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Human Capital Mix in GMS Countries

An impediment to services trade

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Introduction

The services sector plays an important role in economic growth and development. The share of services in the gross domestic product (GDP) of developed economies is typically 60 to 70 percent while the figure in developing ones stands at around 50 percent.[1] Employment created by the service industries accounts for 70 percent of total employment in developed countries and 50 percent of total employment in most developing countries.[2] Most importantly, a fundamental function that many services perform in relation to overall economic growth is that they are inputs into production of all sectors of the economy (Hoekman and Mattoo (2008).

Trade in services encompassing cross-border transaction, consumption abroad, commercial presence and presence of natural persons[3] has recently become the largest and fastest growing economic activity in most of the developed and developing world. It accounts for a large and growing share of international trade and the percentage is expected to be 50 percent by 2020.[4] According to WTO statistics, trade in commercial services grew faster than trade in goods (6.6 percent on average) during the period from 1980-2009. In 2009, the share of services in world trade reached 21 percent, up 2 percent from the previous year.[5]

The Greater Mekong Sub-region (GMS) comprises of six countries, including China (Yunnan Province and Guangxi Autonomous Region), Lao PDR, Thailand, Myanmar, Cambodia and Vietnam, geographically defined by the Mekong River, one of the biggest rivers in the world. In these countries, services account for a significant proportion of the countries' GDP, ranging from 25.7 percent for Lao PDR to 46 percent for Thailand in 2005.[6]

In the same year, the shares of services in Myanmar, Vietnam, Cambodia, China is 33.1, 38.1, 39.1, 39.9 percent respectively. Despite the contribution of services in the domestic economies, trade in services as a proportion of GDP is not very high. According to a World Bank report released in 2011, as of 2010, trade in services (percent of GDP) in Lao, Cambodia, Thailand, and Vietnam was only 10.61 percent, 25.19 percent, 24.85 percent, 16.33 percent respectively as of 2010.[7]

It has been well-documented that human capital is playing a more and more important role in the development of services trade in a country. Shailey Dash (2006) asserted that a country's comparative advantage in services lies in its own resource base in terms of skilled and educated manpower.[8] Likewise, Hoekman and Mattoo (2008) pointed out that human capital is a capital source of comparative advantage when it comes to services.[9] For a sub-region having rich human resources with a total population of 227 million people in 2010 like the GMS, it is much hoped that the development level of trade in services will correspond to its potential.

By using the method of empirical research, this paper seeks to analyse more in detail the relationship between services trade and human capital in the GMS. Subsequently, on the basis of the factual figures in terms of labour force, it examines the human capital mix in the sub-region which is potentially a great impediment to trade in services. The paper also discusses global and regional integration in services trade which brings both opportunities and challenges especially when it comes to human capital. Finally, the paper comes out with some policy recommendations for GMS countries to deal with the relevant issues.

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The relationship between services trade & human capital

First and foremost, it is important to understand various dimensions of human capital. According to OECD (2001), it can be regarded as “The knowledge, skills, competencies and attributes embodied in individuals that facilitate the creation of personal, social and economic well-being”. In a larger context, it can be seen as the collection of skills and knowledge of all the people of a nation, an engine of national growth and development.

According to Dash (2006), when it comes to services, enrolment ratios and years of schooling are most frequently used indicators to define human capital. It is based on a belief that these indicators ensure that the labour force is able to take part in services activities which require at least a certain amount of skills and knowledge.

Earlier studies have identified human capital as an important determinant that makes some countries more capable of exporting services than others. The Heckscher-Ohlin model[10] indicates that a capital-abundant country will export their capital-intensive good while a labour-abundant country will export their labour-intensive good.

According to Van der Marel (2011), besides other determinants such as good rule of law and extensive regulation, human capital is especially important for having comparative advantages in services. Hoekman and Mattoo (2008) also indicated that the interplay between endowments, institutions and infrastructure determines the capacity of a country to trade in services. It should be also noted that not only high-skilled labour but also middle-skilled labour are determinants of comparative advantage in services in a Heckscher-Ohlin model, though high-skilled labour is a more robust determinant, as pointed out by Van der Marel (2011).

Nevertheless, different high-skilled factor intensities will affect countries’ comparative advantage in services and thus services export structure. In case of GMS countries, such services as tourism, transportation, distribution and telecommunication are more relevant as they only require middle-skilled and unskilled labour. In contrast, such services as financial and business services which require a great intensity of skills are not fully explored.

Human capital mix in select GMS countries

GMS has a large workforce, nearly half of the total population of 227 million in 2010. And the workforce increases year by year. China is still by the far most populous nation in the world, hence possesses a great labour force. The labour force in Thailand in 2009 was 38.43 million people. Vietnam has an abundant and growing labour force[11] with over 1 million entrants to the labour market each year and the total labour force in 2010 stood at 47.49 million. It is no doubt that Vietnam’s young and energetic labour force is one of the underlying reasons that has helped the country overcome the difficulties of the global economic crisis and sustained the economy with quite high growth rate. In Cambodia, the country’s labour force has undergone dramatic changes in the past decade.

In 2008, the labour force aged 15 or older numbered around 7 million, representing an increase of 1.9 million from 1998, or an average increase of 3.3 percent per annum.

In 2010 the labour force was 8.8 million out of a population of 13.4 million. By the end of 2010, it was estimated that Lao PDR’s labour force stood at 3.69 million people, with an unemployment rate of 2.5 percent in 2009 (CIA, 2001).

However, despite a large workforce as such, human capital mix in which there is a lack of skilled labour is a prominent issue facing the majority of GMS countries (except Thailand). To illustrate this fact, the first thing to be noted is the percentage of labour force employed in agriculture. Looking at the labour force by sector in GMS countries, it can be sees that the percentage is still comparatively high. In Lao PDR, for example, the share of employment in agriculture and service sector is 85.4 and 11.1 percent respectively in 1995 while the figures are 78.5 percent and 16.7 percent respectively in 2005 (Douangboups and Solaphom, 2010).

Though agriculture has obviously decreased over time but the vast majority of the labour force is still working in low-skilled jobs. There is a widespread lack of skilled and educated workers in almost all sectors. About 42 percent of the adult population is wholly illiterate. The shortage of high-tech and even moderately skilled labour is acute.[12]

In Vietnam, coinciding with national orientation, there has been a significant sectoral shift of employment out of agriculture into industry and services. Nevertheless, 65.3 percent of the labour force was unskilled due to lack of training opportunities and proportion of employed persons working in the low productivity agricultural sector remains high (52 percent in 2007).[13]

Another important thing to note is education. In general, the skilled labour force should be restricted to secondary and tertiary education rather than literacy rates. A literacy rate of 98 percent may not enable Lao PDR to be in a better position to export services while the enrolment ratio at secondary level and tertiary level is 36.0 and 13.4 percent respectively.[14]

Likewise, there is a great difference in gross enrolment rate between lower secondary and upper secondary in some countries like People's Republic of China. Although primary education enrolment ratios in Cambodia have risen sharply over the last decade, this drops significantly in later stages of the educational cycle. The gross enrolment ratio for primary education in 2007 was 119, while the figure for secondary and tertiary enrolment, respectively, was 40 and 5.[15]

This drop may be attributable to cost of tuition but also the implicit opportunity cost of incomes sacrificed in the process of education that prevent students from attending secondary or high schools. As already said, human capital first and foremost implies education of the labour force. Though in reality a very important augmentation of human capital occurs during the process of "on the job training" and work experience, this factor is not usually captured by the macro level statistics as a result of lack of data (Dash, 2006).

Finally, labour productivity also implies the education level of the population, hence the quality of the labour force. Country-wide labour productivity in Lao PDR and Cambodia is the lowest in the region. Labour productivity in Cambodia is three times lower than that in Thailand, and the gap between labour productivity in Cambodia and Vietnam widened over time since 1993.[16] In comparison with other countries in the region, Vietnam's labour productivity growth from 2000 to 2008 was quite outstanding and exceeded all other ASEAN Member countries. However, the country's productivity remains low in absolute terms and was equal to only 61.4 percent of the Association of Southeast Asian Nations (ASEAN) average, 22 percent of productivity in Malaysia and 12.4 percent of the level in Singapore.[17]

Among GMS countries, Thailand is the only country where a labour shortage of unskilled labour is a matter of concern. The reason is that many of those who finish primary or lower-secondary school choose to pursue further studies and only a few of them enter the job market.[18] This is largely attributed to the combination of demographic transition and upgrading of the skills of its workforce.

All these factors greatly affect the development of services trade. In most GMS countries, trade in such sectors as transport, distribution services, tourism contribute an important percentage of GDP and account for a large share of employment as they do not require highly skilled workers. In Cambodia, a huge gap in skilled labour is the biggest constraint to the development of Cambodia's service sector as well as service trade. After years of the brutal Khmer Rouge regime, the country's educational levels have been largely limited to primary education.

Therefore, according to the Economic Institute of Cambodia (EIC), services exports are dominated by tourism activities, which represented around 72.9 percent of the total services income in 2009. Meanwhile, transportation is the dominant services import, with transportation payments representing about 52.9 percent of total service debits in 2009.

Likewise, tourism in Lao PDR is of critical importance in driving the country's economic development as it generates over US$120mn in revenues and accounts for an estimated 23 percent of income from exports (World Bank, 2006). The other service sectors that are also exported include transportation, communication, and insurance. Noticeably, the export of telecom sector was significantly increased from 2006 to 2007 whereas the import of telecom was in an opposite direction (Figure 5 & 6). From 2002 to 2007 the import of travel and construction services followed a similar trend and contributes to the deficit of the BOP. While from 2005 to 2007 the import of construction service was sharply increased, but the import of travel service is constantly declined.

In Vietnam, trade in services still contributes relatively little to Vietnam's annual revenue and the most dramatic growth pattern could be seen in the transportation sector. In Myanmar, there is a peak in trade in services in the late 1990s and communications holds a strong market share given its importance in the sector and its protected nature. Besides, transportation has made the most progress in terms of contribution to GDP. In the above countries, trade in finance, banking, professional services which rank among the highest in skill-to-labour ratios is still very limited. In contrast, with a shortage of unskilled labour Thailand has difficulties in developing labour-intensive services sectors such as tourism, transport, etc.

Regional and global integration on services trade in GMS countries

Trade in services in the GMS countries is rapidly liberalised on the regional level. This results from the countries' membership to the WTO and regional integration efforts among members of the ASEAN, notably through the ASEAN Framework Agreement on Services (AFAS). Apart from Lao PDR, all other GMS countries have acceded to the World Trade Organisation (WTO) and were required to progressively liberalise trade in services according to Annex 1B General Agreement on Trade in Services (GATS). While Myanmar's commitments are limited to tourism and travel-related services,

Table 1: Relative Sector Coverage of AFAS Compared to GATS for ASEAN Members	
Country	***Sectoral Coverage Ratio[20] (GATS+AFAS / GATS)***
Brunei Darussalam	3.38
Cambodia	1.21
Indonesia	1.56
Malaysia	1.26
Myanmar	3.0
Philippines	3.03
Singapore	1.09
Thailand	1.35
Vietnam	1.09
Source: Mikic, 2009, p.24	

Thailand, Vietnam and Cambodia have made extensive commitments on most service sectors.

The ASEAN Framework Agreement on Services (AFAS) was signed by ASEAN Economic Ministers (AEM) in Bangkok, Thailand, on December 15, 1995 aiming at substantially eliminating restrictions to trade in services among ASEAN countries in order to improve the efficiency and competitiveness of ASEAN services suppliers. Under AFAS, ASEAN member states (AMS) are to enter into successive rounds of negotiations to liberalise trade in services with the aim of submitting increasingly higher levels of commitments. At present, ASEAN has concluded seven packages of commitments under AFAS signed by the AEM through five rounds of negotiations since January 01, 1996.[19]

All the GMS countries are signatory party to AFAS though the coverage and level of commitments vary from country to country. The difference in the Sectoral Coverage Ratio (as shown in Table 1 above) shows the countries' degree of willingness towards committing sectors to be liberalised in the two liberalisation frameworks: AFAS and GATS. Some countries like Myanmar are more careful with multilateral liberalisation, having a ratio of 3.0 or higher; while countries like Vietnam or Thailand have ratios closer to 1.0. Vietnam committed to liberalise in a wide variety of sectors, in which construction services, educational services, environmental services, financial services and recreational services maintain a high degree of unbound[21] commitments (between 80 and 100 percent).[22] In contrast, the focus of Myanmar's packages of commitments has been on limited liberalisation of services, mostly in the following sectors: professional services (accounting and consulting in particular), radio and television services, education, tourism.

Global and regional integration as such brings both opportunities and challenges to GMS countries. On the bright side, it provokes international labour migration from GMS countries which is steadily increasing, both within GMS countries and to other countries. It is a great momentum to alleviate the constraints on the development of services trade. In case of inward migration, domestic economies can benefit from not only cheaper and improved quality of services but also knowledge and skills transfer thanks to the local presence of foreign skilled workers. In case of outward migration, benefits include greater employment opportunities and higher incomes for service-related workers in other countries and remittances for their nations and households.

However, it should be noted that movements of labour across national borders within the GMS and the ASEAN consist largely of unskilled and semi-skilled workers. Thailand, as one of the most developed countries in the GMS is the major receiving country for labour migrants from Cambodia, Laos and Myanmar. Meanwhile, for Thailand, migrants represent an important reservoir of cheap and flexible labour and a boost to its competitiveness in certain services sectors such as tourism and transportation.

However, there are also challenges such as the negative impacts on the local labour market of immigration and the effect of brain drain of outward migration. Especially when most of the service sectors such as telecoms, finance, energy, health and education have been dominated by the government for long, the integration process should be carefully managed.

Conclusion

In summary, service industries necessarily make abundant use of labour. Therefore, human capital is a key factor that contributes to the growth of services trade. It goes without saying that the importance of human capital development must be emphasised in the process of socio-economic development since effective development and utilisation of human capital will sustain services trade and sustainable development in the long run. This should be a very crucial factor to enable economies to gain better competitive advantages against other economies.

As analysed above, the high prevalence of unskilled labour is certainly one of the biggest obstacles towards services trade and liberalisation whereas some services are not fully explored. In the case of GMS countries, human capital development still remains a major problem. It is illustrated by the high share of labour force in agriculture, a drop in enrolment rate at secondary and tertiary education compared to primary education and low labour productivity. As a result, countries' growth and development performance were lower than that of other areas in the ASEAN region.

Needless to say, human capital development should be seen as an urgent task and a priority by GMS countries wishing to raise services shares of GDP. However, it is true that not only high-skilled but also unskilled and middle-skilled labour are important for services trade especially in the area of tourism, constructions, telecommunication and distribution. Therefore, there should be a balance between these types of labour so that all service sectors can be fully explored. This has important policy implications for GMS countries with respect to how human capital should be improved.

First and foremost, it is suggested that a strategy of human capital development should be drawn out in which education and training are considered a focus. Especially, effective policies to improve secondary education and high education should be in place so as to produce quality graduates who will become backbone in services trade of the country.

At the same time, unskilled force should be educated and upgraded to middle-skilled level who will be qualified enough for some certain service sectors. A more productive service sector will automatically lead to the improvement of human capital. Besides, special importance should be attached to improving the regulatory skills of high-level policy-makers and regulators as regional integration in services may necessitate re-regulation on a massive scale.

Given the high degree of regulation of service activities, domestic regulations can be significant barriers to market access for foreign-service providers. Last but not least, service players are supposed to have proper knowledge of the relevant regulatory framework before entering certain markets. If these issues can be adequately addressed, human capital will play a more critical role in fostering countries' effective participation in the global as well as regional integration in services, thus contributing to the development of services trade in GMS countries.

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19. More detail is at http://www.aseansec.org/20071.htm
20. According to Vo Tri Thanh and Paul Bartlett in "Ten Years of ASEAN Framework Agreement on Services (AFAS): An Assessment": A sectoral coverage ratio is to measure the degree to which intraregional AFAS commitments represent greater liberalisation of services trade and it presents a straightforward numerical comparison of the extent of each AMC's relative commitments.
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