

Promoting Services Sector Development and Trade-Led Growth in Commonwealth Developing Countries

I. Contextual Background

1. The related challenges of maintaining economic growth, creating jobs, and reducing inequality are central and challenging problems for all members of the Commonwealth, one which poses immense risks to social and political stability. Unemployment rates vary across the Commonwealth; available data shows that at least 17 Commonwealth countries have rates in excess of 10 per cent some as high as 50 per cent. The majority are also grappling with high levels of entrenched youth employment. For many, the phenomenon of “jobless growth” has consigned millions to underemployment and poverty. At the same time inequality is on the rise and has significant economic and social costs for both individuals and society. Rising social inequality has recently been identified as one of the top three risks, which could reverse the gains of globalization by the World Economic Forum in its report on Global Risks 2012.

2. Addressing these central challenges is no easy matter. The current global context has narrowed economic opportunities – for growth and job creation – and has increased the risks faced by many Commonwealth countries. Following the economic crisis of 2008, many countries have less fiscal space to deal with the continued uncertainty and instability of the global economy, as well as with growing inequality and the threat of social unrest at home. The shift in the centre of economic gravity from West to East brings new opportunities but also challenges as established export markets falter. New sources of growth – in the area of primary commodities and emerging services growth centres, for example – bring new policy challenges as governments struggle to turn impressive headline growth figures into more jobs and improved social outcomes.

3. The group of countries in the Commonwealth illustrate the variety of challenges faced in the global economy today and the Commonwealth Secretariat is therefore pleased to be afforded the opportunity to share some of the work it has been undertaking on these issues through the promotion of services sector development and trade-led growth. For many countries in **Africa and Asia** have re-emerged from the economic crisis, but face a longer-term problem – which pre-dates the crisis – in that economic growth is not creating sufficient jobs. **The policy challenge for these countries is to translate growth into rising employment and improved social outcomes.**

II. The Commonwealth’s Work on Trade in Services

4. In supporting its members respond to some of the above-mentioned challenges, the Commonwealth Secretariat has recently focussed its efforts in undertaking a combination of analysis and the sharing of information and good practices on policies geared at sectors with the potential to generate significant productivity gains. Productivity growth in developing countries depends on both within-sector improvements (e.g., adoption of better technologies)

and structural transformation. That is, a reallocation of labour from low productivity activities (e.g., subsistence agriculture) to more dynamic sectors (e.g., manufacturing and ‘modern’ services).

5. For the African and Asian region, strengthening South-South collaboration through the development of regional supply chains to cater for global production networks has been pursued collaboratively with UNCTAD through its joint project on **“Intra-Regional Trade and Potential Supply Chains in Asia and Sub-Saharan Africa”**. The comprehensive analytical studies produced and shared with stakeholders have produced strong evidence that Southern countries have sufficient complementarities to form effective supply chains in three industries - Food Processing Industries; Textiles and Clothing Industry; Leather Industry. Greater international cooperation and policy coherence can also ensure that these trade relationships support growth, employment and poverty reduction in these regions.

6. To complement the above-mentioned work undertaken on supply global chains and in recognition of the importance of services as enablers of this process, the Commonwealth Secretariat has also commenced preliminary analysis on **The Services Trade Dimension of Global Value Chains¹ and its Implications for Commonwealth Developing Countries, including Small States**. Analysis has also been undertaken on **the Role of Aid for Trade in Promoting Global Value Chains for Developing Countries**.

7. Two further sets of issues can also help promote employment inducing growth through the service sector. Firstly, agreement on implementing the WTOs **services modalities for LDCs**, to provide a workable mechanism for granting preferences to the services exports of poorest and most vulnerable countries - analytical work and dialogue will be commencing shortly on practical measures for operationalizing these LDC services modalities for LDCs. Secondly, effectively negotiating favourable rules and market access arrangements in the key emerging growth service sectors of development interest to Commonwealth developing countries, including the African region - through bilaterals, regional integration and economic cooperation arrangements and also through multilateral arrangements. The Commonwealth Secretariat has also been providing ongoing support to its members in this areas.

III. Services Trade Dimension of Global Value Chains and Opportunities for Commonwealth Developing Countries, including Small States

8. There has been much attention in the trade policy conversation to global supply chains for goods. It has become better understood in the process that for many elaborately transformed manufactures the highest value-added is contributed by services inputs, often at the R&D and design phase, or at the logistics/distribution phase. What remains much less well understood is the fact that value chains, including global value chains, exist not only in

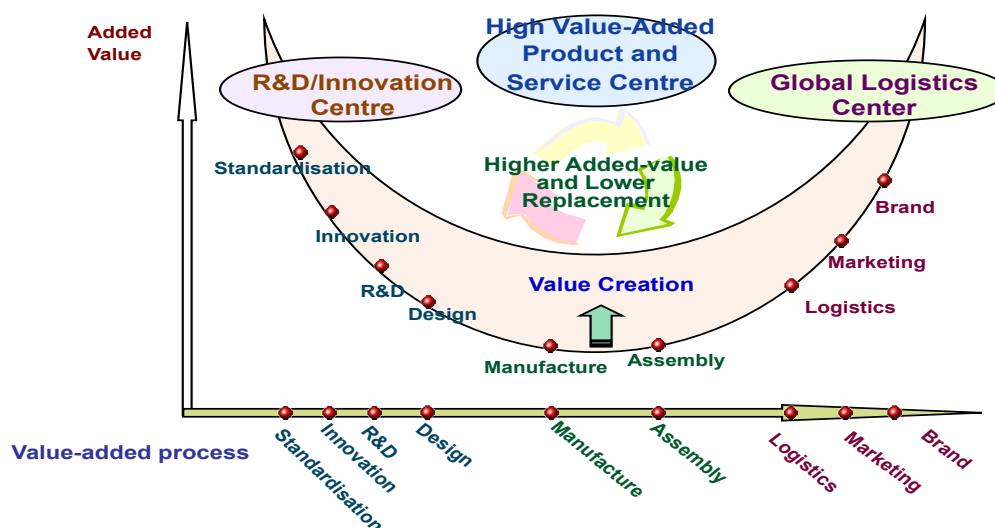
¹ Some clarification is required of the concepts, generally used inter-changeably in the literature, between Global Supply Chain, Global Value Chain and Global Production Chain. The Commonwealth paper adopts the modern “holistic” definitions. Global Supply Chain is the terminology given to a system of organisation of people, technology, activities, information and resources involved in moving a good or service from supplier to consumer. Global Value Chain (which for services often looks more like a network than a “chain”) refers to the full spectrum of value-added activities required to bring a good or service from its conception, through design, sourcing and intermediate inputs, production, marketing, distribution and support to final consumers. Global production chain tends to refer to the linkages within or among a group of firms or suppliers in a particular global value-chain for producing specific outputs. All of these concepts apply also at the regional level.

the goods sectors but also in the services sector itself. Further region-specific research and expert group dialogue is anticipated on these issues over the next coming months.

9. Services play an intrinsic and increasingly important role in the goods supply chain. Services inputs provide the “link” or the “glue” at each point of the value chain, without which it could not happen (for example transport, telecoms, logistics, distribution, marketing, design and R&D). The traditional goods chain both starts and ends with a series of pure services activities and embodied services are involved throughout the processing and manufacturing steps in the chain (such as product design or factory plant controlling software). Embedded services are often supplied with the good (such as maintenance and repair, product insurance, leasing the product recall and waste services). In modern economies which have high services proportions of GDP, merchandise suppliers cannot function without the intermediate services. It is, moreover, the application of enabling services such as telecommunications and IT which have driven segmentation of the supply chain into production units which can be dispersed geographically, and yet be connected.

10. The “Smiley Face” diagram below provides a good visual illustration of the role of services in value added where the highest value added services activities such as R&D/innovation or global logistics, increasingly dominate production value. While the original node of the production process is at the bottom of the “Smiley Face” in the form of manufacture/ assembly, the activities that add value to this core are located on either side of the value chain as they increasingly contribute in value to the final product, moving up to the R&D/innovation centre and the logistics centre, with all of the value added in between coming from services activities. To improve competitiveness, firms are seeking to move up the value chain on either side of the “Smiley Face” through moving into higher value-added services activities, and to focus on each firm’s individual core competency while outsourcing all the rest. This process increasingly atomizes international production and trade.²

Figure 1: The “Smiley Face” – Role of Services in Value-Added

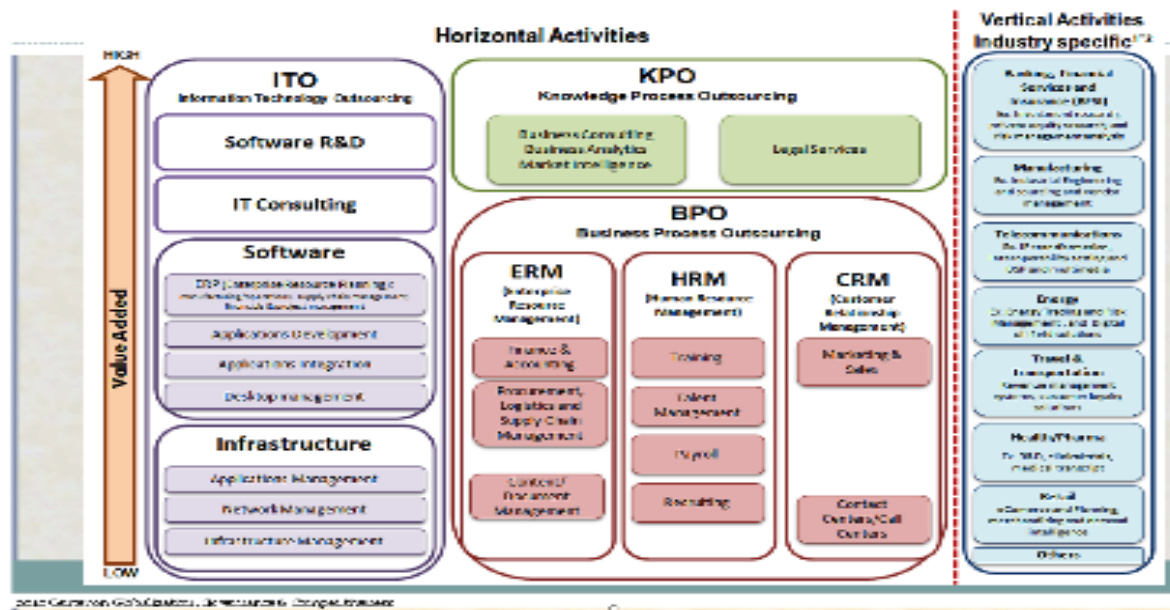


² Rabach and Kim in Gereffi and Korzeniewicz (1994)

Source: Source: *Business Week International online extra, May 16 2005, Stan Shih on Taiwan and China*

11. Studies of regional and global supply chains in goods have started to confirm the predictions of the “Smiley Face”, drawing attention to the fact that for many elaborately transformed manufactures the highest value added is contributed by services inputs, often at the R&D and design phase – or at the logistics/distribution phase. All kinds of tasks along the intermediate phase of the “Smiley Face” between these two high value-added ends are increasingly being outsourced and offshored to wherever each individual task can be most efficiently performed. This intermediate or intra-firm trade is “trade in tasks”.

Figure 4: The offshore services value chain



Source: Gereffi (2010).

12. The three main segments of services offshoring activities in the diagram are Information Technology Outsourcing (ITO), Business Process Outsourcing (BPO) and Knowledge Process Outsourcing (KPO). The ITO segment has four categories; software, R&D, IT consulting, software, and infrastructure. The BPO segment contains 3 main categories including enterprise resource management (ERM), human resource management (HRM), and customer relationship management (CRM). The KPO segment includes business consulting, business analytics, market intelligence and legal services. Each of the various activities or services “tasks” shown under the ITO, BPO and KPO value chains is representative of a different level of value-added. For example, software R&D adds more value than network management in the ITO value chain. Likewise, finance and accounting add more value than document management in the BPO services value chain. And business consulting adds more value than market intelligence in the KPO services value chain. The competitive challenge for firms is of course to move up the value chain or to cover a larger number of related activities in the services value chain.

13. This categorization provides an initial blueprint for economic upgrading strategies within the industry, as firms attempt to “climb” the value chain for offshore services. The substantial growth of the offshore services industry presents a challenge when it comes to collecting data for the relevant services. According to OECD estimates, the size of the offshore services market would have been about US\$252b in 2010. The highest compound

annual growth rate has been experienced in the KPO segment (58 percent), with ITO (26 per cent) and BPO (25 per cent) following.³

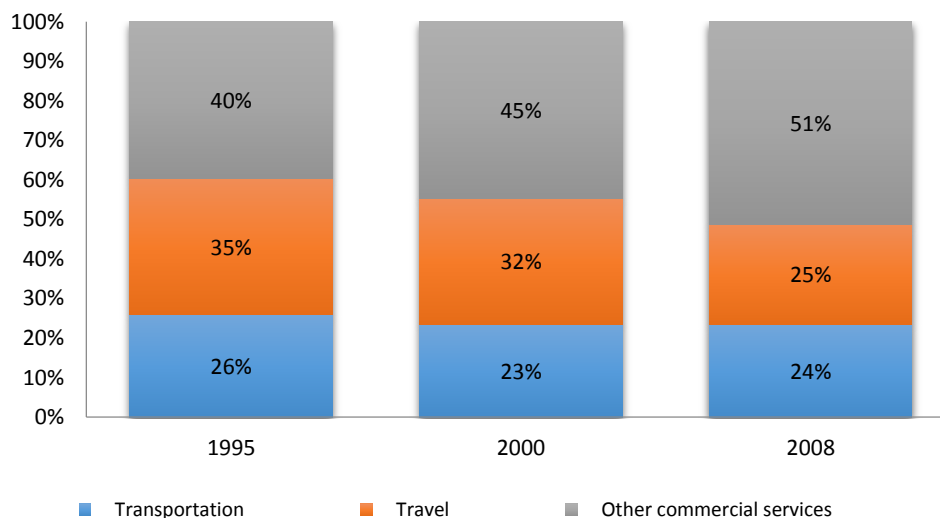
14. Research on pure services value chains is only in the beginning stages and there are not yet many examples of close mapping of this relatively new but growing phenomenon - examples for Tourism and Banking value chains are available. Value chain maps help businesses and governments to understand better where local enterprises are located in the broader value chain. This is a first analytical step in the process of identifying the means by which to climb the value-added ladder on either side of the relevant industry “Smiley Face”.

III.1 Development of Service Supply Chains, Trends and Emerging Service Growth Centres

15. The development of services supply chains has resulted in the composition of services exports undergoing significant change. “Other commercial services” are becoming more important than the traditional “travel” and “transport” components of world services trade. The biggest contributors to the recent growth have been the knowledge-intensive business services such as telecommunications, computer and IT Services, R&D Services, financial services, legal, accountancy, management consultancy services, architecture, engineering and other technical and professional services, advertising, market research, media and energy and environmental services.

16. Figure 12 shows that “Other Commercial Services” are growing in relative importance, vis-à-vis the traditional services sectors of Transportation and Travel. Other commercial services includes business services and ICT services, precisely those IT-enabled services which have the potential to fragment into inputs into value chain operations.

Figure 3: Changing composition of world services trade



Source: Saez (2011)

³ OECD 2011

17. Traditionally, services providers were constrained by their inability to capture, store and possess the value of the intangible. There were few opportunities to create step by step “pathways” to market as services tend to be delivered and consumed simultaneously. The application of information technology is radically changing this; there is now a constant quest in the services sector to segment out any business function in which knowledge can be commoditized and packaged as a “product”, and where ownership can be established, production can be scaled up and trade can take place separately from production. This innovative business process transformation is involving SMEs as well as creating globally integrated services firms.

III.2 Participation in Services Exports and GVCs by Commonwealth Developing Countries, including the African region

18. It is worth noting that the recent World Bank study on developing country services exports draws attention to the fact that a number of Commonwealth developing countries have revealed comparative advantage not only in labour-intensive services, such as construction, travel and transport but also in skill-and technology-intensive services such as communications services, computer and IT services and financial services. Table 1 below, reproduced from the World Bank study, shows the index of revealed comparative advantage (RCA). When the RCA index is higher than 1, it means that the relevant product group has a higher share in the country’s exports than its share in world exports. The World Bank study suggests that common language, colonial history and legal systems have been important contributors to these various success stories.

Table 1: Revealed Comparative advantage in Services Exports for Developing Countries: A few Examples

Services Sector	Input Intensity	RCA for LDC Group	Developing Countries with RCA>1 (examples)
Communications Services	Skill and Technology Intensive	1.29	Indonesia, Venezuela, Colombia, Zambia, Philippines, Botswana, Egypt, Argentina, India
Computer and Information Services	Skill and Technology Intensive	2.08	India, Israel, Costa Rica, Sri Lanka, Uruguay, Armenia, Argentina
Construction Services	Labor Intensive	1.32	Russian Federation, Egypt, Malaysia, Senegal, Mozambique, Tunisia, Indonesia, Slovenia, Israel, Turkey, Botswana
Financial Services	Skill and Technology Intensive	1.30	Tajikistan, India
Insurance Services	Skill and Technology Intensive	0.33	Bahrain, Mexico, Peru, Bolivia, Botswana, Zambia, Paraguay, Sri Lanka, Armenia, Chile, Brazil, Turkey
Other Business Services	Skill and Technology Intensive	0.72	Lebanon, Brazil, Paraguay, China, Oman, Israel, Argentina, Philippines, Russian Federation, Botswana, India
Transportation	Labor and Resource Intensive	1.84	Chile, Ethiopia, Azerbaijan, Sri Lanka, Kenya, Egypt, Uruguay, Colombia, Iraq, Tunisia, Pakistan, China, Malaysia
Travel	Labor and Resource Intensive	1.69	Mexico, Turkey, South Africa, Costa Rica, Tunisia, Philippines, Malaysia, Egypt, Colombia, Indonesia, Argentina

Source: World Bank (2011)

III.3 Pre-conditions: Global Services Value Chains as Catalyst for Economic Growth and Key Inputs into Main Production Sectors

19. The global evidence is that there are prerequisites required for Commonwealth developing countries to enter Global Services Value Chains successfully and that these become more critical at higher points of value-added. One prerequisite is digital infrastructure and in particular, cost effective and reliable telecommunications links. Other prerequisites include technical interoperability, mutual recognition and global standards conformity and assurance. Investment in tertiary education and human capital is also vital. Technical assistance and capacity building efforts need to be expanded to cover services economy infrastructure.

III.4 Developmental Gains from Global Services Value Chains

20. Entry into Global Value Chains can play an important role as a source of jobs and growth for Commonwealth developing countries, including members in the African region. Participation in the international production chains in the services area are potentially more viable than participation in GVCs in the goods area for a number of reasons;

- **First**, services are not linked to natural resource endowment. Firms do not need to make use of petroleum reserves or commodities when they are producing services.
- **Second**, for services, GVCs do not depend as much on the geographic location of the participating firms as transport costs for services, especially when provided cross-border, are negligible. This means that distance should not be a major factor in terms of cost or offshoring decisions; however, proximity to markets can play a role in investor decisions in terms of time zones and how off-shored services are used in inputs to traded goods, where transport does play a big role. Likewise, landlockedness and remoteness should no longer be the obstacles to trade that they once were.
- **Thirdly, one of the main developments for developing economies of the new possibilities offered by services and GVC is that its possible for governments to ‘create’ a comparative advantage in a service task.** Since services are all about people and human capital rather than physical capital, the role of policy can be determinant in this regard. Government programs to train service providers, including importantly in the use of English as well as in information technology skills, and the role of education in shaping the quality of the work force, can be highly critical for facilitating the ability of firms to enter GVCs.
- **Fourthly**, services unlike goods, are not subject to economies of scale in the same manner. Thus producing a greater or smaller quantity of a service activity will affect the final price comparatively little as compared to the labor productivity and the skill content and innovation going into it. For those countries on the lower income rankings, services may provide a platform for “leap-frogging” stages of development if the government can help to create conditions necessary for developing the services sector, allowing countries to bypass the manufacturing stage and move directly into services, including in international markets.

21. There are other positive spillovers they can generate which are less well appreciated.

For example, the opportunities that they open up for women which are broader than those they have traditionally played in developing economies. This is because much of the intermediates and ‘tasks’ are in the services sector where the majority of women are employed. Services activities do not require hard manual labor, nor risky and dangerous occupations. They can more easily be combined with part-time schedules as well, all of which facilitate the employment of women in the services sector. Contributing to tasks in Global Value Chains is therefore an additional way to bring more women into the labour force, which has been shown to be a major factor in alleviating poverty and improving childhood educational opportunities.⁴

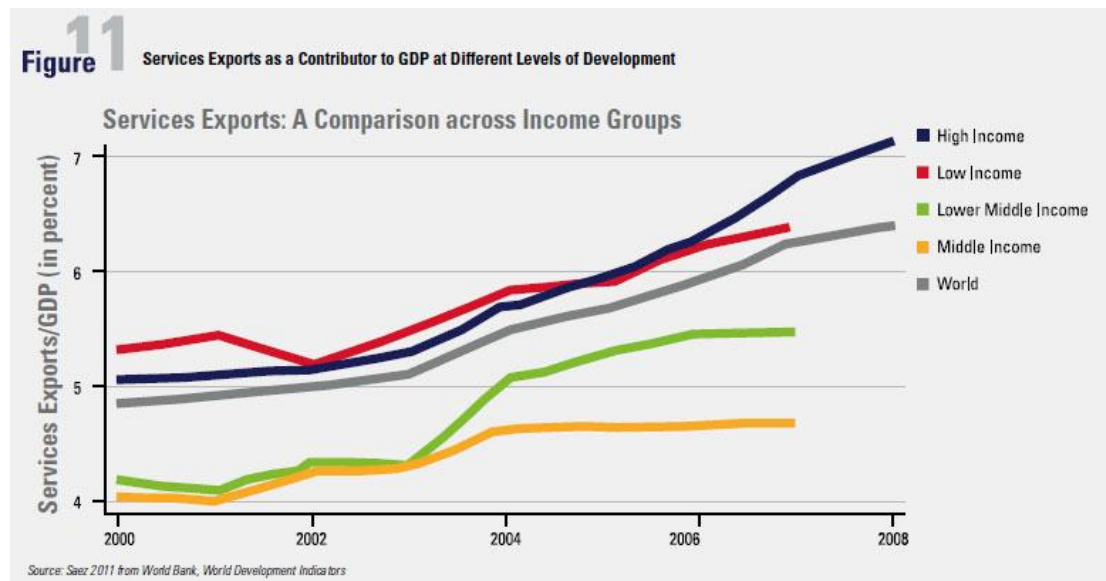
22. It is also important to differentiate between the “value chain” *per se* and “capturing value in the chain”. For purposes of poverty alleviation, low value-added jobs are equally as important as high value-added jobs, especially for developing countries in their first experiences in capturing a services task, or if their level of human skills do not offer opportunities otherwise. Often low value jobs are the first step toward gaining participation in GVCs. The Intel experience in Costa Rica is a case in point which highlights how one small developing country has been able to participate in GVCs to advance its own development, beginning with insertion into a GVC at the lower end with the objective of job creation, poverty alleviation and skills training, and subsequently being able to move higher.

23. On a cautionary note, domestic stakeholders often fear that participation in global activity could prove unsustainable and sometimes mean the future elimination of a services “task” or an intermediate input. GVCs do magnify and accelerate skills-biased technological change and firms/countries need to adapt. In a globalized context, firms can relocate services ‘tasks’ very quickly to countries with lower costs, better skills and/or a more enabling trade environment. In this context, the challenge of is to focus on appropriate education and skills training in order to create the appropriate competitive conditions to retain firms, but also to help retrain those who may be affected by job loss.

24. Figure 2 below shows that services exports are already contributing over 7 per cent of GDP for high income countries but still well below 5 percent for middle income countries. Importantly, as shown in this figure, services exports are making higher contributions to GDP for poorer countries than for middle income economies; just under 6 percent for lower middle income economies and just over 6 per cent for low income economies. Of particular significance for Commonwealth developing and small states, this suggests that the services sector offers a viable alternative development route, potentially enabling poorer economies to “leapfrog” over manufacturing. Finding a way to “fit” into a global value chain through taking on an outsourced services task is one of the ways that countries can target and achieve this objective.

⁴ World Economic Forum (2012)

Figure 2: Services exports as a contributor to GDP at different levels of development



III.5 Policy Recommendations

25. Policy recommendations on Global Services Value Chains Developments for Commonwealth Countries include:

- i. Inadequate donor activity, individually or jointly, exists to fix the widespread information deficit on the services sector, on the services dimension of global value chains and on services trade opportunities for Commonwealth developing and small states. **Improving the evidence base and disseminating the results should be a prime focus of technical assistance and capacity building.**
- ii. Commonwealth developing countries would benefit from greater opportunity to share and disseminate international experience regarding policy and regulatory settings which have proved conducive to attracting services work for the global market onshore. **Further background research should be conducted and case studies collected to inform an active policy and regulatory dialogue at regional and pan-Commonwealth level.**
- iii. Many services are infrastructural in nature and local inefficiencies in their supply are prejudicing Commonwealth developing countries opportunities to participate in Global Goods Value Chains. **Achieving efficiency gains in logistics services and transportation and otherwise facilitating two-way cross border trade in goods should be a sustained focus of Commonwealth developing country policy attention.**
- iv. In value-added terms, services account for nearly half of world trade and the upward trend is clear. Services similarly dominate global investment flows. **Developing country trade officials should be encouraged to give much higher attention to trade and investment in services, including in inter-governmental negotiation at the bilateral, regional, mega-regional, plurilateral and multilateral level.**
- v. Participating in Global Services Value Chains necessarily requires openness to services trade, including to imports of services intermediates. **Developing countries should prepare for greater internal policy coordination on services trade matters and more intensive public private policy dialogue and associated advocacy on Global Services Value Chains.**

- vi. Developing countries, particularly smaller and more vulnerable economies, need assistance to devise appropriate strategies to promote exports of services into global value chains. **Donor countries should partner with other trade-related international organisations to showcase services export promotion best practice methods and tools.**
- vii. Developing countries need technical assistance to review their investment and innovation policy regimes. **Capacity building efforts should focus on investment and industry policy in tandem with trade policy reform.**
- viii. Services should be given higher priority generally in development cooperation initiatives. **Capacity building efforts should be directed to identifying and leveraging the factors that impact on competitiveness both at all-of-services level and in individual prospective services growth sectors.**

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