MAIN FACTORS AFFECTING THE GROWING SHARE OF SERVICES IN INTERNATIONAL TRADE

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Abstract:

Despite the huge disproportion between the value of goods and services in world trade, since 1980s the share of the latter has considerably grown. Though services still account for some 20 percent of global trade, this number may soon exceed 50 percent. There are many impediments to trans-border trade in services, making many of them even non-tradable. Some of these barriers result from the specific features of services (i.e. invisibility, intangibility, non-storability, the need of simultaneous production and consumption), other spring from poor quality of service statistics (data are not comprehensive, detailed, internationally comparable, don’t include sales from foreign affiliates providing services and intra-firm transactions) and finally from still sound protectionism in this sector in many countries. However, many new processes taking place nowadays make it possible to believe that the twenty first century will be the century of internationally traded services. First of all, technological progress creates new opportunities, allowing to overcome above mentioned characteristics of services which have made them either non-tradable at all or reducing the value of trade. Secondly, over the past few years there have been developments in the collection of data on trade in services. Due to recommendations included in the The Manual on Statistics of International Trade in Services there appeared a chance of better estimation of international trade in this sector. Thirdly, common processes of privatization, deregulation and, last but not least, liberalization allow to overcome barriers to service trade flows increasing their value all over the world.

Key words: international trade in services, liberalisation, international economic policy.

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The purpose of the paper is to analyse main factors influencing the growing share of services in international trade. Besides the usual protectionist barriers, the value of trade is restricted by specific features of services. However, technological progress and changes in national and international economic policy make it possible for more and more services to be exchanged internationally.

**Specific features of services and their consequences for trade**

Services are often regarded as intangible, invisible and perishable, requiring proximity between the provider and the consumer, e.g. hotels, restaurants, hairdressing. It has a crucial implication for the nature of services trade: very often a necessary condition of international transaction is the factor mobility. Trade in many services is therefore linked to foreign direct investment and labour movement. Of course, it is possible to give examples of services that have "always" been present in international trade, as they are natural complements to merchandise trade. In particular these are: finance, insurance and maritime transport. There are also services that can be exchanged internationally separately, for example computer and information services, communication, architectonic designs, etc. On the other hand, large segments of the services economy, from hotels and restaurants to personal services, have not been traded internationally. Additionally, lack of technical possibilities to provide services over the borders resulted in common opinion that services are generally non-tradable.

Services play a vital role in most countries, regardless of their level of economic development. They account for the growing, and in developed countries – dominant, share of gross domestic product (Fig. 1). In most economies of the world there is a tendency of shifting employment from goods producing sectors (agriculture and industry) to service sectors. It is particularly well documented in all industrialised (OECD) countries, for which detailed and long-term data exist. As far as developing economies are concerned, data are usually available for one or two years.
The contribution of services in the domestic economies is in huge contrast to the relatively minor share of services in global trade. World exports of services accounts for some 20 per cent of total world exports, despite the fact that since 1980 it has been the fastest-growing component of global trade (Fig. 2).

Moreover, comparison of the value of services produced to those internationally traded reveals very low level of services internationalisation in relation to agriculture and industry products. In 2000 this ratio was some 7 per cent while in case of merchandise it was about 50 per cent.
In order to explain above mentioned asymmetries, a distinction of services with regard to their potential for trade can be useful. International trade in services is dominated by so called infrastructural services, i.e. enabling international transactions both in goods and other service sectors. The examples include transportation, communication, finance and insurance services. All together they account for about 70 per cent of world services exports, while their share in GDP and employment is relatively small (except financial services). In 2001 transportation and communication in OECD economies accounted for averagely 8 per cent of GDP and 6 per cent of employment. Contrary situation takes place in case of service sectors almost absent in international trade but representing a huge part of domestic output and employment. Two categories of services can be distinguished here. Firstly, these are public utility services (water and energy distribution, post and telecommunication, some social services) and retail and wholesale trade. Together they account for the largest share of GDP and employment in most countries. Their absence in international trade can be partially explained by the need of their simultaneous production and consumption and thus lack of technical possibilities of cross-border trade and partially by closing them to international competition. Many of these sectors are regulated by governments and no trade can develop here.

Secondly, there are some business services (for example professional, computer and advisory services) having quite big influence on domestic economies, but disproportionately small representation in international trade. Demand for many business services is structured by local culture and can be hardly satisfied by any external suppliers. What is more, international supply of services is often more complicated and more expensive than supply of manufactured goods. Higher transaction costs thus occur. Firstly, it is because of higher level of consumer tailoring and services uniqueness. Secondly, since there is generally a greater human element in services production, their quality can rarely be standardised. Thirdly, until recently most of the information provided as well as knowledge and experience essential for interpreting the information was tacit and non-codifiable. It required expensive, personal contact to provide this kind of services. Additionally, the possibility of unauthorised use of the information or knowledge (for example by means of copying) creates a threat for the legitimate owner of it [Sauvant, Mallampally 1993, p. 55]. Fourthly, business organisations in services are systems interacting with costumers and their internationalisation involves more sophisticated organisational structures and
involvement of high quality human resources than most manufacturing sectors. As a result, changes in enterprises planning to export services are also usually larger and deeper than in case of exporting goods. Finally, low level of internationalisation of business services is due to lack of incentives of enterprises to develop international activity. This is because in many sectors services are provided by small, private, family based organisations (for example shops, but also services of lawyers, physicians, engineers). Their basic objective is to maximize the owner’s profit not to increase the output and market share [Guile, Quinn 1988, p. 174-175]. Needless to say that these possibilities are anyway limited because of small production, marketing and other capabilities.

Above mentioned features of services create substantial problems with appropriate assessment of the value of services trade. As a result, this value (so their share in world trade too) is most probably underestimated. First of all, there is a difficulty concerned with registering a service crossing the border, just because it is intangible and invisible. Data are collected through systems based on bank settlements, from foreign exchange controls (which rarely provide information on kind of service transaction) or market surveys (which usually are not complete). It is even more difficult as services are often closely linked to goods: either embodied in them (e.g. computer programmes) or supporting sales of them (e.g. advertising campaigns) and therefore unable to be separately assessed. Some service export transactions are never recognised. It is especially common in case of selling services to non-residents staying temporarily abroad. It is almost impossible to say for example how many of them buy tickets to cinemas or sports events in Poland.

The second set of problems concerns comparability and credibility of data. Data are not comprehensive, detailed or internationally comparable. Countries use different statistical systems and definitions of service sectors. For example, what is registered in one economy as a transportation service, in the other one can be recorded under tourist expenses. It leads to huge bilateral and multilateral asymmetries in trade. Some countries do not collect data on service activities, mainly business services. Significant asymmetries are also caused by international offshoring as multinationals do not always record electronic transactions fulfilled within the organisation. India for example recorded in 2002 exports of computer and information services worth 9,6 bln USD while its main trade partners (US, Canada, EU and Japan) imported the same services worth 294 mln USD [IFS 2004]. It is also worth noticing that comparable, detailed data
by partner countries also simply do not exist (except for some OECD countries in 2001 and 2002).

The credibility of service statistics is limited also by the fact that many service activities are undertaken in the “grey zone”, e.g. foreign language lessons offered by native speakers. Moreover, as services are often provided by small and medium size enterprises, they are more likely to hide some revenues because of less strict accountancy regulations.

Finally, the emergence of General Agreement on Trade in Services (GATS) has created new needs for information that fit the accepted definition of trade in services. GATS identifies four modes of supply of services: 1) cross-border trade (service is transmitted from a producer in one country to a consumer in another one), 2) consumption abroad (purchaser consumes the service in the country of the producer), 3) commercial presence (services supplied through foreign affiliates or short-term commercial operations), 4) presence of natural persons (producer performs the service in the country of the consumer). Such definition goes beyond conventional balance of payments statistics, which cover only transactions between residents and non-residents. Sales from foreign affiliates and the activities of the natural persons providing services abroad on a temporary basis are difficult to assess. As an interim indicator of commercial presence, foreign direct investment (FDI) statistics are used, until a new statistical system (Foreign Affiliates Trade in Services, FATS) is fully implemented. Data on services provided by natural persons are partially covered by balance of payments statistics, i.e. trade in business, computer and construction services, compensation of employees and workers’ remittances. However, the last two categories apply to all sectors of the economy, not only services.

The growth of services trade recorded in statistics spring partially from the better estimation of international trade in this sector. Services as such have relatively recently become a subject of economic analyses, new needs are identified, new methods are being developed. It seems that it is only a matter of time to assess trade in services in accordance with GATS definition. Some technical (e.g. relevant human resources and equipment in developing countries) and conceptual (e.g. a method enabling clear division between goods and services) problems must be overcome. During the last decade a lot has been done to make services statistics at least partially as good as merchandise ones.
Technological progress

Technological progress opens up increased possibilities for international trade in services. It helps to overcome specific features of services impeding so far their international trade. In case of some services activities, telecommunication achievements have actually abolished borders between states. Costs of many other services have also dramatically decreased, thus making international trade profitable. Many services have gained the opportunity to be embodied in goods that are traded internationally (e.g. software, movies, music on compact discs).

The most dynamic force behind the internationalisation of services is the expansion of electronic networks (Internet). The emergence of Internet has helped to create a range of internationally traded new services (e.g. telemedicine) and remove barriers to other, formerly perceived as non tradable service products (e.g. advisory services). It enables to unbundle the production and consumption of many services (e.g. research and development, computing, quality control and other information-intensive services). Due to advanced information and communication technologies creating new possibilities of processing and transmitting data, more services can separately cross borders. Services are produced in one place and immediately consumed somewhere else. Where technical advances allow, personal contact is being replaced with long-distance communication. It is well seen in statistical data. Much higher dynamics of exports growth is recorded in sectors where no migration of provider or consumer or both is required (Fig. 3).

Figure 3. Exports of commercial services, annual average growth, 1995-2002

Technological progress positively affects so-called consumption services, directly satisfying consumers’ needs. Thanks to technological developments, many services have become much cheaper. Lower prices together with higher real incomes create additional demand for services, often perceived as luxury goods. The share of services in total expenditures of getting wealthy individuals is growing. People can afford more travels, cultural events, secure financial assets, education or health services. Increasing amount of them can be purchased abroad. Many international transactions, formerly prohibitively expensive, have now become commonplace, because people can easily move and communicate across borders. Moreover, consumers are becoming more homogeneous, due to unifying forces of media, travel, information transfers, etc. It has accelerated the move of service concepts and corporations worldwide. At the same time they are becoming more technologically literate. The increased demand is satisfied by service providers, offering more services, delivered in different forms.

The impact of information technology on tradability of producer services (services that serve as inputs into the production of other goods and services) is even greater. Information and knowledge-intensive service activities can be codified and send abroad via telecommunication networks. The process of production can be separated and the economies of scale of production can be achieved. Only intellectual and (sometimes) cultural proximity between cooperating enterprises is required.

The growing sophistication and variety of services, together with specialisation emerging from economies of scale have led companies to rely more on outsourcing than on in-house departments to provide services necessary for production [GEP 2003, p. 53]. The examples are accounting, computer services, warehousing. From an international perspective, particularly interesting is the situation when supplies are sourced from a company located abroad (either an affiliated one – captive offshoring, or non-affiliated – non-captive offshoring). Production of services can be more easily located in low-cost countries or those offering better quality, economies of scale, access to certain skills or markets. [see: WIR 2004, chapter IV]. Captive offshoring frequently involves foreign direct investment. It is undertaken either by service transnational corporations (TNC) or goods TNCs, whose affiliates support their international activities (sales, marketing, financial intermediation, R&D). Offshore investments of multinationals have also this positive effect for services trade, that they are often followed by other service providers. As TNCs are usually important clients of smaller enterprises, the latter also decide to locate abroad. Some service companies (e.g. banks,
distributors) take similar decision because of improvement in infrastructure in host countries after multinationals had decided to locate there.

The demand for production services is also driven by the very complex environment surrounding companies. They have to be innovative to survive. Thus they need more capital. It is more often raised on international financial markets which, on the one hand, require high qualifications, and on the other, generate threat of mergers and acquisitions. As a result, more services are demanded (mainly information, consulting and financial services).

Technological progress creates new possibilities for services closely connected with goods. Some of them, as mentioned above, can be more easily traded when embodied in goods. Sometimes a service is critical for successful sale of a commodity (promotion, after-sale maintenance). High-tech equipment would be useless if not supported by services. So, the importance of services has risen relatively to the value of manufactured commodities. More sophisticated consumers’ tastes play a role here, too. They make producers to diversify products and to enrich the market offer. Mass production is replaced by short series of production. Thus designing, marketing and distribution services are of special importance.

**Changes in national and international economic policy**

Except mentioned at the beginning of the paper impediments to international trade in services originating in their specific features, there are also barriers diminishing the value of this trade resulting from still sound protectionism in the service sector in many countries. Many of the barriers are not found at the border between countries, but are rather of domestic nature. Because of specific features of services it is quite difficult to “notice” the service crossing the border, and therefore to impose tariffs. The limited scope for border restrictions implies that domestic regulations have a much stronger influence on trade in services than in goods. Moreover, it is these regulations rather than traditional trade policy instruments that impede international trade in services. As regulations differ between countries (for example different technical standards, prudential regulations, qualifications requirements), they cause substantial costs.
Contrary to foreign trade policy instruments, domestic regulations are seldom included in multilateral liberalisation agreements\(^2\).

Governments use regulations to support a wide range of public policies. They help overcome market failures (mainly natural monopolies, the asymmetry of information, inadequate access to services), protect the environment, improve the safety of products, etc. Natural monopolies occur in sectors that require fixed infrastructure (distribution networks). These are so called network services, for example telecommunications, railway transport, energy and water services. Examples of services where the seller has usually the better information than the buyer include most of professional services (doctors, lawyers), public transport (safety), financial services (credibility of banks). Inadequate access to services is most probably to come about in network services and areas where the costs of networks are higher (for example telecommunication services in rural regions). Despite some positive effects, many regulations are responsible for inappropriate allocation of resources, lower productivity of production processes, higher prices. They slow innovation and job creation, reduce competitiveness and the overall wealth of nations.

In order to address these kinds of problems in the mid 1980s many governments started to withdraw from the strict regulations of service activities. All OECD countries launched regulatory reforms, emphasising the need of increasing the competition in the sector. At the same time the processes of privatisation were also started. State ownership rather than regulatory measures was for a long time considered (especially in Europe) a means to ensure public policy objectives. State companies were present in the utilities, telecommunications, transportation, financial services. Until the beginning of the 1990s the privatisation covered enterprises operating in competitive industries (banking, insurance), later it gradually concerned telecommunications, transportation, utilities [OECD 2001(a), p. 54].

Changes in domestic policies enable foreign investors easier access to service sectors so far closed to competition or accessible only after fulfilment of rigorous conditions. Large companies based in developed countries took the opportunity to expand and invest in newly privatised and deregulated sectors. That is why during the

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\(^2\) The example of European Union is very instructive. The future of the Directive on Services in the Internal Market is uncertain. If there is not enough confidence between 25 countries of similar level of development, the same culture, common general objectives it is almost impossible to reach multilateral worldwide agreement covering any matters of traditional domestic competence.
decade of 1990s the share of FDI inward stock in traditional service sectors (trade and finance) decreased in favour of transport and communications, business and some other services (mainly electricity, water supply, health and education).

**Figure 4. Distribution of FDI stock in services, by industry. 1990 and 2002**

<table>
<thead>
<tr>
<th>Year</th>
<th>Business services</th>
<th>Other services</th>
<th>Transport and communications</th>
<th>Trade</th>
<th>Financial services</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>13%</td>
<td>19%</td>
<td>3%</td>
<td>25%</td>
<td>40%</td>
</tr>
<tr>
<td>2002</td>
<td>26%</td>
<td>16%</td>
<td>11%</td>
<td>18%</td>
<td>29%</td>
</tr>
</tbody>
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The last decade has also brought substantial changes in international economic policy. The growing number of countries has noticed the need to liberalize trade in services. If all four modes of supply are taken into account, the number of possible barriers to trade is very long [see for example: UNCTAD 1994, pp. 63-137, OECD 2001(b)]. Barriers can impede the cross border flow of services, the movement of consumers and/or providers. A country has an alternative: it can liberalize its markets unilaterally (so called autonomous liberalization), or it can cooperate with other governments (bilateral or multilateral liberalization). Liberalization of service markets is essential in achieving increased efficiency and competitiveness in the provision of services. It can certainly lead to the growth of the value of trade.

The first multilateral trade agreement relating to international transactions in services to have broad industry coverage and wide membership is General Agreement on Trade in Services. It is an important step towards world-wide liberalisation of import regimes for services, even though the effects achieved up to now are not fully satisfactory. A new round of services negotiations began in 2000 and it represents a valuable opportunity to further liberalisation of trade. There are also many regional integration agreements covering the issues of liberalisation of services trade (usually in addition to goods trade). The most noteworthy ones involving developed countries are: the European Community, the European Free Trade Association, the North America Free Trade Agreement (NAFTA). Developing countries also signed a number of such
agreements, for example Group of Three Trade Agreement, Mercosur (protocol on Services), the Andean Community, Association of South Eastern Asian Nations (ASEAN) [see: Stephenson 1999 for an extensive review of approaches to liberalisation of services]. It is also worth to mention some sectoral agreements influencing international trade in services, such as UNCTAD’s *Convention on a Code of Conduct for Liner Conferences*, International Telecommunication Union (ITU), International Civil Aviation Organisation (ICAO).

**Conclusions**

The structure of international trade transforms in favour of services. The growth of services trade in relation to merchandise trade is an unquestionable fact. The disproportions between these two kinds of products in international trade are decreasing. It is also true for the internationalisation of services: the value of trade in relation to their production increases (Fig. 5).  

**Figure 5. The growth of services trade, 1980-2003**

These changes are possible thanks to many factors. The most important is the technological progress, increasing the tradability of services. It would also be hard to overestimate the role of processes of liberalisation, privatisation and deregulation, facilitating foreign providers the access to service markets. Last but not least, improvement of statistics on international trade in services plays an important role as well.

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3 Due to lack of data on the world value added in service sector in the long period of 23 years (1980-2003) world GDP was the base of the analysis.
References