LDCs themselves through their collective request on the issue to the WTO. Research by ICTSD indicates that, in addition to tourism and ICT services, financial and transport/logistics services are areas of priority for many LDCs.

5.1 Tourism

Tourism – defined as travel alone, without taking into account related services such as transport – accounts for almost 40 percent of LDCs' total services export revenue (see Figure

Figure 4: Changes in the Composition of Service Exports from LDCs: 2005-2015



Source: UNCTADSTAT

4). While tourism is important to many small islands, it is also important (or potentially important) to many other LDCs, including landlocked LDCs such as Uganda, Nepal, Lao PDR, and Zambia.

Tourism has a critical role to play in domestic and regional sustainable development. The tourism sector provides employment opportunities for women and youth. Women account for approximately 60-70 percent of the labour in the sector, while people under 25 comprise more than half of all those employed (ILO 2013.) The fragmented nature of the industry - 20 percent of industry employment is accounted for by multinational enterprises, while SMEs account for the remainder - highlights the importance of tourism services for policymakers seeking to empower SMEs.

Unlike for other sectors, and especially when compared with goods, the main advantage of tourism is that there are fewer regulatory barriers that prevent the export of services due to the fact that the bulk of tourism exports take places via Mode 2. . As such, tourism holds a number of advantages over other potential economic activities:

- Tourism depends on natural and cultural endowments that are in limited global supply or often unique: many LDCs and LICs have both of these, although both need to be actively managed in a sustainable way.
- Tourism can be exploited by smaller countries that suffer from constraints in the supply of both labour and land.
- Competition pressures are manageable: although destinations compete in terms of price and marketing, there are very few of the competitive forces that constantly threaten most processed goods industries. There is no "race for scale," since many tourists instead seek out uncrowded destination and prefer personal service. There is no drive to a single low-cost "winner-takes-all" brand: instead the market is highly segmented with almost endless niches to be catered for.
- Tourism presents few of the physical or administrative barriers - including import tariffs, cumbersome customs procedures, quarantine requirements, and subsidies for home producers - that make the export

of fisheries and agricultural products so difficult and have contributed to holding back many developing countries for decades.

- Tourism does not require costly logistical operations, including shipping and warehousing, or influence over entire supply chains.

- Tourism does not rely on historical trade preferences which will sooner or later be eroded.

- While many developing countries rely on a very limited basket of commodities that suffer large and unpredictable swings in prices on world markets – usually due to international factors beyond their control – tourism operates very differently from commodities markets. The latter revolve around standardised resources (such as oil) which can be traded easily on international markets. Tourism differs in that both consumers and destinations tend to be unique. Countries can, in fact, diversify *within* the tourism market, protecting themselves from shocks in one area by catering for different kinds of tourists.

- While the tourism sector is vulnerable to external shocks – such as natural disasters or downturns in the global economy – evidence suggests that the sector is also relatively resilient. For example, following the Global Financial Crisis and the resulting Great Recession, the sector experienced 15 months of negative growth (until October 2009), but recovered and, by 2010, had reversed all of the losses suffered during the economic downturn. This type of rapid recovery illustrates the sector's resilience in the medium- and long-term (UNWTO 2013).

- Over the long term, there is arguably a secular trend towards an increasing number of tourist dollars globally, especially as consumers in developing countries in the Asia-Pacific region become more prosperous (WEF 2015). The fact that tourism numbers continue to rise, despite the recent economic crisis and increased risk of terrorism, is a testament to this trend.

In light of its importance to current and potential exports from LDCs and LICs, direct AfT support for tourism development is low. Donor support for other sectors, notably agriculture, gains far more attention. While this is partly explained by the fact that tourism is perceived as a largely private sector-driven activity, there are important ways in which AfT and other development resources can help LDCs and LICs better exploit their potential in tourism. Beyond financing for supporting network infrastructure (such as airports and roads), some of the many possible interventions include:

- *Tourism Policy:* Although tourism is largely driven by the private sector, creating a successful tourism industry requires careful planning. There are a large number of policy issues that affect the sector and need to be addressed in integrated and coherent tourism policies and strategies. These range from visas and immigration issues, investment rules, consumer protection, licensing laws, security issues, food safety, and taxation regimes in tourism-linked industries. They can encompass broader issues, such as language and cultural and land policies, alongside measures to support SMEs and to help spread tourism beyond popular destinations to outlying areas. Tourism policy also extends to other issues mentioned separately below, such as infrastructure, marketing, and environmental protection

- *Fostering and strengthening linkages with other sectors:* Successful tourism industries can also have knock-on effects for other sectors, most notably agriculture. For tourism-dependent economies, the development of the tourism industry has also fuelled growth through spill-over effects. Additional tourists (and tourist dollars) will generate more demand for other goods and services and enable other industries to develop.

- *Improving Standards:* together with the private sector, governments, with AfT support, can play an active role in establishing quality standards in tourism and related industries.

- *Marketing:* One of the key determinants for a successful tourism industry is a strong international marketing strategy. There is a general lack of awareness in LDCs and LICs around issues such as market segmentation and specific marketing campaigns: this is especially true of countries that have traditionally relied on one particular market (for example, wildlife travellers). Also poorly understood is the need to develop or improve linkages within international value chains such as dealing with larger wholesalers. AfT efforts to improve the marketing efficiency of tourism operators would go a long way in increasing diversification and export potential.

- *Improving data:* Beyond basic information, such as visitor arrivals and length of stay, there is also a lack of valuable data on tourism in LDCs and LICs. AfT can help with the collection of tourism-related data for use in developing both policy and marketing strategies.

- *Skills development:* Tourism depends heavily on skills and experience. As such, AfT assistance can also play a role in the area of education and training and can facilitate skills exchange.

5.2 ICT-enabled Services

LDCs and LICs have the potential to benefit significantly from ICT-related services exports.[3] ICT has the potential to play a role in helping bring LDCs into the 21st century, without the need to replicate much of the outdated infrastructure that characterizes developed economies. LDCs and LICs, especially those marginalised through population size or physical distance from major markets, stand to benefit significantly from ICT-related services exports.

Direct business opportunities from the ICT-related sector are emerging, although the sector is still in its early stages in many LDCs and LICs; however, given the relative infancy of the sector, some of these opportunities may yet be unforeseen.

The sector has the potential to receive considerable direction from government. A strong lead by government, via a comprehensive ICT policy, can improve the provision of public and private services, including education and professional development, health information and services, government services, entertainment, information services, professional services and commerce. ICT services can enhance access to markets, disaster management, as well as democratic participation and can provide more cost-efficient and effective ways of preserving and promoting local culture. Physical infrastructure (such as server warehouses) can be put in place to handle operations such as data storage or back-up and transactions processing. LDCs also have the potential to become involved in more sophisticated Business Processing Outsourcing (BPO) with higher associated levels of job-creation. Many back-office outsourcing operations – such as data entry, billing, payroll, and benefits administration – may be viable opportunities for LDCs and LICs.

In addition, where the levels of education and language skills are adequate, LDCs and LICs may be able to provide a workforce for front-office outsourcing, including customer-related services such as marketing or technical support. As skills develop, service suppliers may be able to engage in online remote freelance contract micro-work and potentially even higher-skilled activities, such as design work, coding, or cloud accounting for clients overseas. The potential

3 ICT-based services can be associated most readily with Mode 1 cross-border supply, and it cuts across a number of GATS-defined services sectors. From a private sector perspective, the common infrastructure requirements and similarities in the business model (delivering a range of traditional services online) means that it makes more sense to treat such ICT-based services as a stand-alone "sector."

for delivery of many such professional services over the internet favours small or medium-sized "footloose" service providers which can be easily established in many countries. With AfT support, LDCs that invest in improving their infrastructure, level of existing facilities and knowledge, and tax advantages could create incentives for such businesses to relocate.

Box 3: International examples, Policy Options and AfT in ICT Sector

Many LDCs look to the phenomenal success that India has had in developing itself as a hub for ICT-enabled services and BPO. ITC (2013) profiles the success of two individual small-scale Bangladeshi firms in the areas of software design, in part assisted by an AfT project run by the Netherlands Ministry of Foreign Affairs, and found that the firms improved their competitiveness and connectivity with clients in developed countries. The paper also highlights the ambitions of Senegal, Rwanda, and Uganda in ICT and BPO-related fields. Senegal has ambitions to serve as a low-cost call centre outsourcing location (taking advantage of wages that are 10 to 15 times lower than in France), while Rwanda is investing significantly in communications infrastructure to create a US$200 million ICT industry, with niches in coding, billing data processing, and customer contact processes.

Nevertheless, LDCs are likely to face challenges from more developed countries in this area. Looking at prospects for the sector in Kenya, Khanna et al (2016) propose a number of policies for future IT sector development including: (i) adopting approaches that target specific sectors (such as tourism) for developing IT services offerings; (ii) attracting selective FDI to complement local skills, including encouraging Kenyan subsidiaries; (iii) continued IT skills development; (iv) carefully managed support for SMEs, for example, to encourage the adoption of digital technologies; and (v) the strategic use of public procurement. Potentially all of these are areas for LDCs to consider, and where targeted AfT might play at a useful role.

At present, there are few barriers that would appear to prevent or restrict LDCs from supplying services into key overseas markets. Such types of services are, however, relatively new, and new regulations may be put in place which govern data flows or security or local content requirements that govern where data can be held. AfT could be used to help LDCs and LICs negotiate agreements that prevent cross-border impediments for ICT-based services being imposed on their exports. Related to this, AfT interventions could be used to help LDCs bring their data privacy standards in line with international security standards and thereby enhance the competitiveness of the subsector.

The critical input for a country's ability to participate in BPO is its access to high-quality telecoms infrastructure. Related to this, reliable and low-cost energy is an essential input into high-capacity data storage activities. AfT could be tailored to improve the competitiveness and export potential of the sector by increasing electricity outputs and the quality of telecoms infrastructure through regulatory and infrastructural interventions.

In order to boost ICT-enabled exports, LDCs need to ensure that their policy and regulatory frameworks are open and conducive to FDI inflows. For example, India condensed its licensing requirements for foreign firms, Senegal has successfully offered incentives to foreign companies with impressive results, and Mauritius has created technology parks to attract FDI to the subsector and has diversified its economy beyond tourism and related services. Furthermore, the success of Mauritius and Senegal in enhancing the efficiency of their ICT services exports and increasing their international competitiveness through an opening of their domestic market, highlights the importance of service-specific trade policy as well as regulatory and policy frameworks for ICT exports (SET 2016). AfT

interventions could support LDCs in changing and creating new policy and regulatory frameworks in order to boost BPO exports.

5.3 Financial Services

Exports of financial services offer potentially lucrative rewards for LDCs and LICs, although there are significant challenges in establishing viable finance export industries. Models for developing successful financial services export industries will differ from one country to another, based on their specific endowments, policy environments, and market opportunities. Khanna et al (2016) distinguish three different types of international finance services hubs: offshore hub, onshore hub and processing.

5.3.1 Offshore Financial Services

In recent years, and following the global economic crisis, there has been increased scrutiny of the activities of offshore financial centres. The business model of offshore financial centres has come under pressure to comply with increasingly stringent international standards, including those of the OECD, as well as an increased suite of foreign legislation, including the US Foreign Account Tax Compliance Act (FATCA). The increasing focus from developed and developing economies on illicit money flows to secrecy jurisdictions promises to place further pressure on the operations of financial centres.

For exporters seeking to sell financial services to clients overseas, compliance with destination market regulations – particularly the complex prudential regulations in developed markets – is particularly difficult. For example, marketing wealth management services to overseas residents may require licencing in the destination market and subsequent compliance with relevant domestic regulations. Foreign financial services companies may be required to provide the same information as local firms, such as annual financial statements and director's reports, which reduces some of the advantage that might be gained from operating from less heavily regulated environments.

5.3.2 Onshore Financial Services and Processing Hubs

A better model for LDCs and LICs may be the development of onshore financial services hubs and processing hubs which could export financial services to regional markets. Depending on the existing level of financial market development, the hub might be created by developing and expanding the existing domestic banking system in order to generate or mediate international capital flows (e.g. domestic investors looking to invest overseas and vice versa). Alternatively, countries can seek to attract international banks to fill this role through the use of incentives such as tax or jurisdictional advantages (for example, a beneficial regulatory regime). One advantage that LDCs may have over other countries is that, due to a lack of a large corporate tax base, they may be able to offer such incentives at a lower cost relative to their own fiscal position.

Box 4: Successful Financial Services Exports from Cambodia

ITC (2013) highlights the example of Cambodia's Acleda Bank which was established as a national NGO for micro and small-business development and which expanded rapidly across Cambodia after its formation in 1993; by 2003, Acleda became a commercial bank offering a greater range of services including deposit-taking, credit, international funds transfers, trade finance, and currency exchange. The company began exporting financial services in 2007 and has established a commercial presence in Lao PDR (where it has 28 branches) and Myanmar. Beyond establishing a commercial presence overseas, Acleda is also exporting financial services by accepting deposits from and providing financial services to clients overseas.

Source: ITC (2013)

Aid for Trade Responses

LDCs and LICs are significantly disadvantaged in the development of financial services exports since, compared with middle-income and developed-country competitors, their banking and financial systems tend to be the most underdeveloped in the world. In general, this hampers crucial investments in the economy, putting severe constraints on private sector operators in accessing the resources needed to expand.

Looking specifically at the example of Kenya, Khanna et al (2016) propose three areas for policy responses for developing countries looking to develop a services hub. These are

- strengthening macro-prudential regulation: establishing strong regulatory systems for the financial sector as well as measures that seek to protect against the risk of macroeconomic volatility associated with financial market openness. There is likely to be a need for continual improvement of the regulatory framework for financial services as well as regulatory institutions on an ongoing basis;
- labour market development particular to the type of financial services hub being developed;
- The taxation and subsidy regime, including incentives available to attract large overseas banks to establish themselves.

In addition to this list, additionally areas for AfT investments may also be:

- deepening financial markets more generally to build the domestic capital base and reducing inequality in the provision of financial services by broadening the reach and access to services in order to increase levels of inclusion (including through new technologies, such a mobile and internet banking);
- supporting financial development through the provision of finance itself, in the form of concessional loans, as well as beyond aid, in the form of investments into equity companies;
- mobilising resources for the financial sector (through supporting the deepening of financial markets) is also an important area where AfT can play a role.
- improving physical and digital connectivity (as covered previously);
- assisting financial centre authorities and local finance companies with marketing of services and establishing international reputations;
- helping to facilitate exports of financial services at a regional level through the development of regional financial markets.

5.4 Transport and Logistics Services

Transport and logistics services currently make up nearly 20 percent of services exports from LDCs, second only to tourism. Overall, the transport sector covers a number of separate sub-sectors ranging from transport by sea, air, land, and internal waterways, as well as pipelines and electricity transmission and postal and courier services. It covers the carriage of passengers, the movement of freight, the rental of carriers with crew, as well as related support and auxiliary services.

Improving transport services brings greater efficiency to the economy as a whole. Having transport linkages to major markets can make the difference in whether entire export industries (such as cut flowers or fresh horticulture) are viable. Implementation of the recently-concluded WTO Trade Facilitation Agreement is expected to reduce such costs to the benefit of LDCs (Box 4).

Box 5: Trade Facilitation, Trade in Goods, Transport Services, and Aid for Trade

Transport costs are now a far more significant barrier to trade between countries than tariffs. The WTO (2015) estimates that transport costs in LDCs add an amount that is equivalent to an *ad valorem* tariff of around 300 percent. This implies that for each dollar it costs to manufacture a product, an additional three dollars will be added in the form of trade costs.

The WTO Trade Facilitation Agreement, negotiated in Bali in 2014, is expected to help reduce such costs. According to the WTO, the TFA "contains provisions for expediting the movement, release and clearance of goods, including goods in transit. It also sets out measures for effective cooperation between customs and other appropriate authorities on trade facilitation and customs compliance issues. It further contains provisions for technical assistance and capacity building in this area."

If fully implemented, that agreement is estimated to boost trade globally by around US$1 trillion, with most of the gains going to developing countries. LDCs, in particular, are expected to benefit the most, with a 36 percent increase in the volume of export flows and overall trade cost reductions of 16 percent.

Source: WTO (2015)

Amongst LDCs, Ethiopia was the most successful exporter of transport services: the sector was worth US$2.2 billion in 2015, representing more than 63 percent of services exports and around 3.5 percent of GDP (WTO 2015). This was driven, at least in part, by the decision taken by the government to develop Addis Ababa into a major air hub, through the expansion the national air carrier, Ethiopian Airlines, into a major regional airline linking Africa to international destinations. In other LDCs, transport exports are driven by a mixture of tourism and freight hauliers: LDCs relying on transport for more than a quarter of services export revenues include Mozambique, the Democratic Republic of Congo, Benin, Bhutan, Liberia, Togo, Djibouti, Gambia, and Madagascar.

Potential Aid for Trade Interventions

The transport sector is closely linked with other sectors for which it is an input, most notably trade in goods, as well as tourism. Potential areas for AfT interventions in the transport sector include:

- Supporting domestic regulatory reforms to transport operators to improve competition. This may include measures around the governance arrangements for building and managing infrastructure, such as roads, ports, and airports, as well as sector-specific regulations for freight and passenger transport services.
- Improving transportation standards, most notably in terms of safety and security. In the case of air transport, this includes assisting Civil Aviation Authorities (CAAs) and similar operators in ensuring that airports comply with international standards set by the International Civil Aviation Organisation (ICAO) and training Air Traffic Control (ATC) bodies. With the support of the AfT initiative, LDCs can ensure that their ports are in compliance with the International Ship and Port Facility Security (ISPS) Code, amongst other safety measures.
- Removing barriers to regional trade related specifically to transport, including barriers at the border and behind-the-border. AfT interventions could include support for common operating standards for freight carriers and transit arrangements to allow transport operators to move goods easily through third countries.

- Negotiation of market access rights. AfT could support governments in either the brokering of new agreements or in assessing their implications for competition and consumer welfare.
- Investment in infrastructure including roads, railways, ports, storage hubs, and border posts, as well as upgrades to IT systems that facilitate trade, such as e-payment and electronic cargo tracking.

While AfT support is already involved in some of these areas, greater support and technical assistance from donors for integrated transport and trade facilitation projects will be critical in ensuring the sustainability and viability of the transport sector in LDCs and LICs.

Box 6: World Bank Nepal-India Regional Trade and Transport Project

The World Bank-sponsored Nepal-India Regional Trade and Transport Project (NIRTTP) is one of the largest AfT projects on trade facilitation and includes a number of relevant initiatives including:

- A Nepal Trade Information Portal to act as a first port-of-call containing all relevant information and requirements for potential importers and exporters;
- A Nepal Single Window project that will bring Nepal's 53 different agencies working on trade clearance within a single IT system;
- Trade-related laboratories;
- Interagency coordination, including a revitalised National Transport and Trade Facilitation Committee with private sector representation;
- Infrastructure for container storage, including an inland dry port.

A number of areas overlap with the implementation of the TFA, and the Needs Assessment has identified areas where the World Bank Group is expected to contribute to TFA implementation through the NIRTTP. In particular, the project is expected to lead to a number of legal reforms, most notably related to the implementation of the Nepal Single Window.

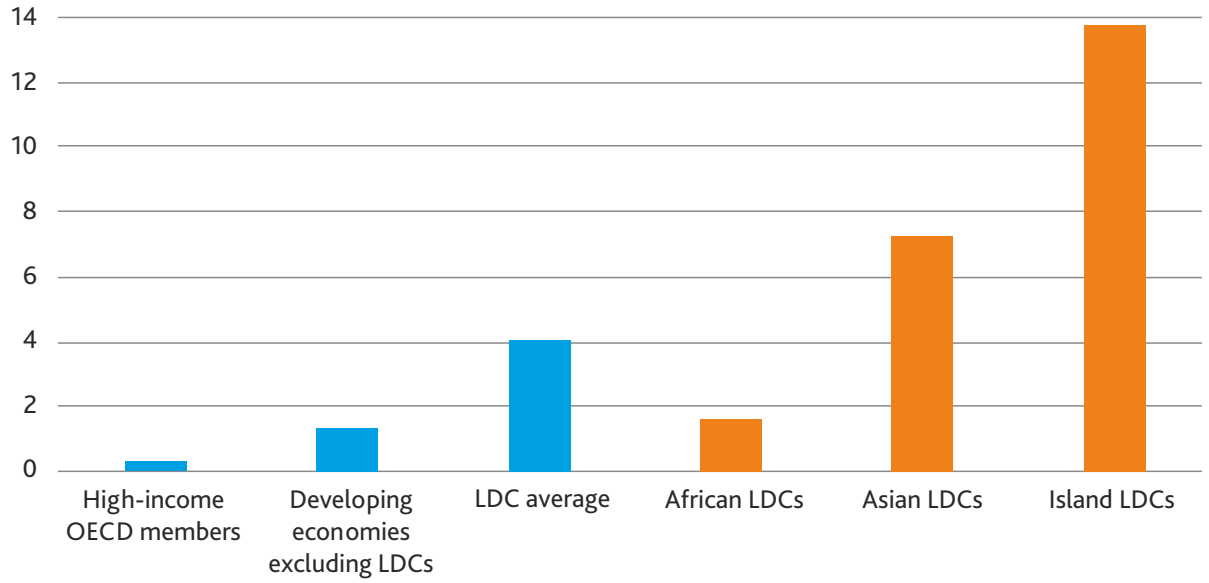
5.5 Temporary Movement of Labour

Although not strictly a "sector," but a mode of supply, the temporary movement of natural persons represents the most obvious area for developed and developing countries to offer meaningful concessions and preferences to LDCs (Macrory and Stephenson 2011; 44). Furthermore, LDCs have indicated within the Doha Round *Modalities for the Special Treatment for LDCs in Negotiations on Trade in Services* that Mode 4 is "one of the most important means of supplying services internationally," and the document also states that WTO members "shall to the extent possible, consider undertaking commitments to provide access in Mode 4, taking into account all categories of natural persons identified by LDCs in their requests"

Nevertheless, the issue is complicated by a number of factors. Firstly, defining Temporary Movement of Natural Persons is a difficult and contentious task: some observers point out that, traditionally, Mode 4 has been taken to cover highly-skilled workers in sectors committed under the GATS; others argue that semi-skilled and even lower-skilled service suppliers can be included. Secondly, there are numerous bilateral or regional arrangements that feature labour mobility

that are complementary to the GATS, but are currently administered outside the WTO framework and vary widely in terms of their provisions (the Recognised Seasonal Employer scheme in the Pacific Islands and CARICOM-Canada seasonal worker scheme). Thirdly, as with other areas where trade liberalisation has the potential to lead to meaningful gains, Mode 4 is an area where there is a high level of political sensitivity. Fourthly, immigration and visa requirements can combine to restrict or nullify any commitments undertaken on labour mobility or lead to *de facto* discrimination amongst WTO members.

Figure 5: Remittances as a percentage of GDP for selected non-LDC and LDC country groupings: 2014



Source: World Development Indicators

Statistics on the importance of movement of labour are equally difficult to obtain, both in developed and developing countries. One often-quoted measure is the level of remittances. Saez et al. (2015) have pointed out the problems with using remittances as a proxy for Mode 4, as remittances measure many types of flows and not simply the contractual exchange of services across borders. Nevertheless, in terms of the sheer contribution to GDP, figures for remittances are difficult to ignore for LDCs. On average, LDCs rely on remittances for 4.1 percent of their total GDP, which is itself more than three times as much as other developing countries. Some LDC groupings, however, rely even more heavily on remittances. For island LDCs, the average contribution to GDP is 13.8 percent and for Asian LDCs, it is 7.3 percent. As a result, important lessons may be drawn from a better understanding of the flows being measured and how much of these flows relate to strict interpretations of Mode 4, or trade in services in a broader sense beyond that defined currently in the GATS.

In terms of assistance to build the supply-side capacity of LDCs and LICs in the export of labour, the most obvious interventions, such as support for schools and vocation training, lie beyond the scope of AfT. Beyond training, however, there are also a number of key areas where AfT can play a role. These include:

- improving statistics through labour force surveys and skills audits, so that an improved understanding of demand and supply dynamics at home, and potentially also in markets overseas, may play a stronger role in labour market, education, and domestic and international trade policies;

- improving systems to match workers to potential opportunities and international placements. This might include putting in place more robust frameworks to manage recruitment agencies, prevent misinformation and exploitation, and subsequent unregulated migration, by ensuring that operators are subject to proper oversight and are providing bona fide opportunities;

- establishing systems to support overseas workers (as has been established in some detail by countries such as the Philippines). This would include support for negotiating protocols on issues such as the portability of social security contributions and health care assistance);

- developing strategies around the export of labour under Mode 4 that target particular sectors where there is long-term demand and potential for access to key markets. Features might include support for the development of policies on return migration to ensure the circulation of skills and other benefits;

- negotiating market access with developed country markets, but also in the context of regional free trade agreements (where there may be less political sensitivity around movement of labour). This also typically includes improving mutual recognition of qualifications or working to align education systems to regional qualification frameworks (which, in itself, creates another export opportunity in the possible export of education services, as explored by LDCs such as Uganda, within the East African context, and Solomon Islands, in the Pacific).

6. CONCLUSION

Services offer enormous promise for developing economies. Services are the fastest growing area of global trade, at a time when growth in trade in goods has slowed. The rise of trade in services is driven by changes in economic policy that have increased competitive markets for services which had traditionally been closed to foreign investment. More recently, technology has dramatically expanded the cadre of services that can be supplied across borders.

As such, services are vitally important for LDCs and LICs, despite the fact that, in many cases, they have received comparatively little attention in those countries to date. The effects on poverty through growth of trade in services are seen through a number of different channels. Improvements in the range and quality of "basic" services – from communication to education and health – lead to direct improvements in consumer welfare and quality of life. A number of key backbone services, such as transport, financial services, energy generation and transmission, and ICT, play a crucial role in ensuring the smooth functioning of modern economies, and improvements in these areas will lead to gains in overall economic efficiency. Finally, the development of services sectors can support the attainment of sustainable development objectives, including the enhanced participation of women and SMEs in the domestic market and in the global economy.

Building a services-oriented economy is, nevertheless, a formidable challenge for LDCs. Building successful services sectors requires critical injections of investment for the construction and maintenance of high-quality infrastructure networks. In light of the resource constraints faced by LDCs and LICs, development assistance mobilised over the last ten years under the banner of the global Aid for Trade initiative has already played an important role in starting to address these areas. Notable amounts of AfT have been deployed to assist countries in making costly investments in transport (road, rail, air, and sea), trade facilitation, ICT networks, and energy production and transmission (including new technologies and clean energy). However, enormous infrastructural deficits persist, and efforts to close these gaps will require further targeted interventions.

In order for LDCs and LICs to catch up to other developing countries and benefit from the services and digital revolution, greater emphasis needs to be placed on services competitiveness and export potential. In terms of export development, required interventions are likely to be specific to individual sectors. These interventions range from improvements in policy and regulatory frameworks to investments in areas such as marketing services. In summary, however, some of the main themes to emerge are:

- The AfT Initiative can assist LDCs and LICs in putting in place long-term strategic plans for the development of services exports which link investment in supply capacity, comparative advantage, and demand dynamics. Service sector-specific policies can be developed using similar value chain approaches currently being applied to manufacturing and agricultural processing. Furthermore, spatial development concepts, such as growth corridors (which, in the case of services sectors, would be more akin to "growth clusters" or "services hubs" with dedicated infrastructure investments), can also be integrated into service sector development plans. AfT can assist countries in carrying out this policy development work. In most cases, LDCs and LICs have yet to develop detailed services export policies and integrate them into development frameworks, and much more work needs to be done in this area.

- Efficiency in services requires efficient markets. Infrastructure investment needs to be accompanied by strong regulatory and legal frameworks which encourage competition and further private sector investment in services sectors.

Regulation not only allows competition, but also establishes and maintains minimum standards and protects against some of the potentially adverse effects of increased trade. In a world in which the provision of services across borders is undergoing rapid changes, many LDCs, that currently have nascent institutions and limited capacity or experience in establishing robust regulatory frameworks, require technical assistance and other AfT investments to help establish, strengthen, and continually update the governance arrangements for services.

- The relative share of AfT commitments destined for communications infrastructure has not increased since 2006. In order for LDCs to take part in the emerging digital economy, further interventions in information and communication infrastructure will be necessary. Support for trade policy and regulations increased in absolute terms, but fell in relative terms. As the services sector is regulation intensive, and many LDCs and LICs are constrained by limited regulatory and technical capacity, further support in this area is required.

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