Chapter 1

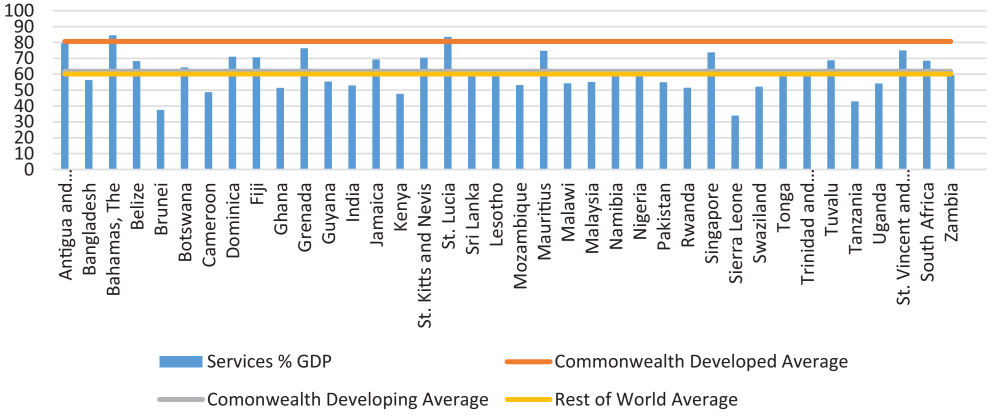
Introduction

The services economy is critically important for Commonwealth developing countries in particular. On average, it accounts for just over 60 per cent of gross domestic product (GDP), although there are considerable variations: in some cases, services make up over 80 per cent of GDP (Figure 1.1). The two countries chosen for this pilot study, Kenya and Rwanda, have services sectors that constitute, respectively, 48 per cent and 52 per cent of GDP—numbers that are fairly typical for countries at their income levels but below the Commonwealth developing country average.

In addition to their standalone role in the economy, many services are also important inputs into the production of other types of economic output, in particular tradable manufactured goods. At the local level, productivity spillovers from services to manufacturing are significant, which in turn means that services policies that promote productive upgrading can in turn spur manufacturing growth and increased trade (Hoekman and Shepherd, 2015). As such, services can be part of a broad-based approach to promoting structural change in developing countries—a point that is particularly true of 'backbone' services like transport and logistics, finance' and telecommunications, which help link local producers with global markets. Indeed, recent research shows that one factor contributing to the relative economic isolation of landlocked countries is restrictive services policies in sectors like transport and communication, which could connect them better to world markets (Borchardt et al., 2017).

In an increasingly globalised world, trade is a more important part of the equation for developing a competitive services sector. Whereas economists have traditionally

Figure 1.1 Services in Commonwealth developing countries, 2015 (% of GDP)



Source: World Development Indicators.

seen services as largely non-tradable, the World Trade Organization (WTO) General Agreement on Trade in Services (GATS) sets out four modes of supply whereby practically any service can be traded in principle, even if trade in fact rarely occurs for certain subsectors, owing to high levels of trade costs. Exporting services, either directly or indirectly through their embodiment as inputs in traded goods, can help diversify a country's economic base and increase its resilience to shocks. Indeed, research has shown that services trade was more resilient than goods trade during the global financial crisis, even though the crisis itself originated in the US financial services sector (Borchert and Mattoo, 2010). It is important to keep in mind, however, that importing services also offers major economic benefits, such as greater competition, higher investment, lower prices, higher quality and increased productivity and competitiveness (EAC and World Bank, 2016).

However, despite the optimism in relation to services trade for development and the significance of services in promoting structural change and economic development, as well as supporting employment, understandings of unnecessarily trade restrictive trade barriers are constrained by a paucity of data on services trade and associated policy measures. The primary reason for this is that, unlike with goods, applied services policies are difficult to categorise and quantify, because they take the form of regulatory measures, not simple taxes (tariffs), and are often applied behind, not at, the border.

The international community's appreciation of the role of services within contemporary trade has nevertheless been transformed since the introduction of trade in value added databases, which more clearly identify their role within value addition processes (the increase of which is the only known way to enhance growth in the long run). However, coverage of Commonwealth member countries within internationally renowned databases is limited. There is a need for more systematic evaluation and expansion of Commonwealth country coverage in globally recognised services policy review mechanisms.

Building on pioneering work by the Australian Productivity Commission, the World Bank and the Organisation for Economic Co-operation and Development (OECD) have both set out to create regulatory databases that can form the basis for Services Trade Restrictiveness Indices (STRIs), disaggregated by GATS mode of supply and by sector. Kenya and Rwanda are both included in the World Bank's STRI, but data are now relatively old (around 2008–2010)—although the World Bank is currently working with the WTO to update data. They are not included in the OECD STRI because the OECD has no mandate to work on these countries.

In the absence of up-to-date and accurate data on policy measures affecting services trade in countries like Kenya and Rwanda, it is simply impossible to undertake quantitative research on services. As a result, governments and stakeholders have little information at their disposal in relation to the development and poverty reduction potential of services, which could also help identify proactive measures to support productivity upgrading and structural transformation.

This study seeks to overcome these important knowledge gaps. First, it demonstrates the feasibility of collecting rigorous, internationally comparable data on policies affecting services trade, in low-income Commonwealth countries. Second, it shows that the data and indices are fully comparable with existing OECD data on 44 developed and emerging economies. Third, the study intends to spur research on trade in services in Commonwealth developing countries, and in particular in Kenya and Rwanda, not only by providing hard data that can be used in quantitative work but also by raising issues of substance and methodology that deserve further investigation.

Against this background, Chapter 2 briefly presents the services economy in Kenya and Rwanda, focusing on recent developments in trade and production. Chapter 3 moves to the methodology for the project and discusses in detail the rationale behind an STRI, as well as the view that the OECD approach is preferable to others. Chapter 4 presents an overview of results in comparative perspective. Chapter 5 looks to complement the STRIs using data on *de facto* constraints affecting services firms in Kenya and Rwanda. Finally, Chapter 6 concludes and offers policy recommendations.

References

Borchert, I. and A. Mattoo (2010) 'The Crisis Resilience of Services Trade'. *Services Industries Journal* 30(13): 2115–2136.

Borchardt, I., B. Guoties, A. Grover and A. Mattoo (2017) 'Services Trade Protection and Economic Isolation'. *World Economy* 40(3): 632–652.

EAC (East African Community) and World Bank (2016) *East African Common Market Scorecard 2016*. Washington, DC: World Bank.

Hoekman, B. and B. Shepherd (2015) 'Services Productivity, Trade Policy, and Manufacturing Exports'. *World Economy* 40(3): 499–516.