The Growth of Services and the Evolution of Comparative Advantage

by

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Three points

I. Services are growing in importance: in GDP, trade and FDI

II. Demographics and digitization are driving services growth

III. Skills and institutions determine dynamic comparative advantage
The importance of services for all countries...

Share of services in GDP and GDP per capita, current USD, 1995

Source: Work in progress with Aldo Pazzini Bortoluzzi drawing upon World Development Indicators
The flip side of premature deindustrialization is premature servicification

Source: Work in progress with Aldo Pazzini Bortoluzzi drawing upon World Development Indicators
Goods trade stumbles, but services trade does not fall

Source: IMF World Economic Outlook


Services trade declined less during the crisis and has grown faster after the crisis
The share of services in trade in value-added terms is higher and has increased more sharply than in gross terms.
In Africa, as elsewhere, most FDI is going into services.

**Services FDI stock, by industry in Africa, 2012**

(Percent of Africa's inward FDI stock in services)

- Finance: 56%
- Transport, storage and communications: 21%
- Business activities: 9%
- Trade: 8%
- Construction: 3%

**Inward FDI stock by sector for Africa, 2012**

(Percentage of total inward FDI stock in region)

- Services: 48%
- Manufacturing: 21%
- Primary: 31%

Source: UNCTAD, FDI/MNE database (www.unctad.org/fdistatistics).
II. What is driving services trade?

The interplay between:

- Demographic change
- Digitization
Drivers of services trade 1: Demographic Change
Young and old have different patterns of demand, e.g. USA

Average of consumption shares by HH types (in %)
(USA, 2012)

Broad expenditure categories
- food
- housing
- manuf. goods
- services
- other

Expenditure on services
- catering
- domestic service
- education
- recreation
- finance
- health
- hotel
- personal service
- social security
- transport
- utility

Housing includes interest on mortgage and property tax

Source: Work in progress with Erhan Artuc, Zovanga Louis Kone, Maggie Liu and Caglar Ozden
Young and old have different patterns of demand especially within services: India

![Graph showing consumption shares by HH types in urban and rural areas](image)

Hi, j, k denotes household of size i, with j children (i.e. of age 0-17) and k elders (i.e. 65+)

Source: Work in progress with Erhan Artuc, Zovanga Louis Kone, Maggie Liu and Caglar Ozden
Therefore, demographic change is influencing services trade by affecting the demand and supply of services.
China’s rebalancing and demographics are already shifting demand towards services

Drivers of services trade 2: Digitization

The international fragmentation of goods production includes both goods parts and services tasks.

Driven by, and boosting demand for, information, communication and transport services.
In parallel, the international fragmentation of services production is creating new opportunities for trade.

Call Centre for customer service, etc.

Medical transcription services

Web hosting and webmaster services

Outsourced consultations and diagnostics

is creating new opportunities for trade
III. What determines comparative advantage in services trade?

The interplay between:

• Endowments, especially of skills
• Infrastructure, especially telecommunications
• Institutions, especially regulatory
Skills matter: Evidence from Indian states

Skilled to total labor ratios across sectors

Services output per capita against tertiary educated per capita

Source: Amin and Mattoo (2006).
And the quality of institutions matter: Evidence from Indian States

Diversity of input sources and output destinations across sectors as measure of institutional dependence

Services output per capita against a proxy for institutional weakness (T&D losses of electricity utilities)

Source: Amin and Mattoo (2006).
The evolution of comparative advantage and structural change: Insights from new value added trade data

Direct and indirect value added exports of financial services, share of GDP, 1995-2009

Direct and indirect value added exports of business services, share of GDP, 1995-2009


Note: Does not include Ireland and Luxembourg
Skill endowments rather than skill intensity may constrain unskilled employment

The surprisingly high unskilled labor value added in services exports

Labor value added (LVA) in $1000 of exports

Source: Joint work with Alen Mulabdic based on Cali et al (2016), "The Labor Content of Exports Database."