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**Policy Dimension of Trade in Services and Economic Transformation**

by

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# POLICY DIMENSIONS OF TRADE IN SERVICES AND ECONOMIC TRANSFORMATION



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# INTRODUCTION

- Debate on economic transformation (ET) centres on transforming agriculture and moving into manufacturing, services remain an unexplored component
- Many policy makers in low-income countries (LICs) do not regard services, even less trade in services, as a focus of action on ET
- Sceptical view suggests that services follow rather than lead ET.
- However, Balchin et al (2016) finds that
  - Productivity differentials are large and occur across countries, across services and other sectors and between firms within services sectors.
  - Services play a key role in aggregate productivity change and successful countries have seen productivity change in services and other sectors at the same time (Balanced growth)
  - Services are embodied in goods trade – developing manufacturing without quality services is difficult if not impossible.

# POLICY CHANNELS

- Policy (including policy directly affecting trade in services) can have major impact in terms of raising the contribution of services for ET
- Even when promoting manufacturing exports is priority, the answer can be found in trade in services policy
- In policy designing, important to recognise the heterogeneity in the impacts of different services sectors on ET.
- Some services are important revenue and foreign exchange earners (hydropower, tourism, information and communication technology (ICT))
- In others, linkages with the rest of the economy are more prominent (e.g. suppliers in the tourism sector).
- Some sectors are key for supporting productivity/trade in other sectors (e.g. ICT, logistics, finance) and these linkages are perhaps less visible

# TARGETED TRADE POLICY IN LICS

- Openness is related to transformative effects in the services sector.
- Export promotion is important for services producers and economic transformation more generally.
- Imported services are a key part of the value added embedded in a country's goods exports: necessary to remain open towards imports in services.
- Openness to FDI: the effect of foreign ownership on labour productivity is large and positive in the services sector in LICs, although heterogenous.
- Trade policy plays a crucial role in opening markets, regionally as well as internationally (e.g. in airline services).
- An open service sector will increase competition and help domestic services firms become more competitive.

# FRAMING POLICIES

- Liberalisation, however, need to recognise the complicated nature of the regulations that affect trade in services.
  - Many regulations are embedded in the domestic regulatory frameworks and they may be justifiable by addressing certain standards of quality (i.e. certification of medical practitioners).
  - But they can constitute a impediment to trade in services, constraining the policy space and requiring more innovative approaches
- Some services sectors in countries have managed to overcome constraints to liberalisation and implemented domestic regulatory frameworks that are non-trade-distorting.
  - Mauritius, South Africa and Uganda have begun to liberalise air access to support tourism services
  - Senegal and Mauritius have also liberalise their telecommunications sector, improving efficiency and making ICT services sectors more competitive.
- There is a range of mechanisms available to negotiate better access for developing countries' services exports.
  - Plurilateral level (WTO General Procurement Agreement)
  - Regional level: they facilitate mutual recognition of services sector qualifications (South-East Asia)
  - Bilateral: facilitated access for mode 4 from developing countries (Chile-US FTA)

# ENABLING POLICIES

- Basic factors are key for success in some services sectors (e.g. natural resources/endowments for hydropower (Lesotho, Nepal) and tourism (Mauritius, Tanzania) or a skilled workforce and telecommunications infra for ICT).
- Active services policy play an important role in promoting exports of services (e.g. software technology parks (India) and a cyber city (Mauritius) to support ICT services).
- Iterative, adaptive and flexible approaches have proven successful in setting up mechanisms to coordinate investment in certain services sectors (e.g. hydropower in Nepal).
- An appropriate regulatory framework for services promotes competition and improve efficiency, ensuring services exports are competitive in int'l markets (e.g. liberalisation of telecommunications in Senegal/Mauritius).
- Regulation and political economy considerations are particularly important in large services sectors.
- Productivity of services firms in LICs that supply exporters is low on average: ET potential by raising their productivity, which will have knock-on effects on trade in goods and services, etc.

# CASE STUDIES

- Financial services in Africa: Higher degree of financial deepening in Kenya than in Nigeria.
  - Policy-led integration with EAC has boosted Kenya's trade in financial services.
  - Lack of integration and sectoral development strategy have hampered the development of the sector in Nigeria.
- Tourism in Mauritius and Tanzania. Improvement in liberalisation air travel in both countries
  - Diversification of offer in Mauritius (medical and business tourism) and improvement of infrastructure.
  - Deficiencies in the availability and quality of tourist-related infrastructure and a shortage of relevant skills in the domestic economy in Tanzania
- IT in India, Mauritius and Senegal. Key good internet connectivity and liberalised telecoms sector
  - Basic factors need to be in place to develop exports of ICT services, including a skilled workforce and telecom infra.
  - Clusters are also important (Cyber City in Mauritius and Software parks in India)
- Airlines: Location is key. Key is the negotiation of bilateral regular services agreements
  - Kenya and Ethiopia capturing traffic between Asia-Europe-Africa. Is there space for other local players? (e.g. Rwanda air)
  - Ethiopia more successful in developed horizontally (e.g. cargo) and vertically (e.g. MRO services)

# FINAL COMMENTS

- Services play a key role in productivity change and successful countries have seen simultaneous productivity growth in services and other sectors (Balanced growth)
- Policy (including policy directly affecting trade in services) can have major impact in terms of raising the contribution of services for ET
- Even when promoting manufacturing exports is the top priority, trade in services policy can be instrumental
- Export promotion and liberalisation of import of services are key: Services are an increasing part of the value added embedded in a country's goods exports. Openness to FDI also important.
- Liberalisation, however, need to recognise the complicated nature of the regulations that affect trade in services.
- Certain policies act as enablers and they unlock the transformational effect of trade policies in the service sector.
- Case studies in LICs suggest the roles that different services have had on ET and the policies that support them.

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