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# Trade in Services and Economic Transformation

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# WHAT IS ECONOMIC TRANSFORMATION?

- Analysing ET involves understanding the determinants of growth and productivity at the micro, sectoral and macro levels.
- This includes understanding how resources move to higher-value uses and the role played by diversification in production and trade.
- ET can be defined as moving factors of production (labour, capital and land) from lower to higher productivity activities. This implies
  - Moving resources between sectors (for example, from agriculture to manufacturing). This is called Structural Change.
  - Improving productivity within sectors (for example, from subsistence agriculture to high-value crops)

# STRUCTURAL CHANGE AND WITHIN SECTOR PRODUCTIVITY

- In poor countries:
  - Agricultural sector: Lower productivity than in rich countries. Large share of labour force.
  - Labour productivity in manufacturing and services lower than in rich countries but smaller gap.
- Evidence suggests that **structural change** plays a key role in the productivity catch-up with developed countries.
- There is a high degree of heterogeneity in firm productivity within sectors. These gaps tend to be bigger in poor countries.
- Within-sector productivity growth implies, therefore, the **reallocation of resources from low to high productivity productive units within a sector**.
  - This implies the exit of low productivity units, the movement of resources to those most productive and the entry of new more productive firms.
  - But, within sector productivity growth is also achieved by increasing efficiency by the upgrading of the existing firms

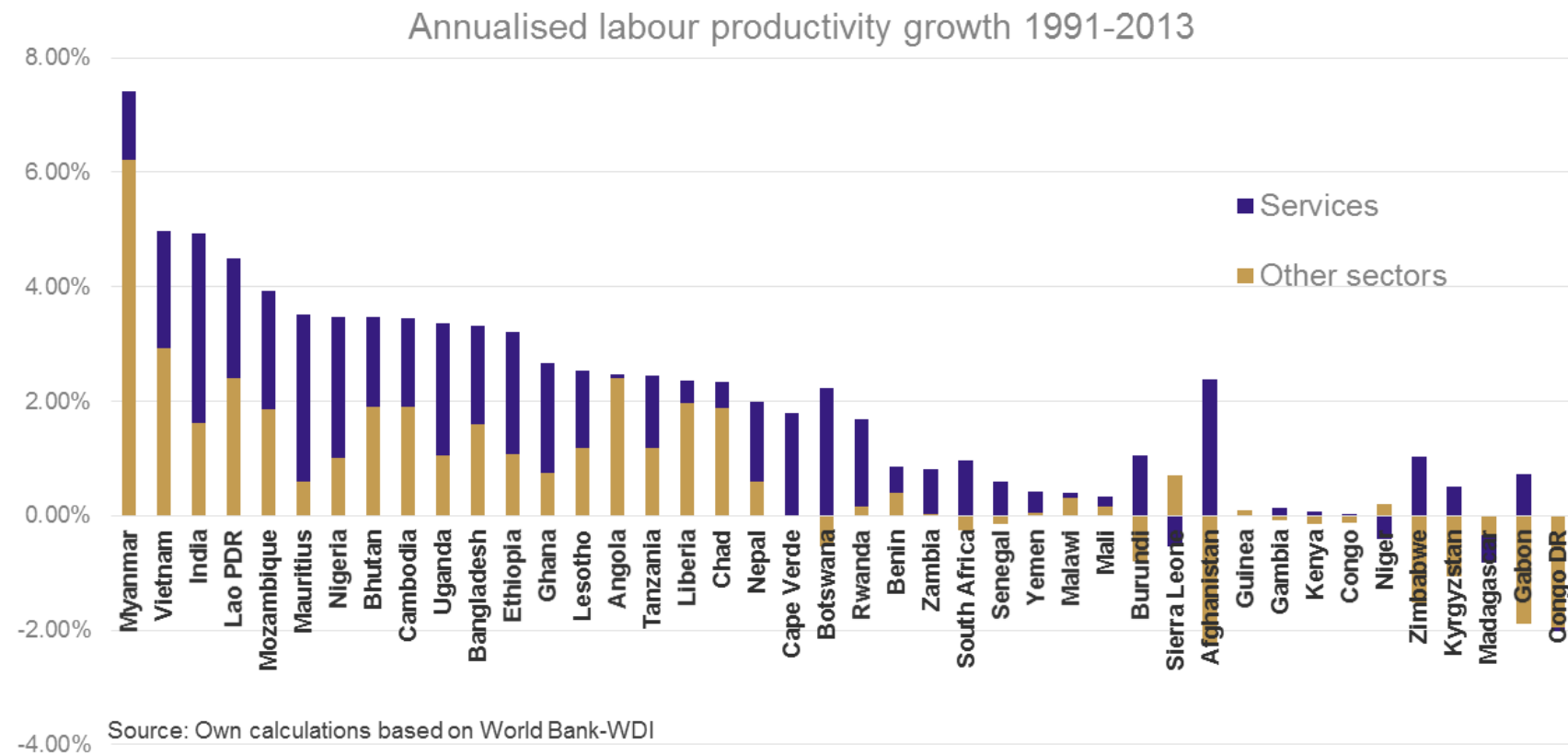
# ECONOMIC TRANSFORMATION AND TRADE

- In Developing countries, domestic markets are not big enough to provide the required size and diversification of demand.
- Market size does not provide enough competition for the provision of efficient and cost effective inputs necessary to increase productivity.
- Therefore, ET and trade are intimately linked:
  - Trade provides opportunities for diversification in production
  - Trade helps on the discovery and development of new productive capabilities
  - It helps to create higher domestic value added in trade.
- At the same time, there is a simultaneity in the relationship. If ET has been successful:
  - we should observe a more diversified production and export structure
  - Higher domestic value added in output and trade
- Global competitiveness, even in large economies, is key in achieving ET. Market size is important but market discipline and other competitive effects are key.

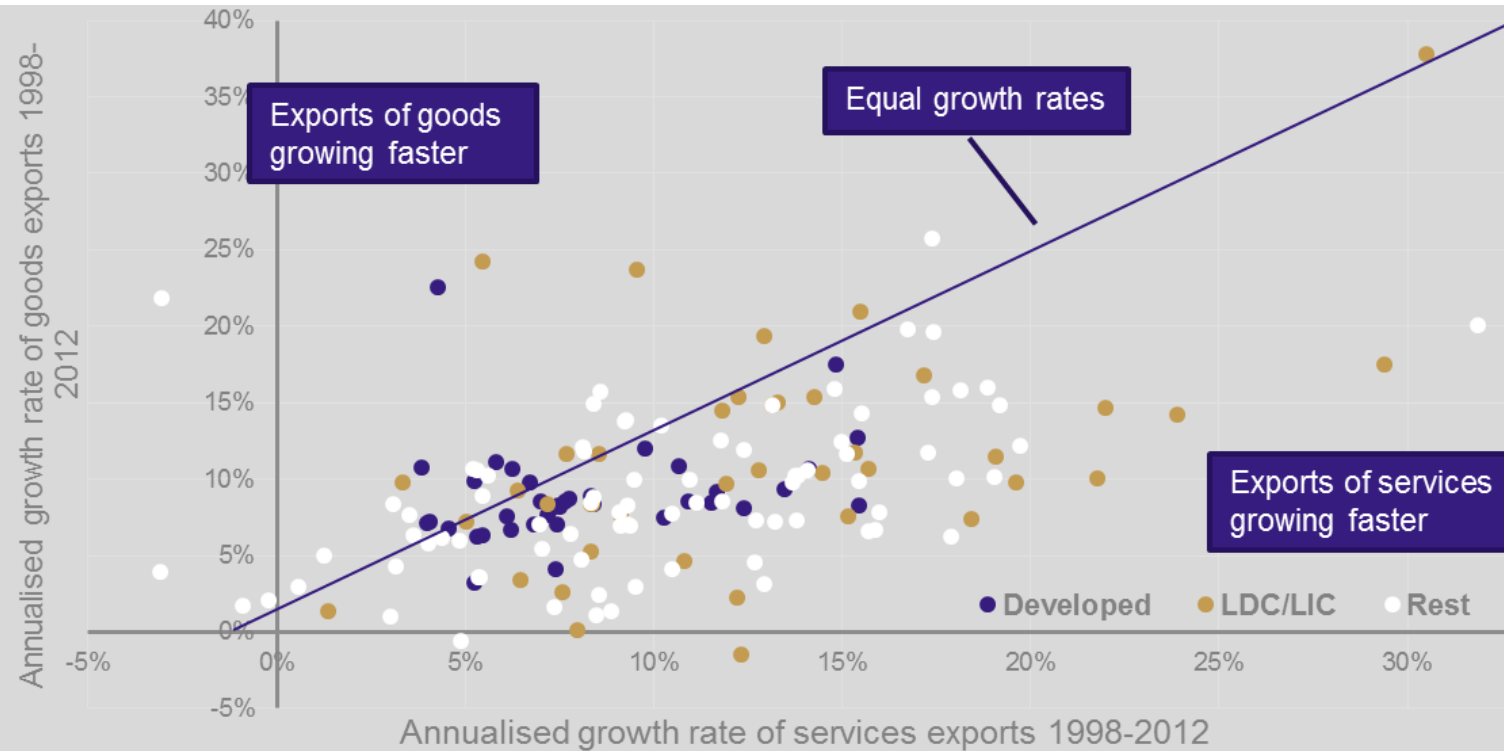
# SERVICES AND ECONOMIC TRANSFORMATION

- Services share in employment and output growing in all countries.
  - In SE Asia is the reversion of a previous industrialisation process..
  - In Africa, there is a movement of resources from agriculture into services.
- Necessary to distinguish two types of services:
  - **Modern:** can be traded with important productivity growth. Employ mostly skilled workers. Easier for middle-income countries to step into them.
  - **Traditional:** normally non-tradable and marginal productivity growth. They employ unskilled workers. Seen in Africa.
- Pessimistic view of the role of services:
  - Movement of resources from agriculture to traditional services keep resources in low productivity activities.
  - Services tend to be mostly non-tradable.
- However, recent evidence indicates.
  - Important services contribution to productivity growth
  - Exports of services from many LDCs have grown faster than trade in goods in the last 20 years
  - Services value added is increasingly embedded in other products exports
- Nevertheless, services are very protected (more than agriculture) around the world, specially in LDCs.
  - Financial regulations is blocking the expansion of mobile financial services in the EAC.
  - Services provided under mode 4 remain mostly restricted (only 0.5% of US imports of services are mode 4)

# SERVICES EXPLAIN MUCH OF THE PRODUCTIVITY GROWTH IN DEVELOPING COUNTRIES

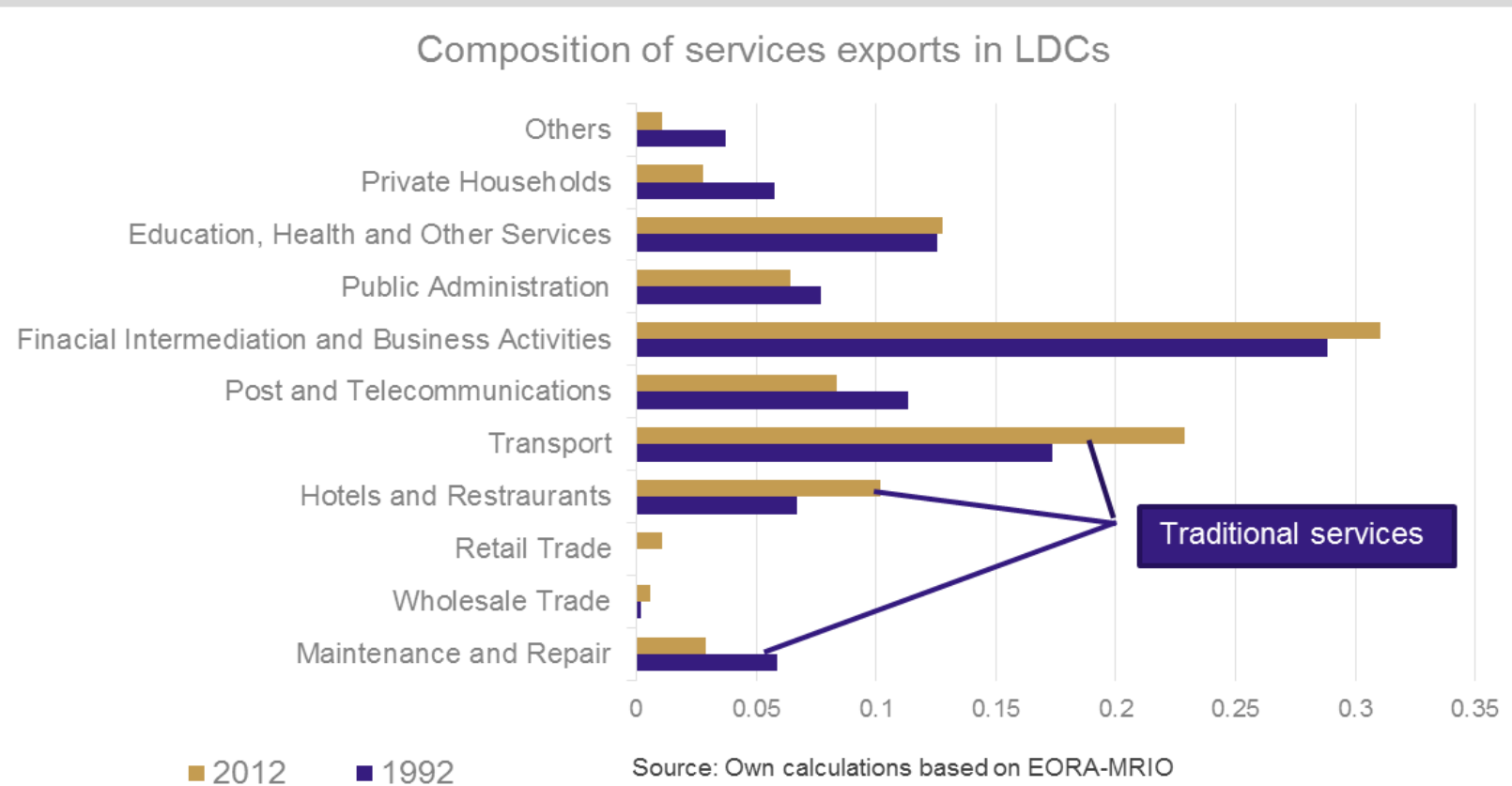


# IN MANY LDCS, EXPORTS OF SERVICES HAVE GROWN FASTER THAN TRADE IN GOODS



Source: Own calculations based on UNCTAD

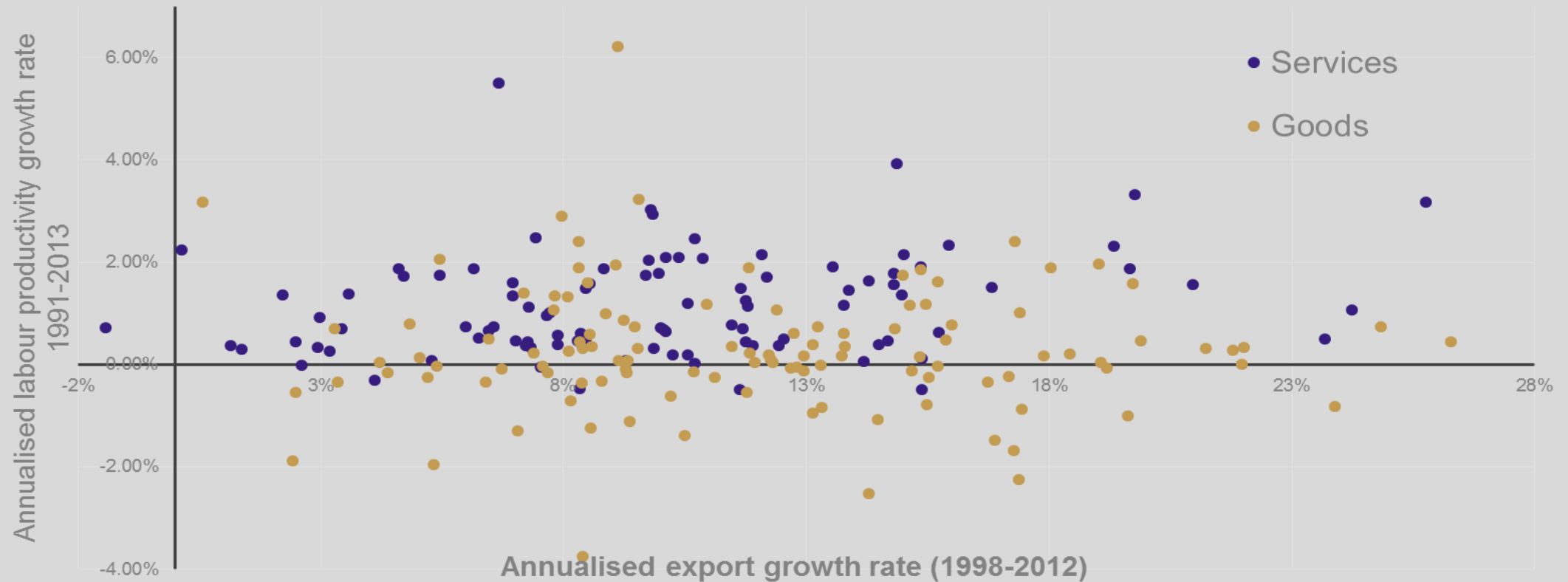
# STRUCTURE OF SERVICES EXPORTS: IMPORTANCE OF EXPORTS OF TRADITIONAL SERVICES IN LDCs



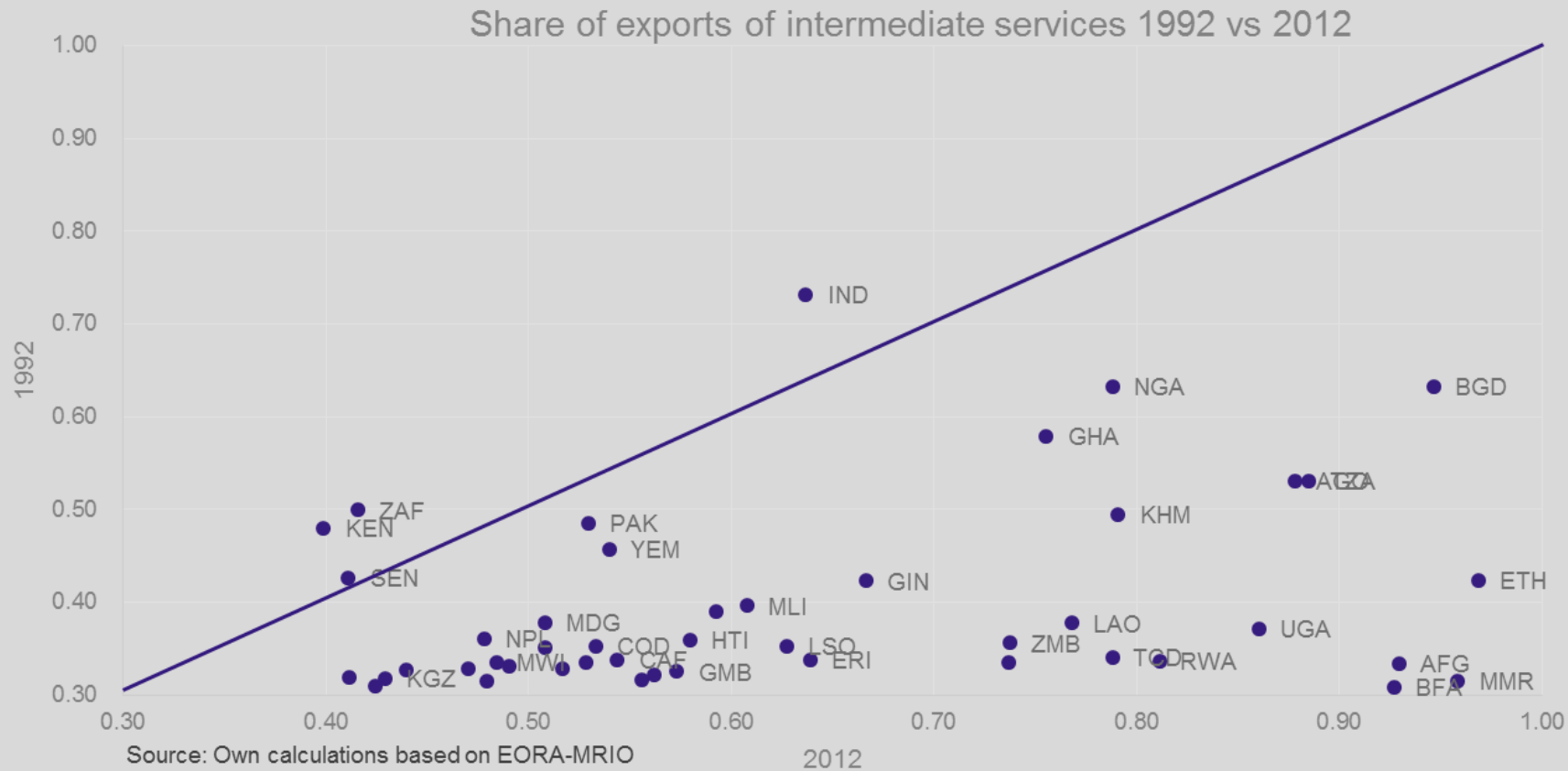


# PRODUCTIVITY GROWTH AND SERVICES EXPORT GROWTH POSITIVELY ASSOCIATED IN MOSTLY ALL COUNTRIES.

Productivity and export growth

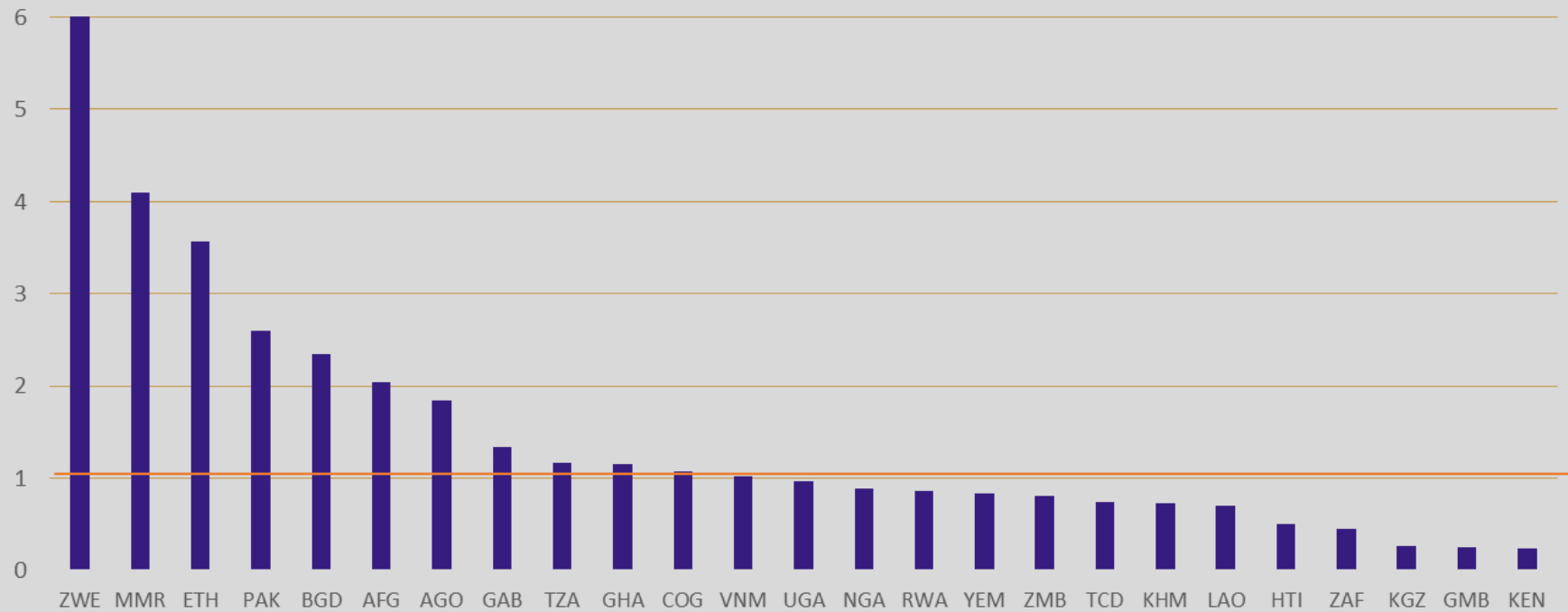


# SERVICES EXPORTED FROM DEVELOPING COUNTRIES INCREASINGLY PART OF VALUE CHAINS IN OTHER COUNTRIES



# VALUE ADDED FROM SERVICES GREATER THAN EXPORTS OF SERVICES IN SOME DEVELOPING COUNTRIES

Services value added in exports and exports of services (ratio) 2012



Source: Own calculations based on EORA-MRIO

# FINAL COMMENTS

- Productivity growth is essential in ET. Countries can jump towards higher productivity sectors or to increase productivity within sectors.
- Manufacturing is generally regarded as the most transformative sector; however, not all manufactures provide the best opportunities for LDCs.
- Although traditional services generally provide weaker links to ET, evidence indicates that they are traded in developing countries and they might have important productivity effects.
- The potential for ET and trade in services is stronger when seen under the light of trade in value added.
- Services are very protected. This limits the possibilities to mode 2 provision (and through value added in exports)
  - More and deeper preferences may be needed for LDCs. Current waiver not suited for LDCs capabilities.
  - There is scope for more services chapters in regional trade agreements, particularly those involving LDCs.
- More open services sectors in LDCs and developing countries contribute to both productivity in the services sector and in the other sectors as well.

# SET

## SUPPORTING ECONOMIC TRANSFORMATION

The Supporting Economic Transformation (SET) is an ODI programme funded by UK DFID to support countries in their quest for economic transformation through data and policy analysis and covering. The views expressed are those of the researchers and do not necessarily represent the views of ODI or DFID.

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