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The role of the services economy and trade in structural transformation and inclusive development

Note by the UNCTAD secretariat

Executive summary

The services economy and trade have the potential to induce structural transformation in support of the 2030 Agenda for Sustainable Development. They may be seen as a new frontier for developing countries, and positively integrating developing countries into the global services economy therefore assumes a developmental significance. National policies and regulatory efforts, as well as multilateral and regional trade policy cooperation, should recognize this developmental potential of services.

Existing research and policy discussions, as well as UNCTAD experience in this area, including its services policy reviews, point to the importance of coherent and fit-for-purpose policy, regulatory and institutional frameworks, including on trade liberalization approaches, and of human skills development, in harnessing the potential of services for structural transformation.



I. Introduction

1. The services sector has emerged as the largest segment in and driving force of the economy, contributing a growing share to gross domestic product (GDP), trade and employment. Opportunities for structural transformation created by the rising services economy are huge, notably derived from disruptive technology and the digital economy. The sector contributes to productivity and economy-wide growth, as it provides essential inputs to other products and services. Many services have emerged as promising tradable services for developing countries, particularly with the development of telecommunications and information and communications technology (ICT) services. In addition, efficient services are catalysts for the expansion of regional and global value chains.

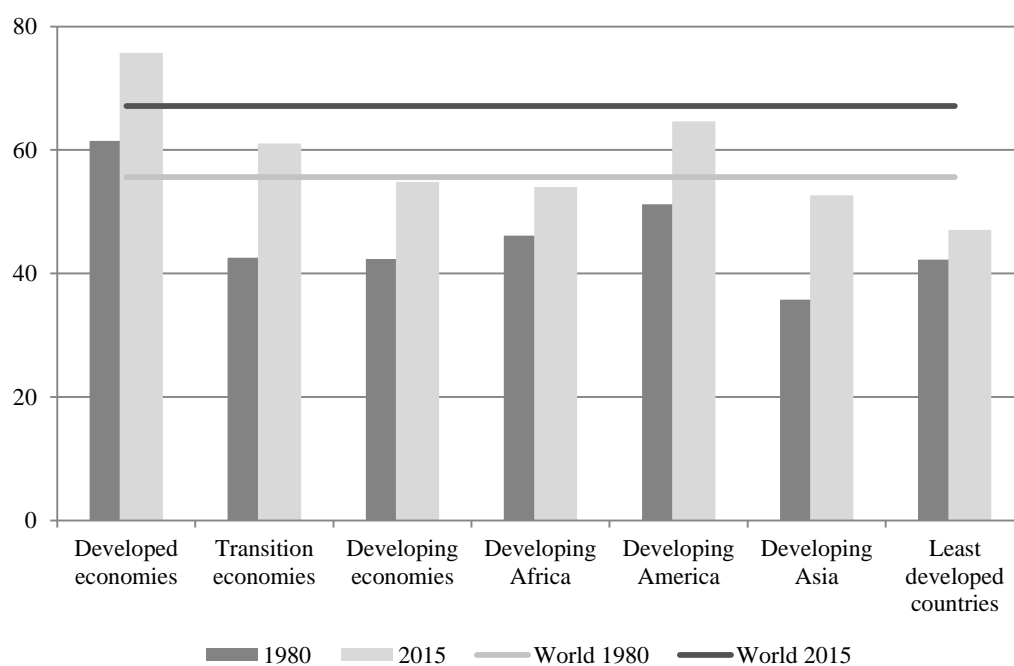
2. Many services activities with important social functions – in health, finance, energy, transport and telecommunications – are indispensable to achieving the Sustainable Development Goals. For instance, basic and infrastructure services can make significant contributions towards achieving Goal 1 on ending poverty, Goal 2 on ending hunger, Goal 3 on health, Goal 4 on education, Goal 5 on gender equality, Goal 6 on water and sanitation, Goal 7 on energy, Goal 8 on economic growth and decent work, Goal 9 on infrastructure development (including financial, telecommunications and ICT services), Goal 10 on reducing inequality, Goal 11 on human settlements (for example through transport services) and Goal 17 on means of implementation (for example through ICT services). Achieving many of the Goals and targets depends on universal access to basic and infrastructure services, suggesting the critical importance of services in the achievement of the 2030 Agenda. Given the multifaceted contribution of services, there is a significant opportunity to explore a services-driven growth and development strategy.

II. Trends in the services economy and trade

A. Services as a growing part of the economy

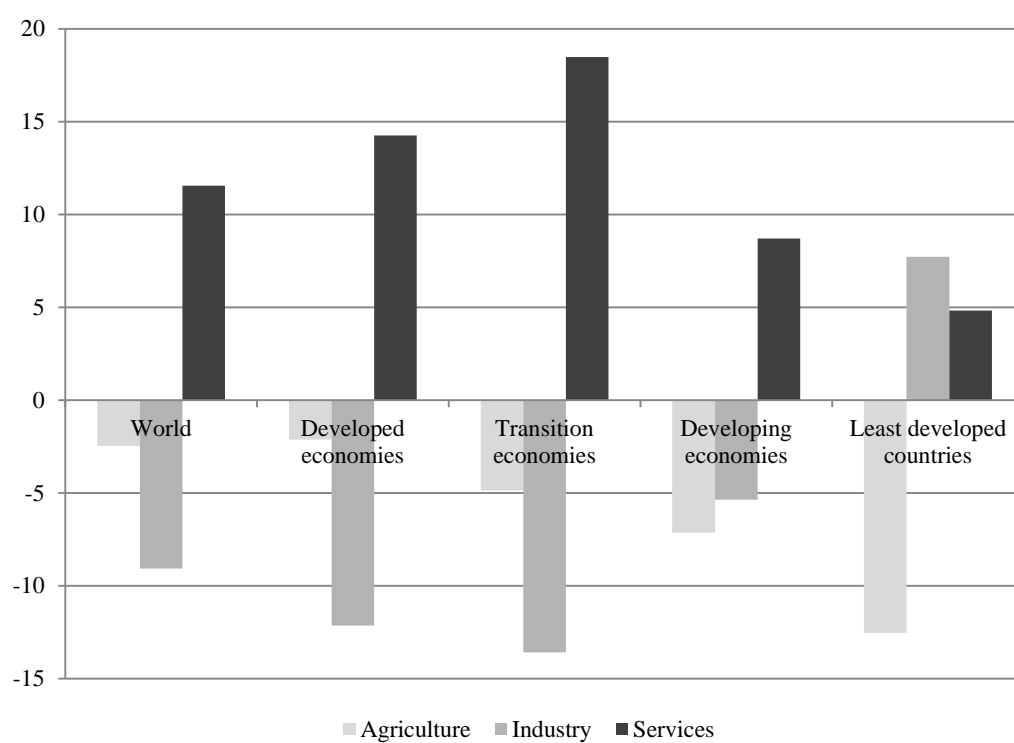
3. The contribution of services to economies has increased over time. In 1980–2015, the share of services in GDP increased in all income level groups, including from 61 to 76 per cent in developed economies and from 42 to 55 per cent in developing economies (figure 1). Services are predominant in all developing regions, including in the least developed countries (LDCs). The increase in services output in this period largely corresponds to a decline in industrial output in developed economies and a decline in agricultural output in developing economies. This may be seen as reflecting the two distinct forms of structural transformation (figure 2). In developed economies, the services sector has grown, and productive resources have moved out of the industrial sector. In developing countries, particularly LDCs, productive resources have mainly moved out of the agricultural sector, to services.

Figure 1
Share of services in gross domestic product by income level and region, 1980 and 2015
 (Percentage)



Source: UNCTADstat.

Figure 2
Share of economic sectors in gross domestic product by income level, change in 1980–2015
 (Percentage)



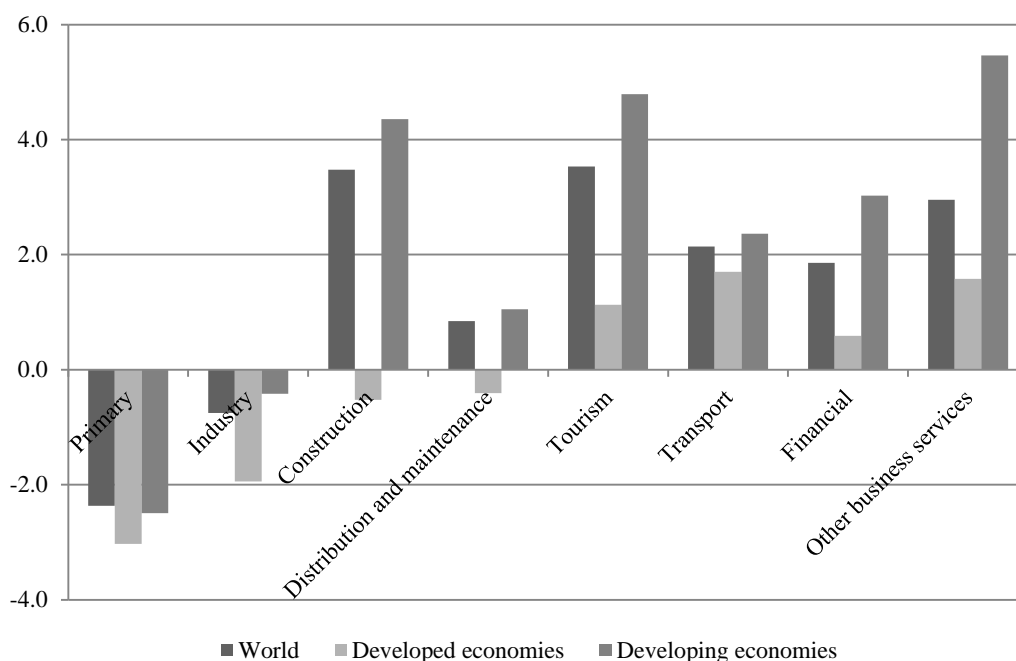
Source: UNCTADstat.

4. Services are also predominant in employment. In 2016, the broad services sector was estimated to account for nearly half (49 per cent) of global jobs. As in output, the importance of services is more pronounced in developed economies (where services jobs represent 75 per cent of the total) than in developing economies (44 per cent).¹ Services have been the main job provider since the mid-2000s, including during the 2008–2009 global economic and financial crisis. Annually in 2001–2016, the importance of the construction, tourism and other business services sectors in the global job market increased, including in developing economies (figure 3).²

Figure 3

Annual change in employment distribution in selected sectors by income level, 2001–2016

(Percentage)



Source: UNCTAD secretariat calculations, based on ILO, 2017.

5. Employment in services is particularly relevant for women as, globally, women have the highest share of jobs in the sector. The participation of women in services jobs in developing economies is 41 per cent, second only to the agricultural sector.³ Services employment is also important for migrant workers as some host countries, such as Canada and the United States of America, rely heavily on migrants in their broad services sectors. Services-related policies are therefore relevant for inclusive employment, especially in the current context of persistent high levels of unemployment.

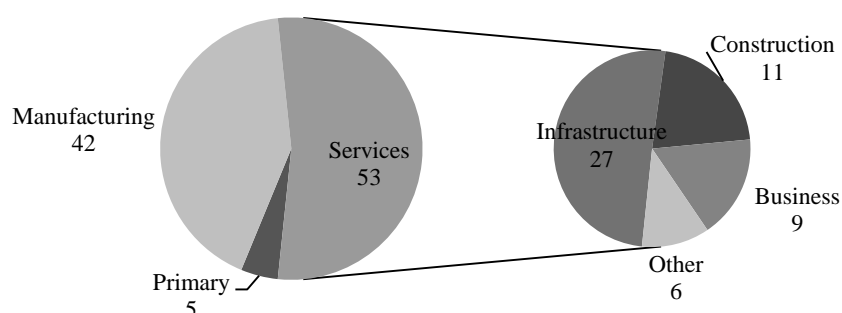
6. Services are also prevalent in foreign direct investment, with announced greenfield investment in the last 10 years mainly concentrated in the services sector. In 2015, services received 53 per cent of investment. In addition, foreign direct investment in services has grown faster than investment in the primary and manufacturing sectors. The infrastructure services sector has grown particularly quickly; in 2015, more than half of announced greenfield investment in services was in this sector (figure 4).

¹ International Labour Organization (ILO), 2017, Key Indicators of the Labour Market database.

² UNCTAD, forthcoming, *Trade, Employment and Development*.

³ ILO, 2016, *World Employment Social Outlook: Trends 2016* (Geneva).

Figure 4
Sectoral distribution of announced greenfield foreign direct investment projects, 2015
 (Percentage)



Source: UNCTAD secretariat calculations, based on UNCTAD, 2016a, *World Investment Report 2016* (United Nations publication, Sales No. E.16.II.D.4, Geneva).

B. Trends in services trade

7. In 2015, the largest global exporters and importers of services were mainly developed economies, in particular the United States and countries in Europe, such as Germany and the United Kingdom of Great Britain and Northern Ireland, as well as emerging economies such as China (table 1). The top 10 exporters accounted for more than 50 per cent of global services exports, and the same trend was seen among the top 10 importers, revealing heterogeneity in the composition of major services exporters.

Table 1
Main exporters and importers of services, 2016
 (Millions of dollars and percentage)

Main services exporters	Value of services exports	Share of global services exports	Main services importers	Value of services imports	Share of global services imports
United States	752 411	15.6	United States	503 053	10.7
United Kingdom	327 176	6.8	China	453 014	9.6
Germany	272 738	5.6	Germany	312 074	6.6
France	236 760	4.9	France	235 679	5.0
China	208 488	4.3	United Kingdom	198 653	4.2
Netherlands	179 776	3.7	Ireland	191 939	4.1
Japan	173 821	3.6	Japan	184 710	3.9
India	161 845	3.3	Netherlands	169 458	3.6
Singapore	149 642	3.1	Singapore	155 581	3.3
Ireland	146 678	3.0	India	133 710	2.8
Total	2 609 334	53.9	Total	2 537 870	53.9

Source: UNCTADstat.

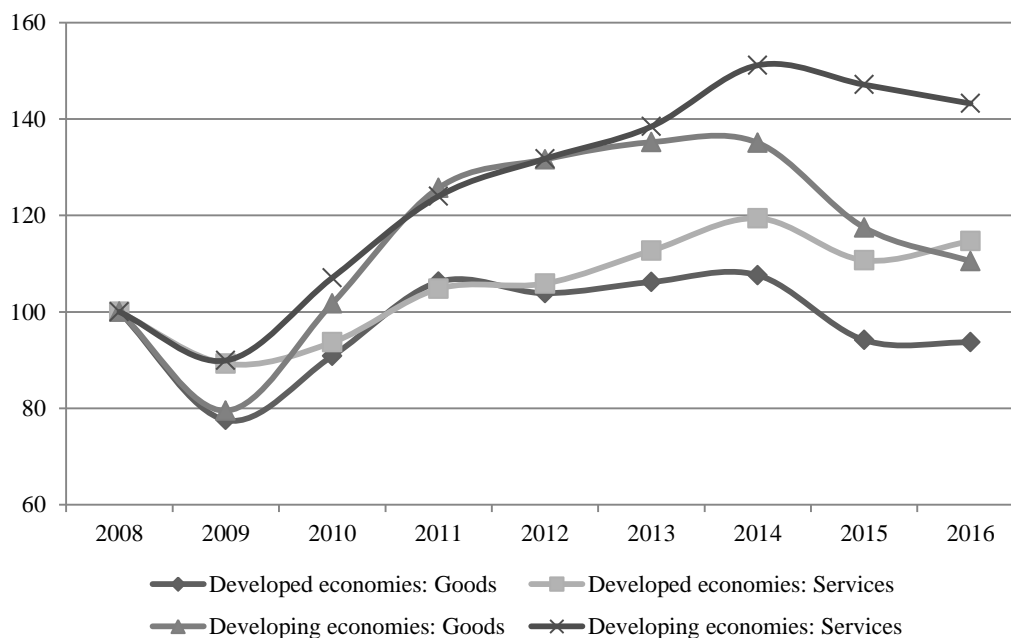
8. In 2005–2016, services exports grew faster in developing economies than in developed economies. The share of developing economies in global services exports rose from 23 to 29 per cent. In 2008–2016, services exports in developing economies expanded faster than in developed economies, and services exports expanded faster than merchandise exports (figure 5). The share of services exports in total exports of goods and services increased from 24 per cent in 2005 to 28 per cent in 2016 in developed economies, and from 14 to 17 per cent in developing economies. Services exports have been more resilient than goods exports. As occurred during the global economic and financial crisis in 2009,

developing economy exports of services in 2015 decreased less (by 3 per cent) than exports of goods (by 13 per cent).

Figure 5

Growth of goods and services exports by income level, 2008–2016

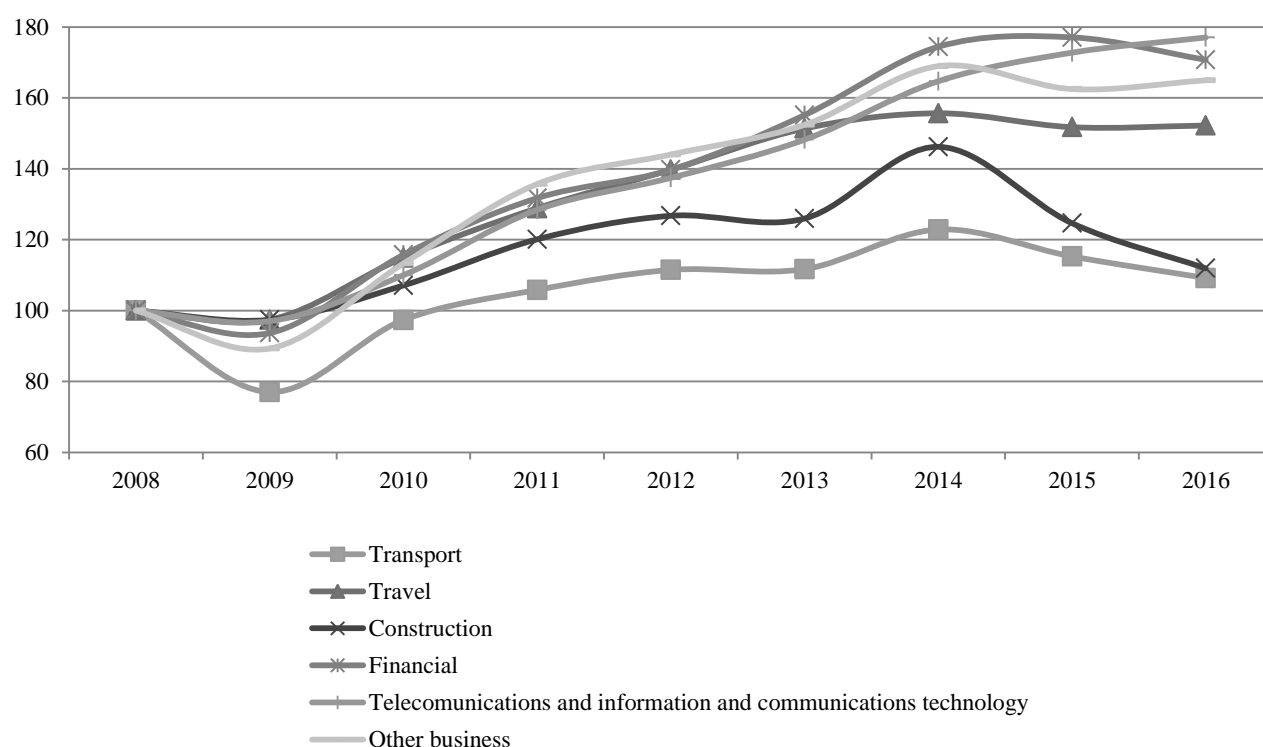
(Index; 2008=100)



Source: UNCTADstat.

9. Among services, developing country exports are growing more strongly in telecommunications and ICT, financial services and other business services (figure 6). However, the sectoral data shows that developed and developing economies continue to have different trade profiles. Although transport, travel and other business services are the largest categories for developed and developing economies, the share of transport and travel services continues to be higher in developing and transition economies (table 2). In contrast, developed economies continue to be more specialized in higher value added categories, such as financial services.

Figure 6
Developing economy exports of selected commercial services, 2008–2016
 (Index; 2008=100)



Source: UNCTADstat.

Note: Other business services covers miscellaneous business, professional and technical services.

Table 2
Exports of selected commercial services by income level and region, 2016
 (Percentage)

Services category	Developed economies	Transition economies	Developing economies	Developing Africa	Developing America	Developing Asia	Least developed countries
Goods-related	3.4	6.4	3.4	2.0	2.5	3.6	1.9
Transport	15.8	35.1	21.1	29.2	16.2	21.2	23.1
Travel	21.4	23.2	33.8	39.1	47.4	31.4	53.5
Construction	1.3	5.6	2.8	2.3	0.1	3.2	1.8
Financial services	13.6	2.2	6.5	4.2	5.0	6.9	2.1
Intellectual property	9.0	0.8	1.4	0.3	0.8	1.5	0.3
Telecommunications and information and communications technology	10.6	9.4	9.5	6.6	4.7	10.4	8.6
Other business	23.9	16.6	20.6	15.7	20.7	21.0	7.8
Personal, cultural and recreational	1.0	0.8	0.9	0.7	2.7	0.7	0.8
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

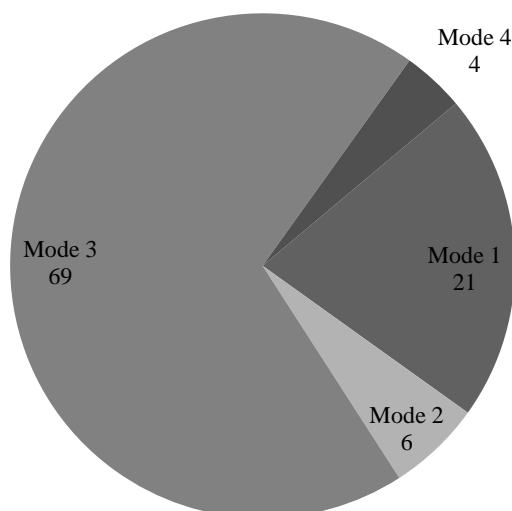
Source: UNCTADstat.

10. Data related to the current balance of payments capture only a part of services trade, as they do not capture trade associated with a commercial presence (mode 3) or the temporary movement of natural persons (mode 4). Commercial presence is the most important mode of supply, as may be inferred from the consistently growing sales of foreign affiliates, if such sales are assumed to also derive from the services component. The amount reached \$37 trillion in 2015, an increase from \$34 trillion in 2014.⁴ Data for the European Union also suggest the predominant role of mode 3 (figure 7). The temporary movement of people supplying services is particularly important in professional and business services. Taking into account the sizeable amount of remittances – in 2016, worldwide remittance flows were estimated at \$575 billion, with \$429 billion flowing to developing countries⁵ – mode 4 is of substantial importance for developing countries.

Figure 7

European Union: Exports of services by mode of supply, 2013

(Percentage)



Source: Eurostat database.

11. Data on cross-border services trade do not capture the significant value added of services incorporated in goods exports. In 2011, services accounted for 44 per cent of value added in total exports in developed economies and 32 per cent in developing economies, above the shares of services exports in total exports. The value added of imported services in gross exports grew for all countries in 1995–2011, and was 16 per cent in developed economies and 11 per cent in developing economies. This shows the increasing tradability of services and their importance as an enabler of trade.⁶ Domestic sourcing can also involve services trade, such as through the movement of people.

12. The increasing importance of services activities in manufacturing companies is also often not captured. To add more value and innovation-related content to their products, to promote client relationships and to keep strategic business functions in-house, firms may develop services activities rather than outsourcing them. In the sample of countries covered by one study, services inputs accounted for 37 per cent of the value of manufacturing exports; adding services activities within manufacturing firms increased this share to 53 per cent, and the overall contribution of services to exports was close to two thirds.⁷

13. High-quality, reliable, timely, comprehensive and sufficiently disaggregated data on services trade flows are important in facilitating specific, evidence-based and

⁴ UNCTAD, 2016a.

⁵ World Bank, 2017, Migration and remittances, Migration and Development Brief No. 27.

⁶ UNCTAD, 2011, *Services, Trade and Development* (United Nations publication, New York and Geneva).

⁷ S Miroudot and Cadestin, 2017, Services in global value chains: From inputs to value-creating activities, Trade Policy Papers No. 197, Organization for Economic Cooperation and Development.

policy-oriented actions. A focus on data is a required strategy to develop the right policies for the right services for structural transformation (box 1). The availability of data is a key element in measuring achievements towards the Sustainable Development Goals. Since a broad array of institutions is usually involved in services trade in all four modes of supply, the provision of valid statistics requires institutional cooperation.

Box 1

Data collection: Brazil case study

In Brazil, the Integrated System of Foreign Trade in Services, Intangibles and Other Operations that Produce Changes in Net Worth is an important tool for services classification, data collection and policy action. The system covers all services transactions between residents and non-residents and data collection covers the four modes of supply. The effectiveness of the system relies on assigning a high priority to and political support for data availability and quality, as well as on national experience in electronic government and electronic platforms. It has helped different authorities identify services exports potential, supported the promotion of trade and provided inputs for trade negotiations. Based on data from the system, specific statistics have been developed to support business strategies for services sectors, and a public–private initiative, Services Export Leverage Forum, has been launched to increase competitiveness by identifying relevant measures.

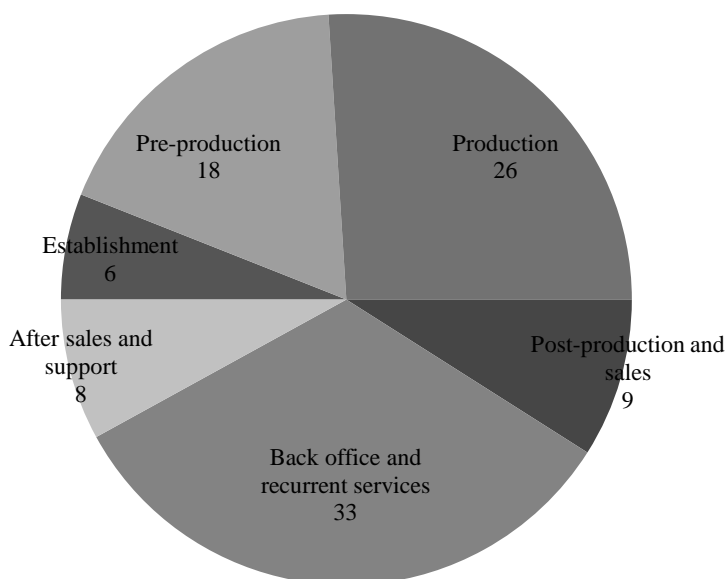
Sources: Communications received from Brazil Ministry of Industry, Foreign Trade and Services; Global Migration Group, 2016, *Handbook for Improving the Production and Use of Migration Data for Development*; UNCTAD, forthcoming, *Trade, Migration and Development*.

III. The role of services in structural transformation for development

14. The contribution of services to the economy is significant as the sector, in particular infrastructure services, can provide intermediate inputs for all economic activities. Such servicification – the growing importance of services in all economic sectors – facilitates production and exports throughout productive processes, mainly in back office and production stages (for example quality control and engineering services), as well as in establishment, pre-production, post-production and after-sales stages (figure 8). In 2015, services support activities (such as research and development, engineering and distribution) represented 25–60 per cent of employment within manufacturing firms.⁸ Services are also important in coordinating production processes. For example, telecommunications services allow for cooperation between different activities in a production process, and knowledge and technology-based services facilitate specialization.

⁸ UNCTAD, 2011.

Figure 8
Share of services activities in production process stages
 (Percentage)

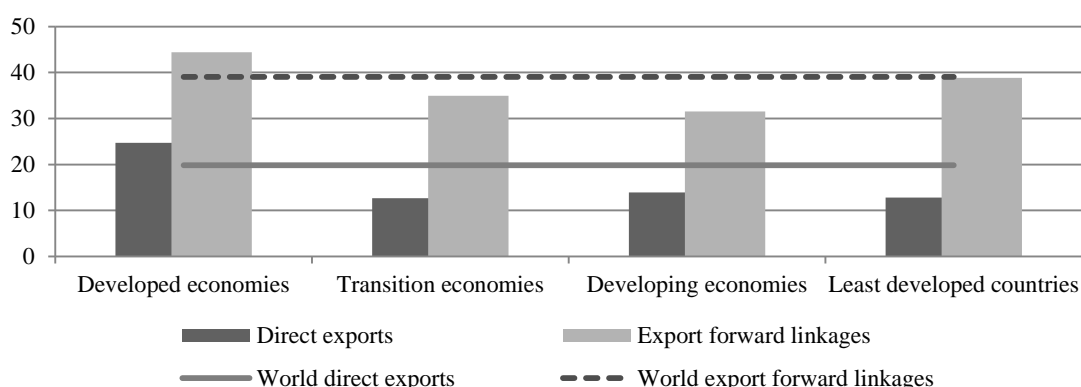


Source: Asia Global Institute, 2015, The role of services in global value chains, presented at the sixty-second session of the UNCTAD Trade and Development Board, Geneva, 17 September.

15. Services value added is incorporated in output and exports in all economic sectors, including agriculture and manufacturing. Its level is higher than the direct contributions of services to output and exports, and shows the servicification of economies at all income levels. In 2011, the gross value of services exports in total goods and services exports was 24 per cent in developed economies and 14 per cent in developing economies. However, as noted, services value added represented 44 per cent of value added in total exports in developed economies and 32 per cent in developing economies (figure 9). Referred to in some studies as mode 5 of supply, this also reflects servicification in international trade.⁹ The significant differences between direct exports of services and of services value added in exports may show the importance of services in improving export capacity and the increased tradability of services, especially when services value added is traded in tandem with value added from inherently tradable goods and services.

⁹ L Cernat and Z Kutlina-Dimitrova, 2014, Thinking in a box: A mode 5 approach to service trade, Chief Economist Note Issue No. 1, European Commission.

Figure 9
Share of services in total direct exports and total forward linkages in exports, by income level, 2011
 (Percentage)



Source: UNCTAD secretariat calculations, based on World Bank Export Value Added database.

16. Services providing intermediate inputs may serve as catalysts for enhanced efficiency, productivity and competitiveness in all sectors. Opportunities may emerge for economic agents to join value chains supporting exports, including, in some instances, for microenterprises and small and medium-sized enterprises (MSMEs; box 2). Yet participation in global value chains alone does not guarantee relevant development gains. Attention needs to be paid to moving towards high value added services activities, such as design, distribution and marketing.

Box 2

Services and microenterprises and small and medium-sized enterprises

Globally, MSMEs represent 95 per cent of firms, 50 per cent of output and 60 per cent of employment. In the Organization for Economic Cooperation and Development countries, small and medium-sized enterprises (SMEs) account for on average 60 per cent of total employment and 50–60 per cent of value added. MSMEs are sources of innovation and provide more opportunities for women and youth. However, MSMEs confront significant challenges, such as low productivity, minimal participation in international trade and a focus on low value added production. Trade costs are higher for MSMEs due to lack of scale, including with regard to access to information and financing and compliance with requirements. By providing inputs and linkages throughout production processes, services, particularly infrastructure services, can improve the productivity of MSMEs and allow for their diversification and upgrading. Services activities, often less capital intensive and dependent on economies of scale, can also facilitate the integration of MSMEs in the economy and trade. MSMEs may concentrate on producing specific services inputs for different stages of broader production processes. The incentives thereby created for the formalization of MSMEs and workers are found to be beneficial. For instance, the increasing formalization of the economy of Brazil since 2000 appears to have enhanced growth. This also applies to MSMEs using online marketplaces to engage in electronic commerce (e-commerce). For example, SMEs account for a larger share of businesses trading through the e-commerce company Alibaba than in non-ICT enabled markets, and Chinese companies trading through Alibaba can reach up to 98 export destinations, almost double the number in non-ICT enabled markets.

Sources: Edinburgh Group, 2013, *Growing the global economy through SMEs*; Organization for Economic Cooperation and Development, 2017, *Small, Medium, Strong: Trends in SME Performance and Business Conditions* (Paris); United Nations, 2017, *World Economic Situation and Prospects 2017* (New York).

17. By supporting productive and export capacity, services can change relative prices in the sectors to which they contribute, thus impacting production, employment, investment, trade and consumption decisions related to those sectors. This creates services-led changes in the economic structure, whereby some sectors become more important than others by building on competitive services inputs. Such structural changes may be particularly beneficial if they favour sectors that tend to have higher productivity, are more technologically intensive or have greater potential to upgrade, leading to services-led growth. It is arguable that services should no longer be regarded as an alternative to industrialization but as part of a transformative strategy for all sectors, including manufacturing.

18. In Asia, since 1990, structural changes from low to high productivity sectors, leading to growth, have been supported by closer linkages between competitive services and other sectors of the economy, especially manufacturing. Conversely, in other regions, workers have often been displaced to lower productivity activities, including in services and the informal sector, leading to reduced growth.¹⁰ Servicification may therefore promote industrialization, which is a driver for technological improvements with important spillovers for the rest of the economy.¹¹ The services sector is more likely to play a greater supporting role in accelerating structural transformation in countries that have a dynamic manufacturing industry with fast productivity and income growth.¹² For example, no less than one third of aggregate productivity growth is associated with performance in the services sector in countries in which manufacturing has grown rapidly, such as Viet Nam.¹³

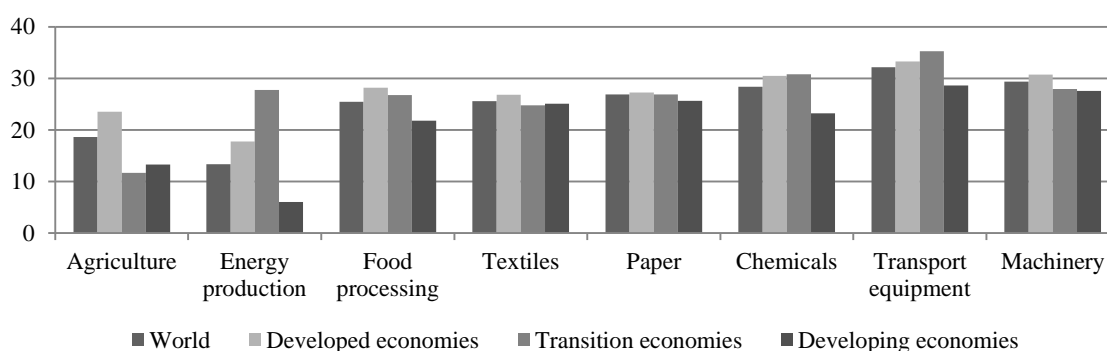
19. Developing countries incorporate less services value added than developed countries in many sectors, particularly in agriculture and energy production. In 2011, services value added accounted for 23 per cent of agricultural output in developed economies and 9 per cent in developing economies, and for 27 per cent of textiles output in both developed and developing economies.

20. A similar trend may be observed in exports. In 2011, services value added accounted for 24 per cent of agricultural exports in developed economies and 13 per cent in developing economies and for 27 per cent of textiles exports in developed economies and 25 per cent in developing economies (figure 10).

Figure 10

Participation of services in total backward linkages in exports of selected sectors by income level, 2011

(Percentage)



Source: UNCTAD secretariat calculations, based on World Bank Export Value Added database.

¹⁰ M McMillan, D Rodrik, and I Verduzo-Gallo, 2014, Globalization, structural change and productivity growth, with an update on Africa, *World Development*, 63:11–32.

¹¹ Overseas Development Institute, 2017, Trade in services and economic transformation.

¹² UNCTAD, 2016b, *Trade and Development Report, 2016* (United Nations publication, Sales No. E.16.II.D.5, New York and Geneva).

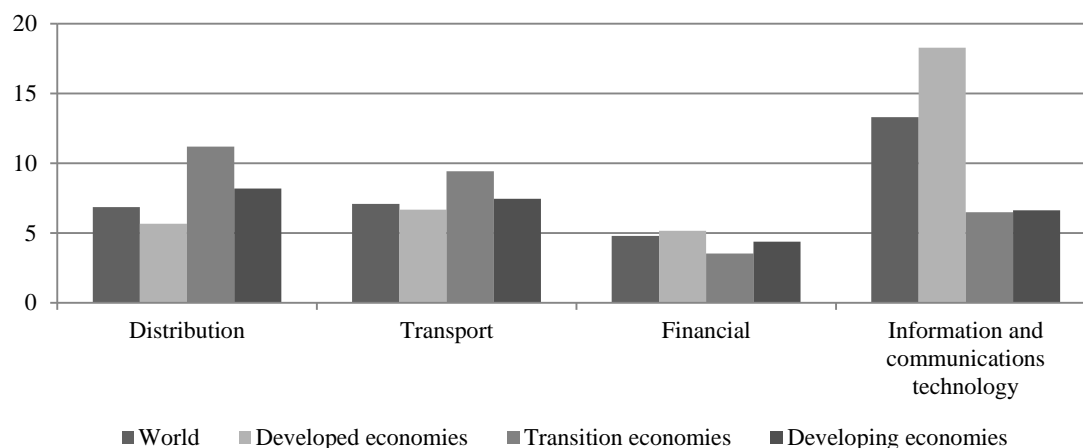
¹³ Overseas Development Institute, 2017.

21. In 2011, the services sectors that contributed the most value added to total global exports were distribution (7 per cent), transport (7 per cent), finance and insurance (5 per cent) and ICT (13 per cent). While transition economies and developing economies tend to incorporate more value added from distribution and transport services into total exports, developed economies incorporate more value added from financial and insurance services and, in particular, from ICT services (figure 11).

Figure 11

Share of selected services sectors in total forward linkages in exports by income level, 2011

(Percentage)

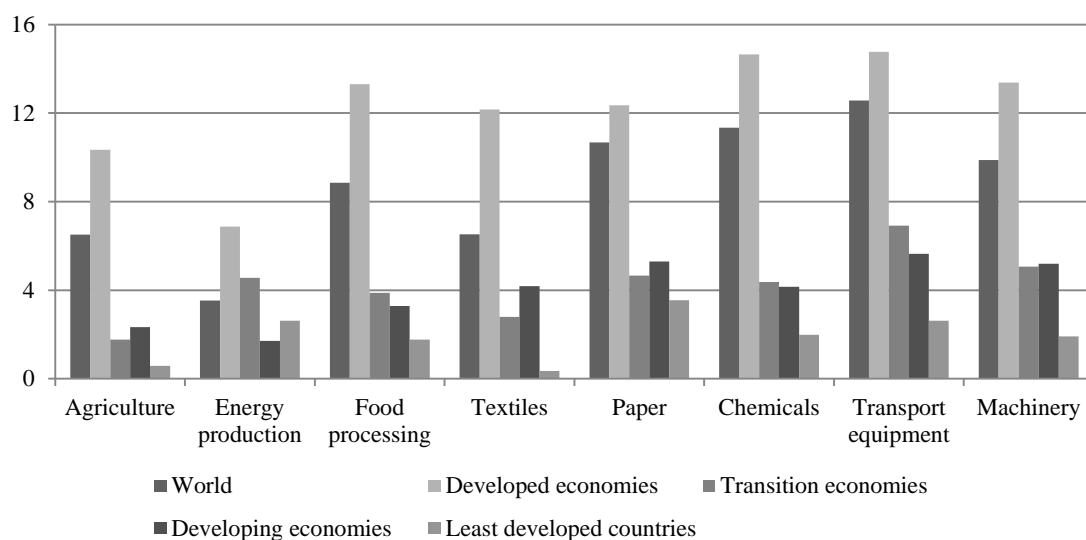


Source: UNCTAD secretariat calculations, based on World Bank Export Value Added database.

22. Developed economies are more advanced in incorporating ICT services value added in agricultural and manufacturing exports. In 2011, the share of ICT services value added in agricultural exports was 10 per cent in developed economies, compared with 2 per cent in both transition and developing economies and less than 1 per cent in LDCs. In manufacturing, the share of ICT services value added in exports of transport equipment was 15 per cent in developed economies, 7 per cent in transition economies and 6 per cent in developing economies (figure 12). ICT services are relevant to improved performance in services activities. ICT diffusion, among other factors, is associated with higher productivity in wholesale and retail trade and business services. These two sectors have been found to be responsible for most of the labour productivity differentials between Europe and the United States.¹⁴

¹⁴ C Buiatti, JB Duarte and LF Saenz, 2017, Why is Europe falling behind? Structural transformation and services' productivity differences between Europe and the U[nited] S[tates], Cambridge Working Papers in Economics No. 1708.

Figure 12
Share of information and communications technology services in total backward linkages in exports of selected sectors, by income level, 2011
 (Percentage)



Source: UNCTAD secretariat calculations, based on World Bank Export Value Added database.

IV. Enabling policies and regulations for structural transformation

A. Experiences of regulatory and institutional frameworks

23. A set of enabling policies and regulations is required for the improvement of services performance to support economic transformation that favours sectors with higher productivity and value added. Elements of possible policy mixes in support of services sector development may be found in existing literature and national experiences.

24. In Africa, services provide inputs to exports related to agriculture, energy and manufacturing. Access to low-cost, high-quality services helps countries participate in local, regional and global value chains and to achieve social development objectives. This requires services trade policies, such as for adequate levels of openness and regulation. Successful structural transformation in rural areas requires investment incentives, productivity growth and risk management. Policy priorities may therefore include investment in deficient physical and institutional infrastructure, such as roads and electricity and telephone and Internet access, as well as financial and agricultural extension services, with a focus on science, technology and innovation services to ensure the sustainability of growth decoupled from exhaustible natural resources.¹⁵ It is also necessary to encourage the emergence of rural financial institutions and products to help farmers and traders manage risk more efficiently, as financial market failures in rural areas generate problematic resource allocation patterns that perpetuate low productivity and ultrapovertry.¹⁶ For example, Kenya's relative success in including services in a transformation strategy¹⁷ comprises the Vision 2030 strategy, which contains clear objectives for tourism, retail trade, business process outsourcing and financial services sectors. Success factors also include determined public and private efforts in ICT-enabled services, significant public investments in ICT infrastructure and strong regulation, for instance for financial services.

¹⁵ UNCTAD, 2012, *Economic Development in Africa Report 2012* (United Nations publication, Sales No. E.12.II.D.10, New York and Geneva).

¹⁶ CB Barrett, L Christiaensen, MB Sheahan and A Shimeles, 2017, *On the structural transformation of rural Africa*, World Bank Policy Research Working Paper No. 7938.

¹⁷ Overseas Development Institute, 2015, *Trade policy and economic transformation*.

25. In Chile, importance has been given to financial services to raise and mobilize resources and encourage investment for structural transformation towards higher productivity sectors. The country has liberalized the financial sector, yet the Banco Estado, a State-owned commercial bank, has remained a key player in providing financial services to SMEs.¹⁸

26. In China, the process of economic transformation has had several industrial upgrade phases, which culminated in the country's accession to the World Trade Organization (WTO). The Government opted to mobilize limited resources to build special economic zones and industrial parks in which it provided competitive infrastructure and business environments. More general economy-wide reforms were introduced at a more gradual pace.¹⁹ In 2013, the pilot free trade zone in Shanghai deployed several reform measures to further improve the business environment and open up investments. In 2016, a negative list for foreign investment was initiated to test market-opening policies, comprised of 122 items, which will be shortened, following which the Shanghai free trade zone model will be expanded across China (see <http://en.shftz.gov.cn>).

27. The economy of India is mainly services intensive; 55 per cent of economic activities are services intensive. While services and agriculture appear to have little interdependence, industry is also highly services intensive; 70 per cent of its activities are related to services. The services sector is more growth-inducing than agriculture or industry, but this potential requires growth impulses from all sectors.²⁰

28. Such national experiences, as well as UNCTAD research, suggest that harnessing the potential benefits of trade and services for structural transformation requires sound, evidence-based policy, along with regulatory and institutional frameworks adapted to local conditions and introduced gradually. These are key components of services policy and necessary to addressing domestic supply-side constraints, externalities and coordination issues in services, particularly infrastructure services; minimizing inadvertent trade-restrictive effects; and determining services performance. They are especially important to ensuring efficient and competitive markets and available, affordable, convenient, equitable and quality infrastructure services.²¹ The effectiveness of such frameworks relies on achieving the necessary coherence between several policy areas, as well as between these areas and trade liberalization.²²

29. Cross-cutting lessons for effective regulatory and institutional frameworks from UNCTAD services policy reviews also point to the importance of policy coherence and coordination between services sectors and other areas, including trade, investment, competition and industrial and social policies.²³ This requires a multi-stakeholder approach to policymaking, involving the private sector, such as through coalitions of services industries. Regulatory design that ensures policy objectives and avoids unjustifiable restrictions is a major component of ensuring coherence. Sound institutions and good governance are also required, including at subnational, national, regional and international levels of coordination. Such lessons also underscore the need for an enabling and productive technology and business environment, promoting business facilitation, formalization of the economy, enhanced technology and producer associations and

¹⁸ UNCTAD, 2014, *The Least Developed Countries Report 2014* (United Nations publication, Sales No. E.14.II.D.7, New York and Geneva).

¹⁹ JY Lin and Y Wang, 2014, China-Africa cooperation in structural transformation: Ideas, opportunities and finances, World Institute for Development Economics Research Working Paper No. 46, United Nations University.

²⁰ SK Hansda, 2005, Sustainability of services-led growth: An input output exploration of the Indian economy.

²¹ UNCTAD, 2012, *Services, Development and Trade: The Regulatory and Institutional Dimension of Infrastructure Services* (United Nations publication, New York and Geneva).

²² TD/B/C.I/MEM.4/11.

²³ UNCTAD, 2013, *Services Policy Reviews: A Detailed Methodology for Reviewing Policy, Regulatory and Institutional Frameworks for Services* (United Nations publication, New York and Geneva). See services policy reviews for Bangladesh, Kyrgyzstan, Lesotho, Nicaragua, Nepal, Paraguay, Peru, Rwanda and Uganda, available at <http://unctad.org/en/Pages/Publications/Services-Policy-Reviews.aspx>.

clustering. The development of labour skills is required, as a qualified workforce promotes knowledge and technology-intensive services, supported by a sound education strategy that matches labour demand and skills. Finally, the improved collection and analysis of services data is key to evidence-based policymaking.²⁴

B. Sectoral policies and regulations

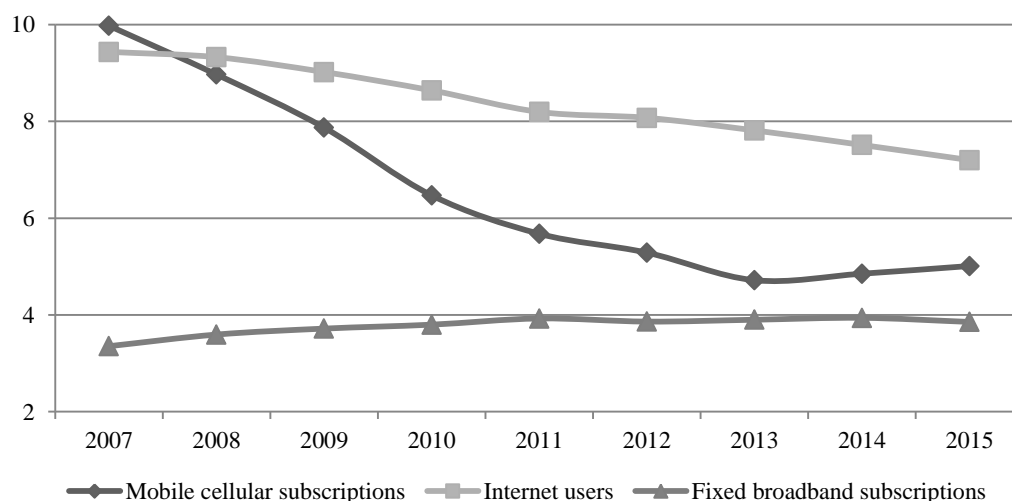
1. Telecommunications and information and communications technology services

30. Telecommunications and ICT services are essential for all economic activities, with digitization allowing for increased productivity and greater efficiency, as well as reduced production, transaction and trade costs. However, progress in reducing the digital divide between developed and developing countries remains insufficient; developing economies continue to lag behind in the number of Internet users and fixed broadband subscriptions (figure 13). The digital divide is also seen in exports of telecommunications and ICT services; the review of revealed comparative advantages confirms that developing countries remain less specialized in such services.

Figure 13

Difference between global and low and middle-income economies in number of subscriptions and level of use of selected telecommunications and ICT services, 2007–2015

(Per 100 users or subscriptions)



Source: UNCTAD secretariat calculations, based on the World Bank World Development Indicators database.

31. Regulatory and institutional frameworks remain critical to enabling telecommunications and ICT services and connectivity. Promoting universal access is a key component of this broad objective, including by funding mechanisms for infrastructure and services uptake, provisioning grants, encouraging innovation and increasing demand, for example by extending digital literacy. In the Republic of Korea, for example, Internet access for households was facilitated by an informatization promotion fund focused on ICT investments, including earmarking ICT-related profits, while new financing methods (such as “invest first, settle later”) and Government seed money attracted private investments.²⁵

32. Facilitating the investment and business environment, including by supporting technology clusters, is critical. Regulators can play a role in public–private partnerships used to expand investment in telecommunications and ICT infrastructure, by encouraging infrastructure and network sharing and spectrum pooling, as well as by establishing licence-

²⁴ TD/B/C.I/MEM.4/8.

²⁵ Ibid.

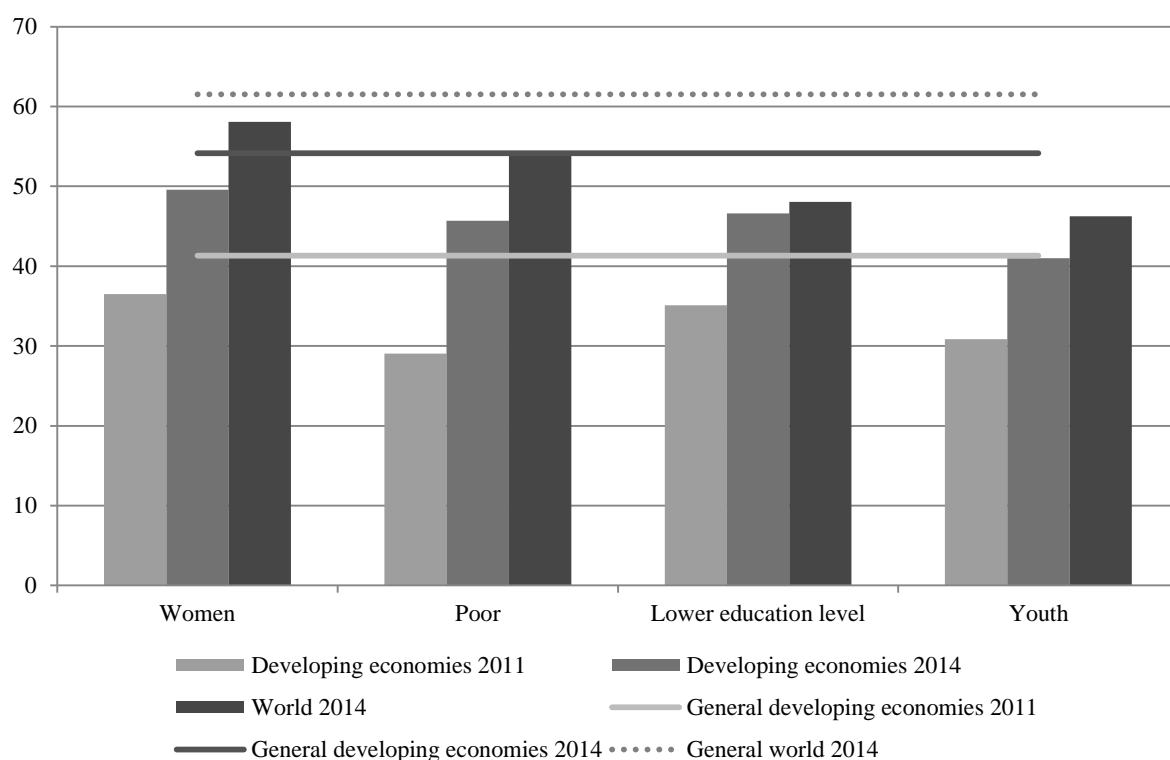
based obligations. Ensuring competition is another key component, including measures to facilitate market entry and licensing, encourage non-discriminatory access and mobile number portability and address high mobile termination rates. The growth of the Internet of things and of mobile applications and services brings new challenges with regard to improving connectivity and addressing regulatory issues related to spectrums, switching, roaming and numbering.²⁶

2. Financial services

33. Financial services facilitate transactions, mobilize savings and channel investment and credit for firms, including MSMEs, as well as households. Although progress has been made in recent years, a large variation in financial inclusion – defined as the effective access and use of affordable, convenient, quality and sustainable financial services from formal providers – remains with regard to income, region, gender and age. The share of adults in developed economies who have a financial services account is much higher than the share in developing economies, and women and youth lag behind (figure 14). Financial inclusion is a central element of achieving the Sustainable Development Goals. Access to financial services can contribute to facilitated, speedier, safer and less costly remittances and to maximizing the development role of remittances by facilitating options to invest private funds in productive activities, social services and infrastructure.²⁷

Figure 14

Financial services account owners, globally and in developing economies, by gender, income level, education level and age, 2011 and 2014
(Percentage)



Source: UNCTAD secretariat calculations, based on the World Bank Global Financial Inclusion (Global Findex) database.

²⁶ International Telecommunication Union, 2016a, *Trends in Telecommunication Reform 2016: Regulatory Incentives to Achieve Digital Opportunities* (Geneva).

²⁷ UNCTAD, 2013, *Maximizing the Development Impact of Remittances* (United Nations publication, New York and Geneva); UNCTAD, 2015, *Access to financial services as a driver for the post-2015 development agenda*, Policy Brief No. 35.

34. Supply-side policies with regard to financial services include subsidies and mandatory requirements to enhance access, such as universal services obligations, and proportional regulatory and institutional frameworks that address undersupply and oversupply. For example, in India, simplified branch authorizations and no frills accounts have been implemented and, in Mexico, simplified account requirements have been introduced to achieve inclusion through proportionality.²⁸ Increasing levels of regulation and demand for reporting have led to the development of regulation technology, or regtech solutions, another example of the importance of digital services (box 3). Demand-side policies include government use of financial services, support for information availability – for instance by setting standards for disclosure and transparency – and improvements in financial literacy and consumer empowerment.²⁹

Box 3

Regulation technology solutions

Where there are more regulations and more demanding requirements, economic agents face greater compliance-related challenges. In developing countries in particular, managerial and operational impacts may be important in implementing regulations and in preparing reports and evidence of compliance. As in many other areas of production processes, services can contribute to increasing the compliance of firms with regulatory frameworks. Technology services, notably software services, are increasingly important in addressing regulatory requirements; they allow for more agile and integrated solutions in implementing and reporting on regulatory compliance, in particular when big data sets need to be processed and analysed, such as in financial services. Related tools include those for management information and for conducting regulation gap analyses, training, monitoring and reporting, automating compliance tasks and reducing risks of non-compliance.

Source: Deloitte, 2015, Regtech is the new fintech: How agile regulatory technology is helping firms better understand and manage their risks.

35. Digital financial services play a key role in financial inclusion, building on ICT services to reduce infrastructure costs and increase coverage. They are more inclusive and have positive externalities, such as incentivizing the use of banking services. Developing digital financial services requires addressing several challenges, such as the infrastructure gap, for example the availability and reliability of energy and ICT services; data and personal privacy issues; fraud and security issues; a lack of technological skills; need for adequate agent networks; and in interoperability.³⁰

3. Energy services

36. Energy services, in particular electricity services, remain paramount to the prosperity of economies and to social welfare. This is reflected in Sustainable Development Goal 7 on energy. Despite this importance, some regions, such as sub-Saharan Africa, have yet to achieve a high level of access to electricity (figure 15). Improving access to energy requires, for instance, a regional policy with harmonized regulatory frameworks that explore the potential of the regional dimension in the optimization of supply, involving the creation of common regional infrastructure and power interconnections and the harmonization of specifications, as well as common markets that facilitate the cross-border trade of energy. A digital ecosystem is important for energy services, enabling smart power grids that improve efficiency in the transmission of power and the monitoring and maintenance of delivery systems.³¹

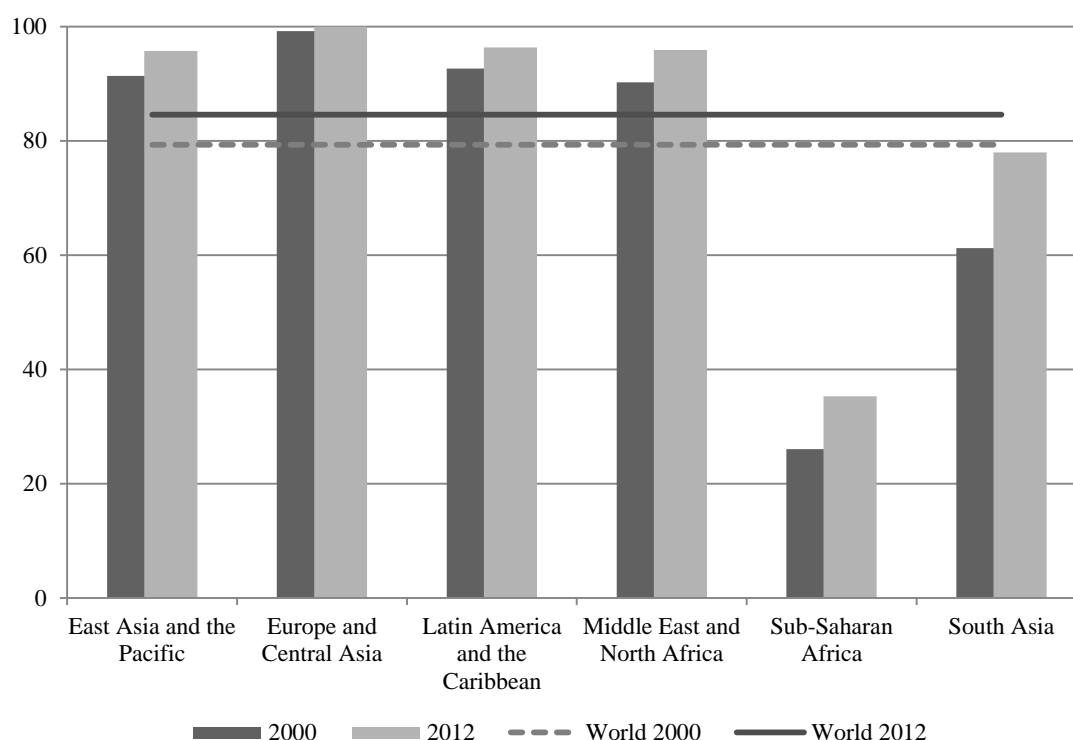
²⁸ UNCTAD, forthcoming, Access to financial services and digital economy for sustainable development.

²⁹ Ibid.

³⁰ International Telecommunication Union, 2016b, The digital financial services ecosystem, Focus Group Technical Report.

³¹ International Telecommunication Union, 2016a.

Figure 15
Access to electricity by region, 2000 and 2012
 (Percentage)



Source: UNCTAD secretariat calculations, based on the World Bank World Development Indicators database.

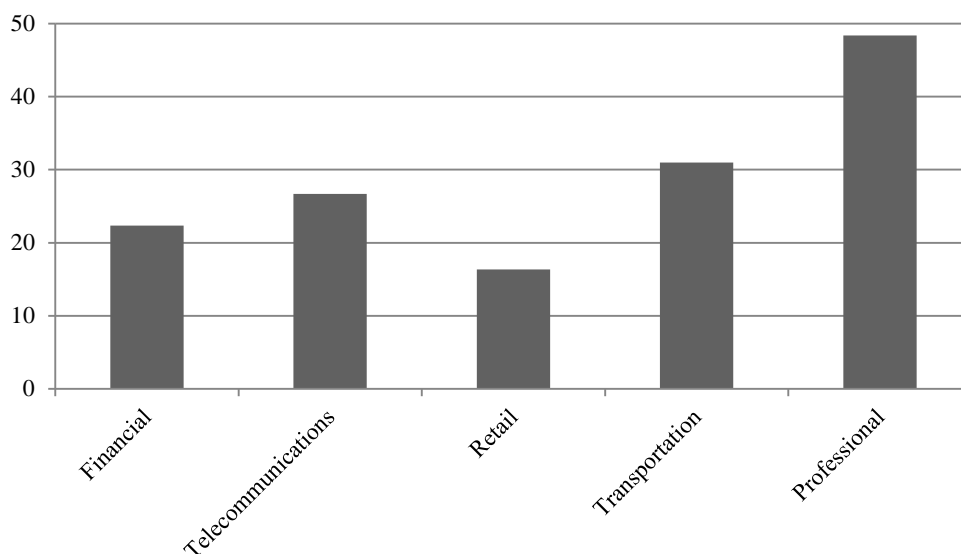
V. Role of international trading system in services sector development

A. Trade policy for services

37. Given the importance of the services sector, addressing barriers to international trade in services remains important in harnessing the development potential of the sector. Such barriers can take the form of prohibitions of foreign providers, limits on foreign ownership and personnel and implicit discriminations in qualification and licensing requirements. The impact of services trade restrictions is found to be higher in services exports than in imports, as they affect the competitiveness of both local exporting firms and foreign firms supplying intermediate services. Although some countries have reduced restrictions, mainly related to mode 3, there are tighter restrictions on the temporary movement of people to provide services through mode 4, such as quotas, labour market tests and limits on durations of stay.³² Despite its importance, services trade continues to face certain restrictions, particularly in professional services and transport (figure 16).

³² International Monetary Fund, World Bank and WTO, 2017, Making trade an engine of growth for all: The case for trade and for policies to facilitate adjustment.

Figure 16
Index of services trade restrictions average, selected sectors



Source: World Bank Services Trade Restrictions database.

Note: Index values are from 0, signifying that the sector is completely open to trade, to 100, signifying that the sector is completely closed.

38. Addressing restrictions requires proactive, appropriately sequenced trade policies to reform the services sector, including through trade negotiations, facilitation and promotion. This may best be done through inclusive multi-stakeholder processes. Liberalization policies require attention to be paid to the risks, costs and trade-offs that the reform agenda may entail for national regulatory autonomy and policy space. This points to the importance of adequately designing the content, pace and sequence of the liberalization process, in order that regulatory and institutional frameworks may be built in advance of liberalization, and the importance of ensuring that the trading system allows countries to address adjustment challenges, including through adequate revision and rollback mechanisms of commitments and facilities for adjustment support. Support to developing countries is important, for example through preferential treatment and aid for trade to build supply capacity, towards an international trading system that helps achieve the Goals. Regional, multilateral and international cooperation is necessary, particularly to strengthen national regulatory frameworks.

B. Multilateral trading system

39. Progressive services liberalization has been pursued at the multilateral level under WTO. Services negotiations were integrated into the Doha Round launched in 2001. However, lack of progress and uncertain prospects have contributed to intensified plurilateral and regional initiatives outside of WTO. In an effort to deliver multilateral outcomes, countries have recently opted for a less ambitious agenda. The main services-related outcome of the tenth Ministerial Conference, held in December 2015, was the extension of the preferential treatment to services and services suppliers of LDC for an additional four years until 31 December 2030. Services are also relevant for graduation from the LDC category (box 4).

Box 4

Services-related preferential treatment and graduation from the LDC category

The Programme of Action for the Least Developed Countries for the Decade 2011–2020 aims for half the number of LDCs to meet the criteria for graduation by 2020, and target 17.11 of the Sustainable Development Goals aims to double their share in world trade by the same year. LDCs are not yet on track to meet this target. Their share of merchandise exports in global exports decreased from 1.1 per cent in 2010 to 0.9 per cent in 2016. Services exports from LDCs rose from 0.6 per cent in 2010 to 0.7 per cent in 2016. As LDC exports are still concentrated in a few primary products, it is important to strengthen industrial and services productive capacity to promote economic diversification, including by addressing services trade barriers.

A preliminary assessment of 23 services waiver notifications shows some preferences submitted under the Doha Round and matching preferences in regional trade agreements. A modal analysis reveals that there are several preferences under mode 4, but that the majority of these have limitations. Generally, few notifications focus on preferential regulatory treatment, support for LDCs in conforming to domestic regulations and meeting quality standards in foreign markets – a key avenue to providing meaningful and effective preferences.

Sources: A/71/275; Overseas Development Institute, 2017.

40. New efforts prior to the eleventh Ministerial Conference, to be held in December 2017, aim to identify deliverables with regard to services, namely domestic regulation disciplines; propose a trade facilitation agreement for services; and address services aspects of e-commerce. In the long term, there is a need to effectively operationalize the development provisions of the General Agreement on Trade in Services (GATS), such as article IV and the annex on telecommunications, to allow countries to implement proactive policies necessary to explore the potential of services for structural transformation.

1. Domestic regulations

41. Disciplines for domestic regulations are highly relevant to the efforts of countries to enhance the contribution of services to structural transformation and global value chains. GATS mandates WTO members to conduct negotiations to develop multilateral disciplines on domestic regulations for qualification and licensing requirements and procedures and for technical standards, in order that these instruments do not act as unjustifiable trade barriers. Following years of inconclusive negotiations to develop a comprehensive set of disciplines covering all issues in article VI.4 on transparency, licensing, qualification and technical standards requirements and procedures, a less ambitious building-block approach has been adopted to focus on a few specific elements of the possible disciplines.

42. One recent proposal seeks to address the administration of requirements and procedures for licensing, qualification and technical standards. The aim is to simplify the steps required for suppliers applying for authorization to supply services in sectors and modes of supply in which WTO members have undertaken specific commitments, such as through the establishment of single windows. Another proposal addresses transparency, proposing that members provide the information necessary for services suppliers or persons seeking to supply a service to comply with the requirements for obtaining authorization. A key element relates to the opportunity for interested persons to comment on and receive information before the entry into force of regulations. Two other proposals with regard to the development of measures raise concerns regarding policy space, as some provisions could impose constraints on developing countries, such as with regard to publications, information availability and enquiry points (which might lead to an obligation for members to disclose information to suppliers or persons seeking to supply a service, and not to other members, as under GATS).

2. Trade facilitation agreement for services

43. WTO members have recently embarked on discussions regarding a proposal by India for a trade facilitation agreement for services. The premise for the proposal is the importance of ensuring a timely and cost-effective delivery of services for members and the related need to facilitate the movement of information, data, technology and natural and juridical persons to enable services trade in an increasingly globalized and digitized world, while easing the regulatory burden for the realization of the full benefits of trade in services. It is proposed that the agreement apply all measures by members affecting trade in services in sectors in which specific commitments have been undertaken.

44. The proposed agreement includes several elements of domestic regulations related to publication, information availability and the administration of measures. The agreement also provides guidelines regarding fees and charges, the administration of economic needs tests and the recognition of qualification and licensing requirements. Several measures are proposed to facilitate the effective supply of services through different modes, such as the cross-border transfer of information by electronic means, facilitating consumption abroad, and provisions facilitating the movement of natural persons (for example through separate visa categories that correspond to each category of natural person in respect of which commitments have been undertaken, multiple entries and exemptions from social security contributions for natural persons engaged in the supply of services). The agreement models special and differential treatment provisions on the Agreement on Trade Facilitation. Conversely, some elements of the proposed agreement are contested by its possible impact on developing countries, including provisions on transparency, cross-border flows of information and economic needs tests. Some proposals emphasize that the supply and consumption of services rarely involve a single mode in isolation and that a discussion of all modes is therefore necessary. Typically, modes 1 and 3 complement mode 4. This topic has traditionally been considered an area of particular interest for developing countries, yet their services suppliers face a variety of barriers in mode 4. Further discussions on mode 4 regional trade agreement practices have been proposed, including on access, pertinent regulatory disciplines and mode 4 commitments administered within broader regulatory frameworks, such as labour and immigration frameworks, where non-economic and non-trade policy objectives play a significant role.

45. Other WTO discussions concern investment facilitation, which may impact GATS and elements of the proposed trade facilitation agreement for services. The question of whether there is need to develop rules in this area has been raised.

3. Electronic commerce

46. With regard to e-commerce, a group of countries has suggested examining developments in and potential constraints on related business opportunities, and the ways in which trade disciplines can facilitate e-commerce. Proponents aim to ensure balance is preserved between further unlocking the potential of e-commerce and fulfilling legitimate regulatory objectives related to e-commerce, such as on data protection, privacy protection and cybersecurity. Such objectives may lead to controversial regulations, such as commercial presence and localization requirements. It is therefore important to examine the need to develop rules in this area and determine the best technological and regulatory means of ensuring policy objectives.

47. One proposal suggests extending, at the eleventh Ministerial Conference, the moratorium on e-commerce, to continue the practice of not imposing customs duties on electronic transmissions. Yet another proposal focuses on electronic signatures as one of the essential tools for e-commerce and electronic contracts and bank operations. Another proposal focuses on trade policy considerations and how digital technology is transforming the global economy. Several developing countries have emphasized the importance of e-commerce for development. Related issues of interest to developing countries include empowering smaller businesses to use e-commerce and lower the costs of conducting trade (such as through access to logistics services); addressing infrastructure gaps (such as in broadband access) to enable e-commerce; and improving business and consumer access to various payment options, including payment through mobile telephones

and cash-on-delivery options, to better enable them to conduct and access cross-border e-commerce.

C. Plurilateral and regional initiatives

48. Services have become a key feature of new-generation regional trade agreements oriented towards deeper and more comprehensive integration, with a strong regulatory focus, and addressing behind-the-border regulatory measures affecting services, investment and competition, such as the continental free trade area (box 5) and the Trans-Pacific Partnership.

Box 5

Continental free trade area

The continental free trade area negotiations, launched in June 2015, aimed to achieve a comprehensive and mutually beneficial trade agreement by 2017. The first phase of negotiations covered goods and services and the second phase is expected to cover investment, intellectual property and competition issues. Negotiators are currently considering a draft agreement on trade in services, as well as modalities for trade in services negotiations. Key principles of the negotiations include the following: negotiations shall be driven by member States of the African Union, regional economic commissions and customs territories; free trade agreements of regional economic commissions shall serve as building blocks for the continental free trade area; preservation of *acquis*; variable geometry; substantial liberalization; and there shall be no *a priori* exclusion of any services sector or mode of supply of services in negotiations.

Source: African Union, 2015, Decision on the launch of continental free trade area negotiations, Decision No. 569-587.

49. Following the withdrawal in January 2017 of the United States from the Trans-Pacific Partnership, the remaining members are seeking to pursue the agreement with a *minus one* approach. In a marked departure from GATS, the investment chapter of the Trans-Pacific Partnership covers all investments, including in services, while the cross-border trade in services chapter encompasses the supply of services under modes 1, 2 and 4. The agreement also includes a chapter on regulatory coherence, defined as “the use of good regulatory practices in the process of planning, designing, issuing, implementing and reviewing regulatory measures in order to facilitate achievement of domestic policy objectives”. The agreement reiterates the sovereign right to identify regulatory priorities, yet also promotes regulatory coherence as a means of facilitating increased trade and investment between the parties.

50. The Trade in Services Agreement has been negotiated since 2012 between 23 members of WTO, representing 70 per cent of global services trade. Negotiations were expected to be concluded in 2016, yet this did not materialize. Participating countries have identified common criteria to evaluate the offers presented, including on commitments beyond GATS and commitments that match the best free trade agreements of countries. Particular attention is given to the level of commitments under mode 4, as well as the treatment of new services. Divergences have emerged related to certain issues such as the liberalization of public services, data protection and the process for dealing with new services in schedules of commitments.

VI. Conclusion

51. Services play a crucial role in support of economic transformation. Adequate regulation and international trade can generate further transformation opportunities, particularly for developing countries. Trade in services plays an important role in economic transformation, employment creation and value addition, enabling countries to diversify and upgrade their economies, including through integration into global value chains. There is a need for economies to pursue a balanced growth strategy to capitalize on the

growth-inducing and catalytic role of services. It is also important for the positive effects of services on structural transformation and in achieving the Sustainable Development Goals to be widely communicated and appreciated.

52. Maximizing the positive contributions of services requires, as preconditions, good policies, adequate regulations and strong institutions, together capable of creating an enabling environment for the services economy and trade. Evidence-based policymaking requires sound, timely and disaggregated data, including at the firm level. Human, regulatory and institutional capacity-building is fundamental to allowing developing country exporters to export, producers to use imported services inputs and policymakers to effectively regulate and develop services sectors. An inclusive and multi-stakeholder approach to and public-private partnerships in services policymaking are needed to ensure policy and regulatory coherence. The assessment and revision of national services economy and regulatory frameworks are prerequisites for evidence-based, active policies aimed at services-led growth. UNCTAD services policy reviews have been found particularly useful in this regard.

53. At the international level, efforts are needed to advance a global services trade agenda in the international trading system that is supportive of the Sustainable Development Goals, and includes preferential treatment, flexibilities, experimentation, adjustment mechanisms and support and capacity-building for developing countries, in order to unlock the transformative potential of services trade to spur growth and development. Adequately designing the content, pace and sequence of the liberalization process and coordinating this process coherently with the implementation of national policies and regulations, is essential to creating an enabling environment for trade in services. Complementary measures, such as strengthening regulatory cooperation relating to services trade to create a more facilitative services trade environment, could also make an important contribution.
