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Overview of Trends and Performance in Services Trade

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Introduction

This overview of trends and performance in services trade focuses on the following areas:

- Gains from and reasons for services trade;
- Growth and productivity impact;
- Trends and patterns in services trade flows in relation to balance of payments statistics (Modes 1, 2 and 4), foreign affiliates trade statistics (Mode 3 and also Modes 1 and 4) and recent services trade resilience.

It will also briefly touch upon the General Agreement on Trade in Services (GATS) Commitment Restrictiveness Index by the World Bank Institute and the Services Trade Restrictiveness Index (STRI) by the World Bank Trade Research Unit.

Gains from services trade

'How is the staging of a MotoGP race related to services trade?' To see just how many aspects of trade are involved let us consider some facts about a MotoGP race that took place in Sepang, Malaysia, in October 2009.

- A multinational company managed the local race events, which in GATS parlance would be 'commercial presence' (Mode 3). The same company managed a global website and broadcast via video through the same website over the internet, which is cross-border trade (Mode 1).
- The audience at the live event of the race included foreign visitors, i.e. tourists (Mode 2).
- Payments were made to the racetrack owner in the host country, i.e. rent (Mode 1).
- The racing teams came from different countries, which is mobility of service providers (Mode 4).

This simple event provides an example of all of the aspects involved in trade in services and that the GATS framework attempts to capture, especially in negotiations. In measurement it is a different ballgame because while it is straightforward to measure cross-border trade and to measure consumption from the balance of payments statistics, it is very difficult, especially in developing countries, to get any numbers related to commercial presence or to mobility of service providers.

Comparative advantage

In all trade the gains for both parties can be realised whenever relative prices or relative costs differ, and there are gains even if one country has an absolute cost disadvantage in all products. It is the difference in the relative prices that really counts and that gives any country the opportunity to engage in trade. Therefore, it would be incorrect to say that China or India are more competitive in every area and other countries have nothing with which to compete against them even in services. Comparative advantage is rooted in differences between countries. There are some differences like climate that little or nothing can be done to change. But there are other factors – like labour skills, institutions, land endowments and technology – that can be changed in the long term. In other words, comparative advantage is not cast in stone; it can be moulded and changed by policy, by public investment and by other types of general public intervention.

A large amount of services trade takes place between different countries and comparative advantage explains well the trade between different countries with different endowments. For example, in North–South trade in business services Indian call centres provide back office and customer care services for American firms, nannies from the Philippines move to Dubai to provide childcare services and Italian eco-tourists fly to the Amazon for a week in the jungle.

However, a lot of services trade also occurs between similar countries. Comparative advantages and differences between countries can explain a lot of trade. This is especially so in services trade where a great deal is traded between similar countries, South–South and even in the North; for example, when Kenyan architects design a convention centre in Arusha, the capital of Tanzania, or subsidiaries of an Italian commercial bank provide banking services to domestic customers in Austria.

New theories relate the roots of this trade between similar countries to increasing returns to scale that affect most services and to the advantages from product variety that consumers and business users of services value. There are also agglomeration and network effects that explain this trade. The examples given above show countries can target their services exports or imports at countries with very different endowments, but the opportunities to trade with similar countries are also very high. This has an implication, because traditional theory tends towards the view that only small gains come from regional trade among similar countries, especially on the goods side – but on the services side that story is different for many of the factors mentioned.

Reform in services, more rapid economic growth

A number of studies have documented ex-post a strong positive impact of services trade liberalisation, especially the component related to commercial presence (Mode 3), which can be approximated by the level of foreign direct investment (FDI) it affects. So for instance, research on economic growth found it was 1.5 per cent higher in telecommunications and the financial sector in liberalised countries (Mattoo, Rathindran and Subramanian, 2001);[1] another on the manufacturing productivity of 350 Czech firms, based on a 2004 firm-level survey, found that a 10 per cent increase in FDI in each services sector led to a 3 per cent increase in the average productivity of Czech manufacturing firms (Arnold, Javorcik and Mattoo, 2007).[2]

There is further evidence from India, where several major services reforms took place during the 1990s and in the early 2000s (Figure 1.1) and the growth in foreign direct investment in the services sector was much faster than in goods (Figure 1.2).

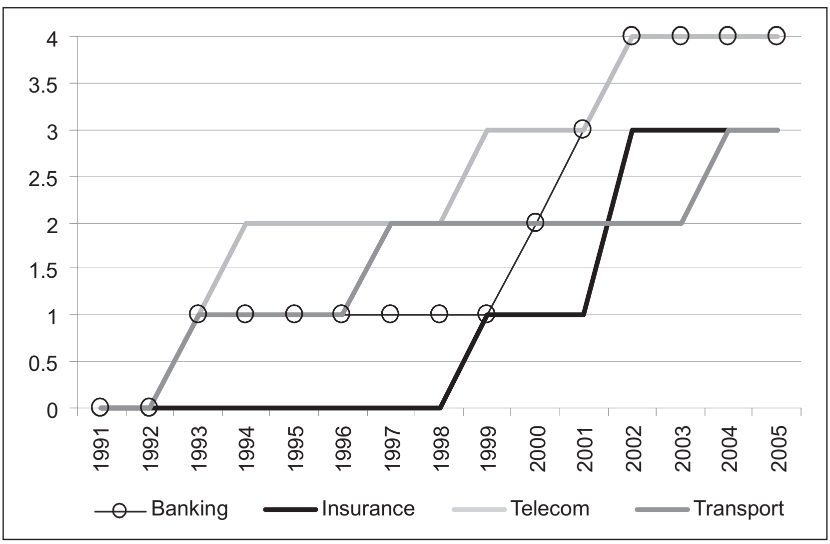

Figure 1.1. Newly created index of services reform
Source: Arnold et al. (2007). Policy Research Working Paper Series 4109. The World Bank

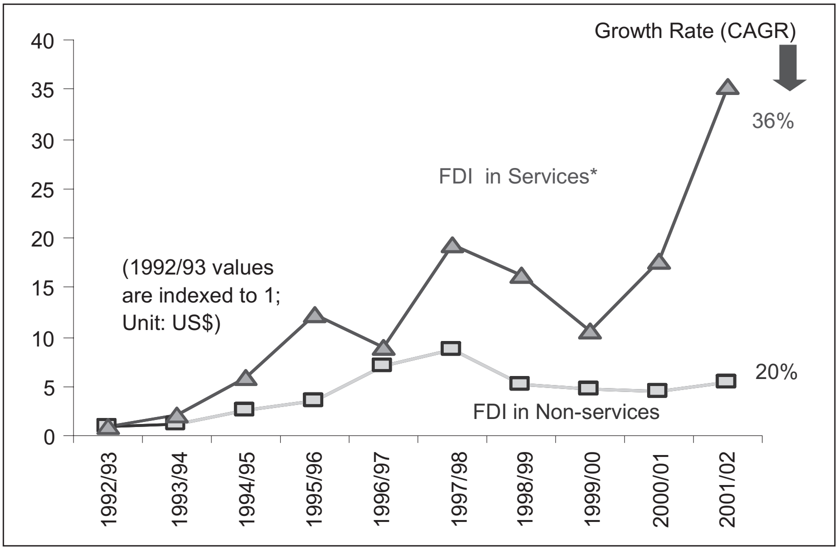

Figure 1.2. India: FDI in services sector is growing faster than in non-services
Source: Arnold et al. (2007). Policy Research Working Paper Series 4109. The World Bank

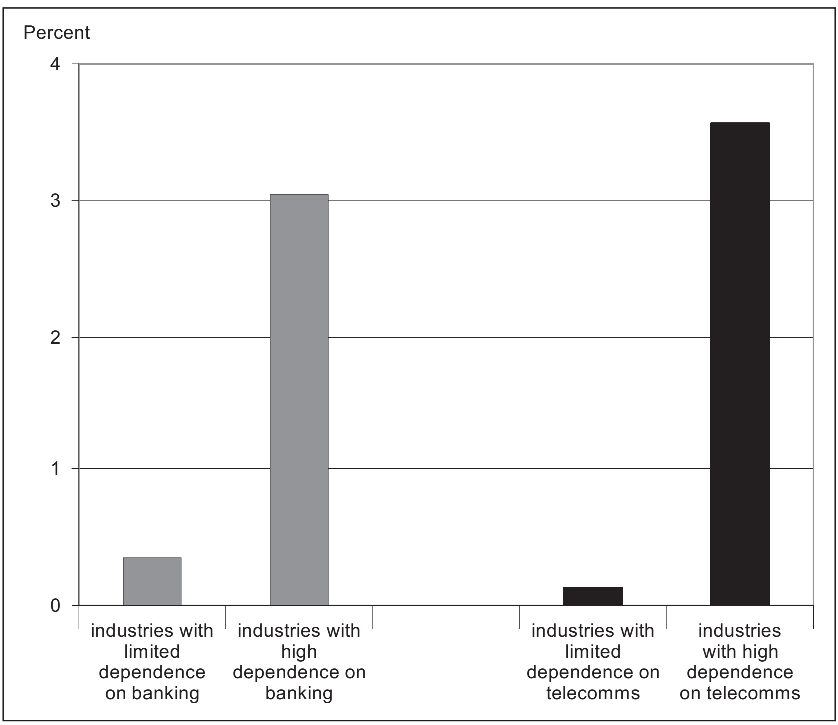

Figure 1.3 Gains in annual TFP growth after services reform
Source: Arnold et al. (2007) Policy Research Working Paper Series 4109. The World Bank

Figure 1.3 demonstrates that the reforms resulted in major gains in productivity for manufacturing firms. This shows how important services are not only in terms of the export opportunities they may offer, but also in improving domestic competitiveness among the other sectors in the economy. This is so even though India's services reform process is incomplete and there are still restrictions and over-regulation in various areas. For example, Indian horticulturists receive only one-sixth of the final price because of inefficient storage, transport and distribution; restrictions in professional services impede Indian participation in the growing international division of labour; and the over-regulation of higher education threatens India's skill endowment. Furthermore, restrictions on foreign ownership and entry persist in communications and financial services. The lesson here is that benefits accrue merely from starting the process and moving forward in critical areas.

Economic models also show potential for large gains, according to various studies. One of them, a simulation of what countries could gain from relaxation of temporary labour mobility restrictions, shows that the global gains, shared between developed and developing countries, could exceed US$150 billion (Winters, 2008).[3] The US could save over US$1.4 billion annually even if only one in 10 American patients were to undergo just 15 types of low-risk treatment abroad (Mattoo and Rathindran, 2006).[4] The large gains made by Russia on WTO accession are almost entirely attributable to dynamic and productivity effects from implementing its own services trade liberalisation commitments rather than to the marginal market access improvements from joining the WTO (Tarr, 2007).[5]

Patterns in services trade flows

During the last two decades the production process for goods has become so fragmented that it has led to much trade and more trade growth than the growth of output and value added. In fact, this process of fragmentation of the production process has given rise to opportunities for many developing countries to take advantage of producing specialised products, components and inputs into the manufacturing of complex goods.

In services, a similar process has taken place and although it started later, it has already gone very far. For instance, health services provided by hospitals have been fragmented and outsourced – a hospital in the US is likely to have a call centre for customer service that can be located anywhere in the world, it may have subcontracted out medical transcription services and payroll management is probably done somewhere else as well (indeed, payroll management at the World Bank, including the reimbursement of all staff travel expenses, is located in Chennai, India).

This process of fragmentation of production, in both manufacturing and the services industry, also opens new opportunities for developing countries.

What does the global picture look like for services trade? In recent years, the services sector has accounted for over 50 per cent of the GDP in developing countries (between 30 and 40 per cent for the very poorest countries) and over 70 per cent of the economy in OECD countries. It has also been the largest source of employment growth in most countries because while employment tied to manufacturing has declined in the developed countries, it has increased in many developing economies that have manufacturing centres, including China. In recent years, the services sector has accounted for about 20 per cent of the total world cross-border trade and about 16 per cent of developing economies cross-border trade. Services sector exports have grown faster than merchandise exports since 2000 (over 15% p.a.) in both developed and developing countries.

These figures show quite a big gap between the services trade share of global trade compared to the services sector share of global GDP. The process of fragmentation, facilitated by the IT revolution, can be expected to increase the share of services trade over total trade in the coming years. Just as in the past two decades when services sector exports grew faster than merchandise exports, the higher growth of services trade can be expected to continue in the long-term during the next decade or two.

A large amount of services trade is delivered by foreign affiliates that sell to domestic customers in the host countries. Those sales are captured by statistics that are available in developed countries, but only a handful of developing countries have started collecting such data. However, more than half of annual FDI flows are in services and the value of outward internal (i.e. within the host countries) sales by foreign affiliates of OECD services firms is estimated to be more than their balance of payments recorded (cross-border) exports for the US and Germany (2+ times) and France (1.5 times).

World exports of commercial services rose from about 16 per cent of total exports of goods and services to about 19 per cent in the period 1980 to 2008 (Figure 1.4).

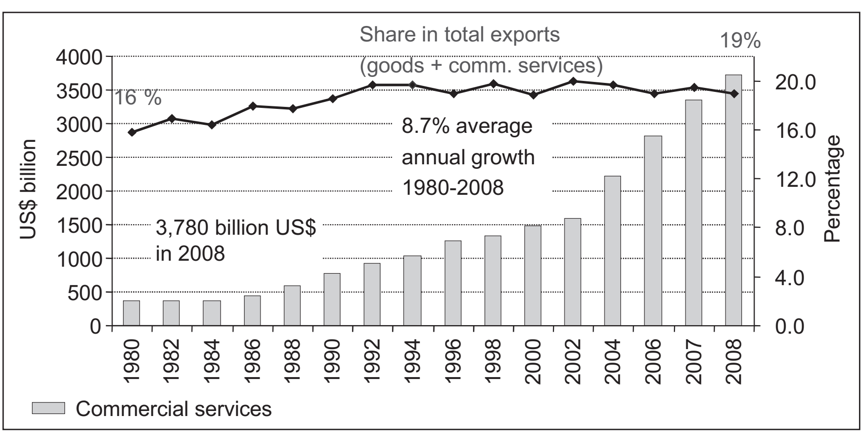

Figure 1.4. World exports of commercial services, 1980–2008
Source: WTO estimates; February 2010 presentation at WBI services trade course in Vienna

Developing countries increased their share of exports of commercial services from 24 per cent to 27 per cent in the period 1995 to 2008. Much of this trade by developing countries has been limited to middle-income countries and the large countries like China and India, with only 0.04 per cent coming from the least-developed countries.

In the same period, world exports of traditional commercial services decreased in importance; for example, the travel sector went down from 34 per cent to 25 per cent and the transport sector from 26 to 24 per cent. This was largely due to the higher growth of 'other' commercial services, which rose from 40 to 51 per cent, but partly also because of lower prices for transport and travel and thus their lower contribution to total trade in nominal values when their share is calculated.

It is even more interesting to consider the composition of world exports for 'other' commercial services exports. The biggest component is 'other business services' (Figure 1.5), which is the category that contains professional services and IT enabled services (largely overlapping with outsourcing).

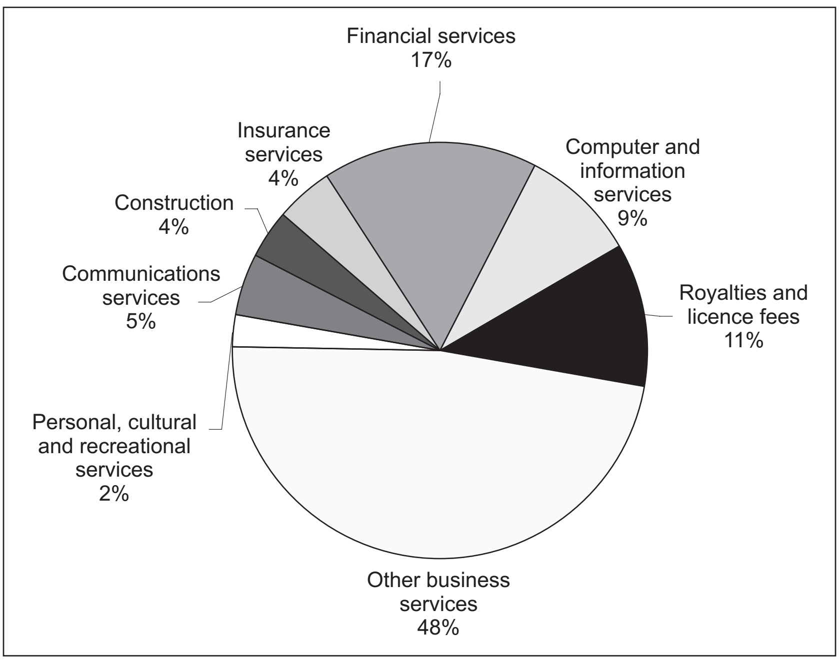

Figure 1.5. World other commercial services exports, 2007
Source: WTO estimates; February 2010 presentation at WBI services trade course in Vienna

Between 2000 and 2007, 'other business services', with an average annual growth rate of 15 per cent, was among the fastest-growing categories, which included computer and information services (19%), insurance services (17%) and financial services (17%). There was less growth in construction (14%), royalties and licence fees (12%), and personal, cultural and recreational services.[6]

In this period of spectacular growth rates, India and China, and even Russia, were among the emerging economies that made big gains in world exports of other commercial services (Figure 1.6). However, most of the least developed countries (LDCs) were not able to take advantage.

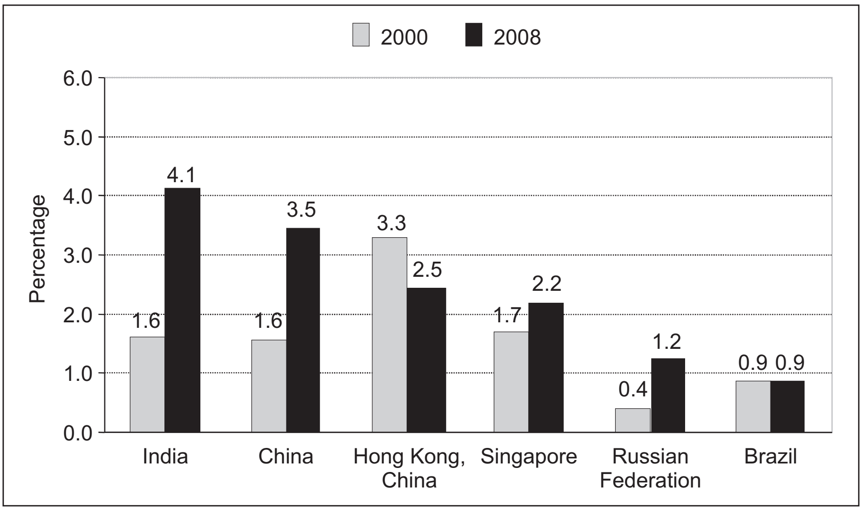

Figure 1.6. World exports of other commercial services by selected emerging economies (share of total)
Source: WTO estimates; Feb. 2010 presentation at WBI services trade course in Vienna

Outward domestic sales/output of US foreign affiliates

'FATS' statistics are the outward sales of US foreign affiliates in the host country. Some do not cross a border. These are US affiliates in another country selling to domestic customers. Figure 1.7 compares the estimated size of such sales with the exports of commercial services for the foreign affiliates of various OECD countries (for which such data are available). As can be seen, for countries like the US and Germany and even France and Italy these FATS sales are much higher than cross-border exports.

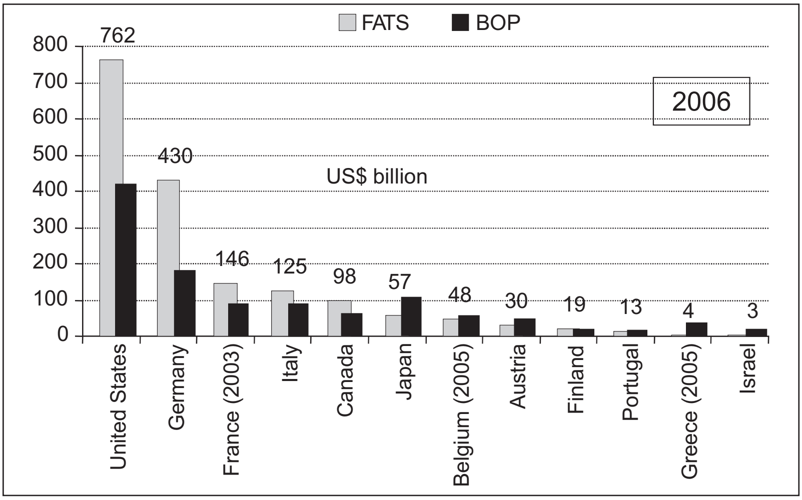

Figure 1.7. Outward domestic sales/output of US foreign affiliates* vs OECD exports of commercial services
* Affiliates primarily engaged in services activities. *Source*: WTO estimates.

Figure 1.8 shows the exports generated by US foreign affiliates abroad – for example, a US-owned company in Mauritius exporting to the rest of the world from Mauritius – from the point of view of the host countries. These are the numbers that come from the balance of payments, but it is evident that the total value of exports of US foreign affiliates in the world is higher than the value of US direct exports (originating from within US) through cross-border trade.

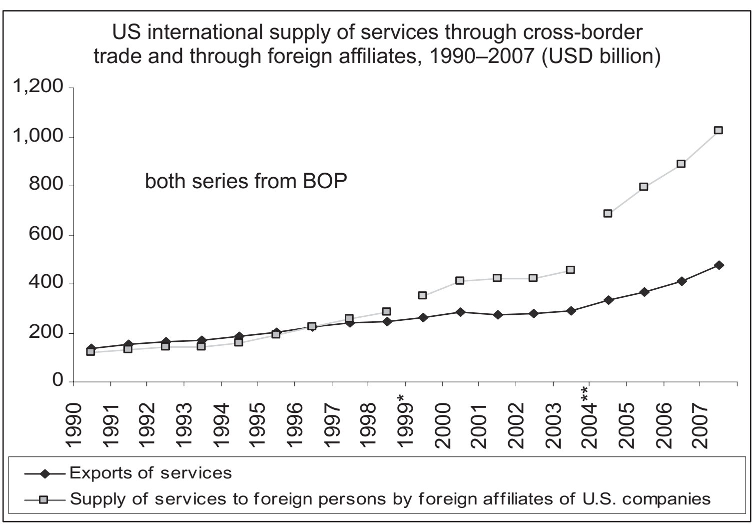

Figure 1.8. Outward foreign sales/outputs of US foreign affiliates* vs US exports of commercial services, 1990–2007
Source: WTO estimates; Feb. 2010 presentation at WBI services trade course in Vienna

Inward turnover (sales)/output of foreign affiliates

Figure 1.9 shows the value of local sales by foreign affiliates of firms from OECD countries in the US and in various other countries for which such data are available. The numbers are huge, which is why Mode 3 is considered to be the largest mode of provision of services. The problem is in trying to quantify some of these flows when much of the data for Mode 3 are not available for developing countries.

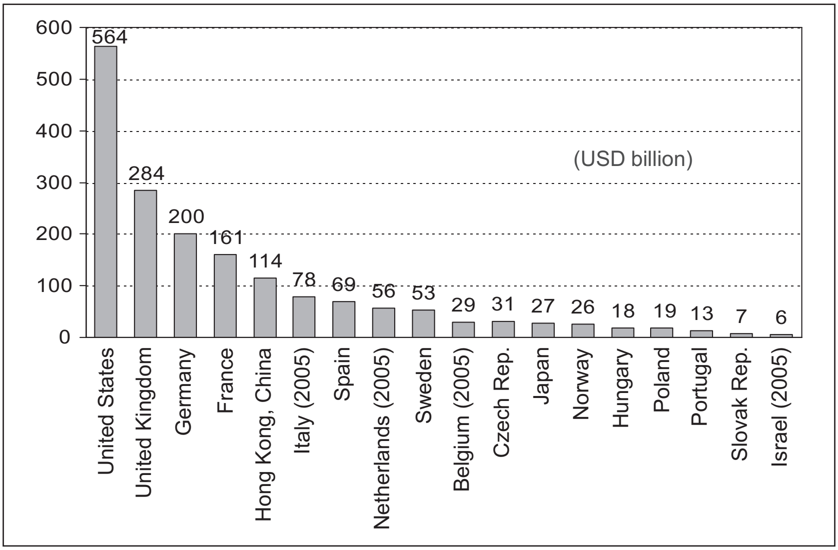

Figure 1.9. Inward turnover (sales)/output of foreign affiliates, selected economies, 2006
Source: WTO estimates; Feb. 2010 presentation at WBI services trade course in Vienna

Services trade resilience

The services trade was resilient during the global economic crisis that started in 2008. Figure 1.10 shows how resilient US imports, and even European imports (which correspond to exports from the rest of the world), were in 2008 and how in 2009 they started to grow again fairly fast.

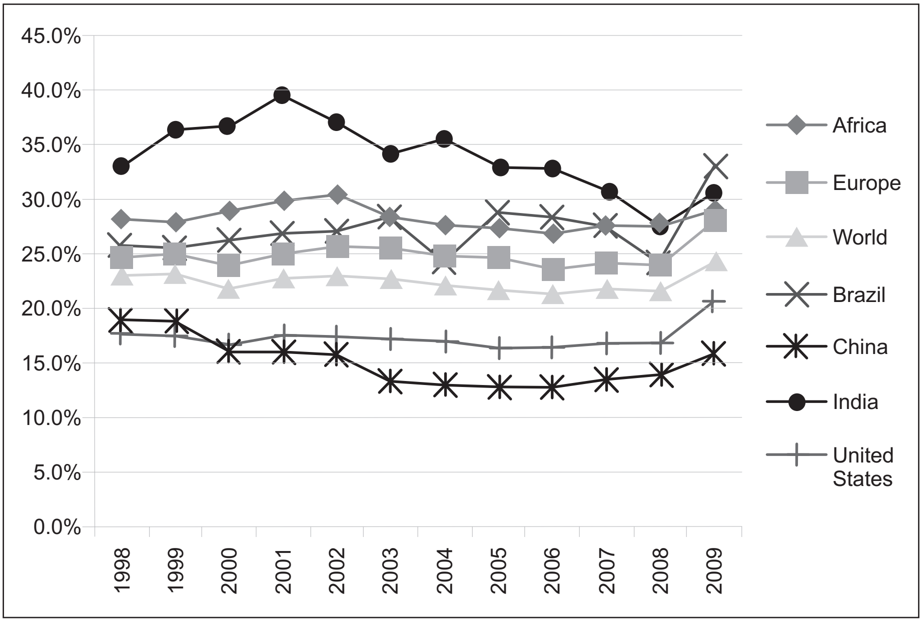

Figure 1.10. Global services imports (1998–2009)

Figure 1.11 shows how strong the impact of the crisis was on merchandise trade from about the middle of 2008 until the turnaround in about May 2009 when growth started picking up again. However, contrast this pattern with that of the US services imports and services exports and see how stable they have been throughout these years.

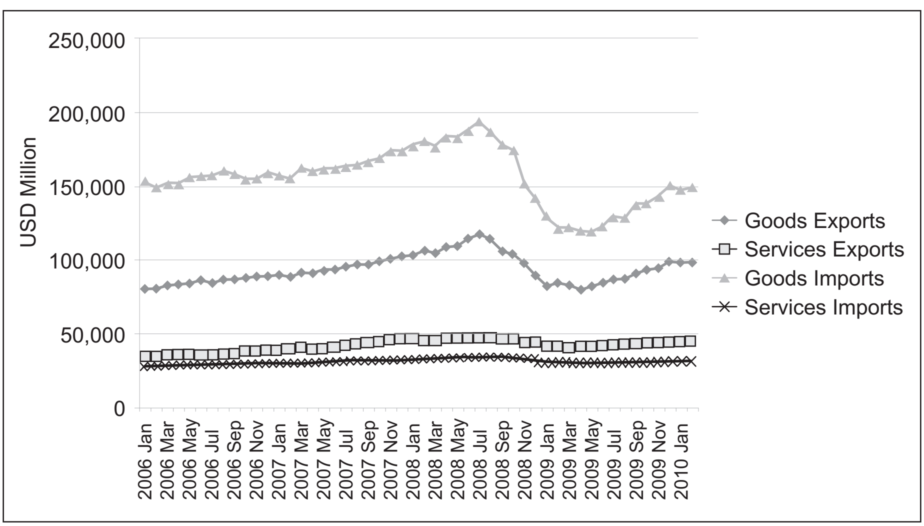

Figure 1.11. US monthly imports and exports of goods and services, January 2006 – February 2010
Source: WBI update of a chart through Feb. 2009 in Borchert and Mattoo (2009)

Figure 1.12 is a breakdown of the other commercial/private sector services by some of the main categories. Travel and transport services trade flows reflect more closely those on the goods side. However, the 'other' private sector services (same as the 'other' commercial services in the charts above) have been growing very fast, supporting exports from the rest of the world to the US. They dipped at the end of 2008 and beginning of 2009, but these dips have been very small in size and duration.

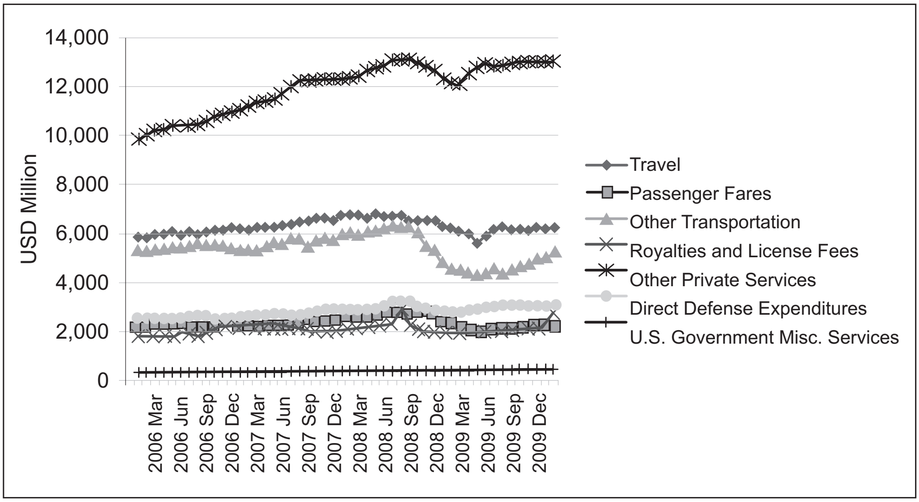

Figure 1.12. US services imports by sector, January 2006 – February 2010

'Other private sector services' is the largest component (39.4%) of US services imports (Figure 1.13) and it is the category that includes professional services and IT enabled services.

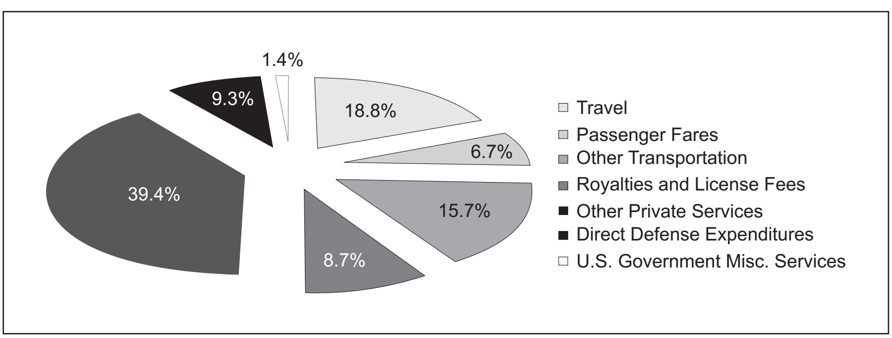

Figure 1.13. Breakdown of US services imports by sector as percentage of total US services imports, February 2010
Source: WBI elaboration of U.S. BEA high frequency data.

Why is services trade more resilient? Borchert and Mattoo (2009)[7] are somewhat speculative and tentative, but they suggest this may be because the demand in rich countries for services imports is less cyclical than for goods. Producer services are an integral part of the production function of many OECD firms, whether manufacturing firms, such as carmakers, or service firms such as banks and it is also not easy for them to cut down back-office services like accounting. So, due to the nature of the services provided and the multi-year contracts being established with the foreign providers, there was no major pull back from outsourcing and business processing and IT enabled services during the crisis. As the crisis intensified the provision of services from developing countries was the most cost effective way to control costs. In addition, services trade is less dependent on external finance. Indian BPO firms, for instance, are fully internally financed, so they did not have to worry at all about the credit crunch associated with the global economic and financial crisis. Finally, in the services areas the protectionist backlash has been very weak, more so than on the goods side.

Services trade barriers

The main barriers affecting services trade are quotas and even more so regulatory barriers; tariffs are relatively uncommon. The regulatory barriers include: limits on the number of foreign firms; limits on per cent of foreign ownership in banking, insurance, etc.; foreign providers completely shut out in some sectors (transport within a country); foreign exchange restrictions limiting consumption abroad (tourism, education); limits on movement of foreign personnel; and local content requirements in broadcasting.

Quotas and regulatory barriers do not generate revenue unless they are auctioned off. They also help create domestic market power and they raise lobbying and corruption costs compared to straightforward tariffs on the goods side. However, large gains can be made when quotas and regulatory barriers are reduced or abolished. The removal of these quotas and regulatory restrictions does not generate fiscal revenue losses, which is usually the case when tariffs are removed, so there is no loss there. Consumers and users most often benefit, especially the domestic workers in the sector affected, because foreign providers come in to offer their services in the local market and hire local workers at higher wages than the incumbent domestic providers. The usual losers are the domestic owners of services industries, unless they form joint ventures or otherwise form partnerships with foreign services providers.

Not all barriers are discriminatory. Some clearly are, like preferential taxes and subsidies, preferential access to essential facilities or prohibition of foreign ownership in services sectors. However, there are also non-discriminatory measures, such as qualification and licensing requirements and technical regulations governing safety or quality, which are mainly to protect consumers. These measures affect services trade nonetheless and in negotiations trading partners often make demands to scrap or adjust them.

How do we measure these barriers? The options are limited. The database on non-tariff barriers that is available at the WTO in Geneva is 10 years old now and it largely covers barriers on the goods side, not on the services side. One way is to look at the GATS commitments, even though most countries (with the important exception of recent WTO accession countries) have liberalised much further than their 1995–1997 GATS commitments. Nonetheless, in the absence of better comprehensive data, the commitments made by a country send signals to the world about the extent of openness in the services sector and the country's willingness to lock-in that level of liberalisation.

The World Bank Institute (WBI) has produced a GATS commitments index as part of the work for the World Trade Indicators 2008.[8] What the index shows is that the ECA and the high-income OECD countries have committed the most to open services and the low-income countries have committed the least. Table 1.1 shows that in the GATS commitments rankings the countries on top are the WTO accession countries that were asked to commit to their existing or (most often) higher levels of liberalisation, and the rich countries. Notice, however, how South Africa is also in the top 20 in terms of commitments. Countries in sub-Saharan Africa, including some middle-income ones, make up the bulk of countries at the bottom of the list.

Table 1.1. GATS Commitments Rankings

	Top 20			*Bottom 20*	
1	Moldova	84.32	1	Namibia	3.94
2	Austria	72.09	2	Bangladesh	3.36
3	Georgia	70.5	3	Mauritania	3.27
4	Latvia	69.14	4	Burkina Faso	3.21
5	Kyrgyz Republic	66.61	5	Kenya	3.21
6	United States	65.24	6	Uganda	3.16
7	Albania	65.12	7	Cameroon	3.11
8	Iceland	64.38	8	St Kitts and Nevis	3.11
9	Armenia	63.16	9	Mali	3
10	Lithuania	59.68	10	Costa Rica	2.79
11	Australia	58.95	11	Chad	2.69
12	Hungary	58.46	12	Central African Republic	2.49
13	Oman	57.44	13	Guinea-Bissau	2.35
14	Finland	57.18	14	Maldives	2.33
15	Estonia	56.72	15	Niger	2.3
16	Norway	56.55	16	Fiji	2.25
17	Jordan	56.41	17	Congo, Rep.	2.18
18	Saudi Arabia	55.51	18	Belize	1.61
19	Switzerland	53.67	19	Tanzania	0.98
20	South Africa	53.43	20	Madagascar	0.4

Source: World Bank Institute World Trade Indicators: www.worldbank.org/wti

The World Bank's recently constructed Services Trade Restrictiveness Index (STRI) seeks to measure services trade restrictiveness in the most important sectors and for the most important modes of supply.[9] The STRI covers five major sectors in 102 countries: financial, telecommunications, transport, retail distribution and professional services. The data shows how countries in South Asia and the Gulf are among the most restrictive and how the Latin America and ECA regions are closer to the OECD and the rich countries, with the other regions in the middle (Figure 1.14). In professional services there are many restrictions, including by the rich countries but also by all the other regions (Figure 1.15).

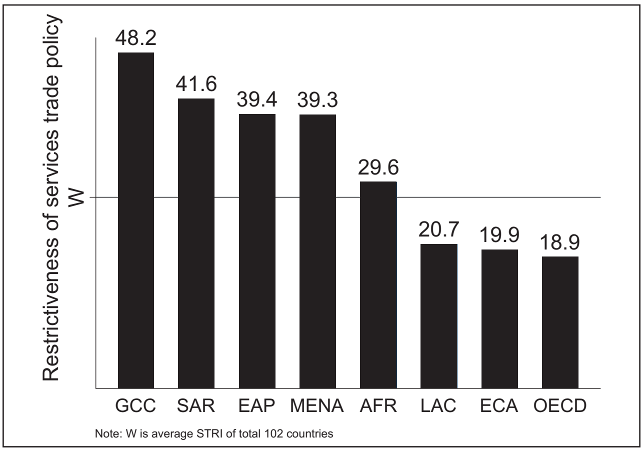

Figure 1.14. STRI by region
Note: GCC-5, SAR-5; MENA-8, EAP-8, LAC-18, AFR-22, ECA-14, OECD-22, World-102 countries

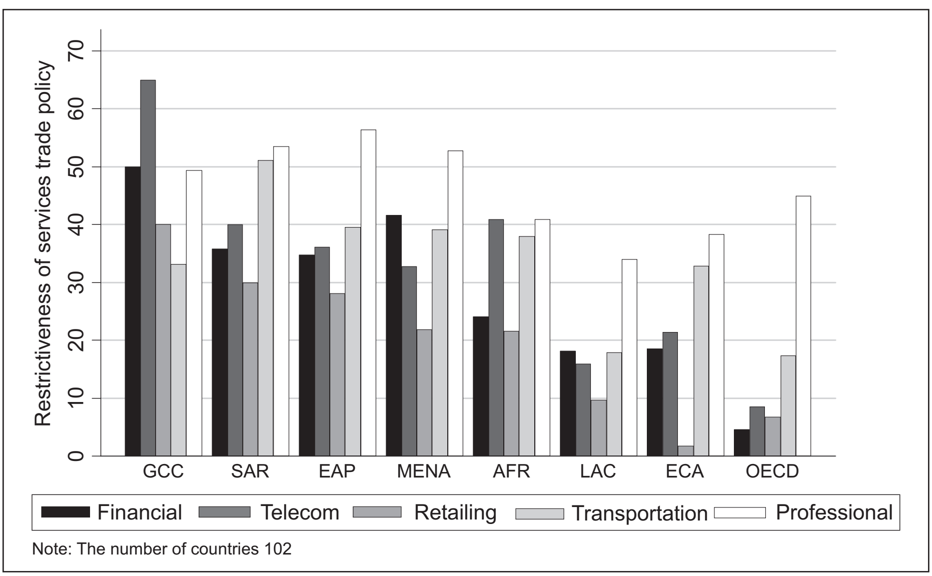

Figure 1.15. STRI by region and sectors

Conclusion

The services sector can be a driver of growth in many countries, regardless of size, location or stage of growth. But, there must be a clear understanding of the enabling conditions; of the fact that engaging in services exports means integrating the global economy. Hence, structural as well as regulatory reforms often are preconditions for service-led growth.

Notes

1. Mattoo, A, R Rathindran and A Subramanian (2001). 'Measuring services trade liberalization and its impact on economic growth: an illustration', Policy Research Working Paper Series 2655, The World Bank.
2. Arnold, J, B Javorcik and A Mattoo (2007). 'Does services liberalization benefit manufacturing firms? Evidence from the Czech Republic,' Policy Research Working Paper Series 4109, The World Bank.
3. Winters, AL (2008). 'The Temporary Movements of Workers to Provide Services' in A Mattoo, RM Stern and G Zanini (eds), *A Handbook of International Trade in Services*, Oxford University Press.
4. Mattoo, A and R Rathindran (2005). 'Does health insurance impede trade in health care services?'. Policy Research Working Paper Series 3667. The World Bank.
5. Tarr, D (2007). *Russian WTO Accession: What Has Been Accomplished, What Can be Expected.* World Bank Publications.
6. Source: WTO estimates, February 2010 presentation at WBI services trade course in Vienna.
7. Borchert, I and A Mattoo (2009). 'The crisis-resilience of services trade', Policy Research Working Paper Series 4917, The World Bank.
8. This online database allows the user to generate country rankings, charts, tables and maps and to define time periods and country groups: www.worldbank.org/wti.
9. The STRI is based on responses to a questionnaire sent to local legal or management consultancy firms in 78 developing countries and, for the OECD countries, information publicly available online.