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Services Trade and Global Value Chains: It's Not What You Make but What You Do

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In some ways, services play a role similar to goods in global value chains (GVCs), whether they are meant for final consumption or as inputs in the production of goods or other services. However, services deserve special attention for four reasons, relating to how they are transacted, how they affect downstream sectors, how they are regulated, and how international cooperation can contribute to integrating national markets.

How Services are Transacted

The most detailed analysis of the role of services in value chains—drawing on the new world input-output tables and value-added trade databases—relates only to situations in which services are traded in a manner akin to how goods are traded. Even though the share of services in trade in value added varies across countries and industries, it is generally high (and rising) and considerably larger than the share of services in gross trade. While directly exported value added has increased in recent years, close to two-thirds of the growth of services value added in exports is due to an increase in services embodied in exports of other sectors—particularly foreign services, revealing the growing importance of GVCs.

The reasons for these developments are variants of the older arguments for why the share of services in GDP tends to grow: the splintering or outsourcing of services activities from manufacturing firms; the growing importance in a GVC world of connecting services like telecommunications and transport; the growing services component in sophisticated manufacturing goods, such as software in cars; and the increase in the prices of services tasks relative to manufacturing tasks because manufacturing tasks are easier to offshore to lower cost locations. However, there is little empirical evidence for these arguments, and understanding the reason for these developments should be an area for future research.

For services GVCs, there are good reasons to look beyond the traditional arm's-length cross-border trade data, to encompass also transactions within countries between national and foreign entities. While there may also be a reason to take a similar broad view of GVCs involving only goods, the case is overwhelming for services because focusing only on cross-border trade would ignore the large share of international transactions in services that takes place through consumers traveling to other countries, commercial presence, and the presence of natural persons. Even though our ability to measure the role in GVCs of international services transactions through commercial presence is limited – despite efforts by the U.S. Bureau of Economic Analysis and the OECD - ways have been found to estimate their economic impact.

How Services Affect Downstream Sectors

The argument that services can have a substantial economic impact because they are vital inputs into producing downstream goods and services may not seem a sufficient reason for separate consideration. After all, goods such as computers are also vital inputs. But two features of services seem to merit special focus. One is that the very existence of GVCs is due to improvements in services like transport, communication, and computing (or information and communication technology [ICT] services) that have made it possible to fragment and coordinate production globally.

Another is the growing evidence that when GVCs include finance, communications, transport, and professional and other business services in favorable price-quality bundles and diverse varieties, firms perform better. These services enable firms to invest in new business opportunities and better production technology, to exploit economies of scale by concentrating production in fewer locations, to efficiently manage inventories, and to make coordinated decisions with their suppliers and customers. The result can be increased total factor productivity and other aspects of the performance of downstream firms. The development of domestic services sectors and access to foreign services can also shift the pattern of comparative advantage. Preliminary evidence suggests that trade-in-value-added data could help in understanding dynamic structural change and deindustrialization—areas that merit more analysis.

It's Not What You Make But What You Do

Some have called for developing a notion of GVCs that goes beyond arm's-length market-based transactions to functions within the firm. It may be feasible to distinguish between tasks that would have been services if they had taken place at arm's length (such as book-keeping) and other tasks that are intrinsically agricultural or manufacturing in nature (such as wood processing). But such distinctions slide on a slippery slope: ultimately, almost any task can potentially be conceived of as an arm's length service. A horticultural laborer can be hired as a worker in a horticultural firm, or the laborer's "fruit-picking" services can be purchased from an individual or a firm. This kind of deconstruction of a firm into its constituent tasks could reduce each firm to a bundle of services regardless of what it ultimately produces.

Perhaps what really matters is not what a person makes but what the person does. For a long time, notions of economic performance have been closely tied to economic sectors—manufacturing, agriculture, and services. In a world of fragmented production, these distinctions are hard to sustain and may not be economically meaningful. Instead, the focus could be on the implications of performing certain tasks. Do product design and marketing offer greater scope for innovation and learning-by-doing and thus for productivity growth than product assembly? Such task-based analysis—perhaps initially focusing on occupational structures—could be more help than the traditional sector-based analysis in comprehending the implications for individuals and countries of the new international division of labor.

How Services are Regulated

Even though most services markets are much more open today, thanks to unilateral liberalization, services reforms remain incomplete, and barriers to domestic and foreign competition persist. In fact, most of the policy barriers to competition and to foreign direct investment are not in goods but in services. Many countries that have reaped huge benefits from the liberalization of trade and investment in goods, continue to maintain restrictions on trade in services. Trade in transport services, in particular, remains impeded in both industrial and developing countries by the exclusion of third-country providers and by quantitative restrictions in bilateral agreements. Trade through commercial presence in banking and communication services must confront restrictions on foreign ownership and regulatory requirements that can be discretionary and discriminatory. The presence of foreign professionals is prevented by restrictive visa and work permit rules as well as by a refusal to recognize their qualifications and licenses. And trade in all data-intensive services is threatened by diverging national privacy laws.

How International Cooperation Can Contribute to Integrated Services Markets

International cooperation in services has attempted to replicate the goods model of reciprocal market opening, but so far that approach has delivered little incremental liberalization. Because the impediments are different for services-related GVCs, international cooperation needs to take a different form. Much more could be achieved through a greater emphasis on regulatory cooperation. First, and most obviously, greater regulatory convergence—as in prudential regulation-intensive financial, health, education, and professional services—is needed to create more integrated markets in which competition, economies of scale, and GVCs can develop. Second, credible regulatory commitments by exporting countries to safeguard the interests of consumers in importing countries—as for deposit protection when capital flows internationally or privacy when data flow internationally—could also induce greater liberalization of explicit barriers to international transactions by providing importing countries with the regulatory reassurance they need.