Role of Services and Services Trade in Developing Asia’s Growth

Submitted by: ADB
Role of services and services trade in developing Asia’s growth
Session 1

Dr Donghyun Park, ADB (dpark@adb.org)
APEC Workshop on Role of Cross-Border Services in New Growth Strategies
Sendai, Japan
16-17 September 2010

Outline of presentation
- Introduction: why do services matter for Asia?
- Stylized facts about services in Asia
- Role of services in long-term structural change
- Role of services in rebalancing Asia
- Concluding observations and policy implications
1 Introduction: why does services matter?

- Services is a heterogeneous sector, ranging from low-skill, low-tech to high-skill, high-tech
  - Street vendors versus medical services
- While Asia has a world-class manufacturing sector, services sector lags substantially.
  - Share of GDP and productivity
- Manufacturing has been Asia’s primary engine of growth.
  - East Asia’s export-oriented manufacturing
  - In the special case of India, export-oriented services

- Services can become a new engine of growth for the region.
  - Precisely because it is under-developed, lot of scope for growth.
- Services industries remain a promising area for investment.
  - Reverse past under-investment.
  - Already a lot of capital stock in manufacturing.
- Productivity improvement in services can promote productivity and hence GDP growth.
  - Asia is shifting from accumulation-led growth to productivity-led growth ⇒ Park and Park (2010).
1 Introduction: why does services matter?
• More and better services also lift productivity of manufacturing and other sectors.
  ◦ i.e. services are an input in manufacturing.
  ◦ e.g. better access to financial services promotes innovation and technological progress.
  ◦ e.g. transportation and distribution are vital for agriculture.
• Services is a major source of jobs.
  ◦ Services tend to be labor-intensive relative to manufacturing.
  ◦ Even McJobs help to reduce poverty.

1 Introduction: why does services matter?
• Services are conducive for environmentally sustainable growth.
  ◦ “Smokestack factories” are harmful for environment.
  ◦ Knowledge-based industries, which are often services, tend to have smaller environmental costs.
    ◦ E.g. education, medical care, entertainment
  ◦ However, services are also a source of pollution.
    ◦ E.g. low-end tourism
• More and better services enhance consumer welfare.
  ◦ More and better shops make for happy shoppers.
  ◦ More and better restaurants make for happy diners.
2 Stylized facts: share of services in GDP

2 Stylized facts: share of services exports in total exports
2 Stylized facts: share of services imports in total imports

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>China, People's Rep. of China</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>India</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Japan</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Korea, Rep. of Korea, Republic</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Malaysia</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mexico</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Philippines</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Singapore</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Thailand</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>United States</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

2 Stylized facts: share of services trade in total trade

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>China</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>India</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Japan</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Korea, Rep. of Korea, Republic</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Malaysia</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mexico</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Philippines</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Singapore</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Thailand</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>United States</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
2 Stylized facts: share of services in total employment

2 Stylized facts - summary
- Popular view that services are underdeveloped in developing Asia is largely supported.
- Services account for a smaller share of output in the region than advanced economies.
  - Also, smaller share of trade and employment
  - In many cases, most notably China, smaller share relative to economies at similar incomes.
- Asia’s services productivity lags substantially.
- There are some exceptions, such as India’s business services, and Singapore and HK.
- Overall, however, there is a large scope for growing the services sector in Asia.
3 Role of services in structural change

- When economies grow, they typically change rather than replicate themselves. [ADB (2007)]
  - Structure of economy changes – i.e. shift from agriculture to services and manufacturing.
  - The structure of output within each sector also changes – i.e. low-tech to high-tech manufacturing.

- In Asia, as elsewhere, services played an important role in structural change.
  - Share of services in output and employment has risen gradually, closely in step with share of manufacturing.
  - Share of services rises monotonically with income and does not accelerate.

3 Role of services in structural change

- Asia tends to be more industrialized for given levels of per capita income.
  - Supports manufacturing bias of Asia’s growth pattern.

- There is much greater “inertia” in the movement of employment shares than in output shares.
  - Agricultural employment shares tend to be much larger than output shares.
    - Labor productivity is higher in manufacturing.

- Speed of structural change has accelerated over time.
  - Comparison of advanced economies versus East Asia
3 Role of services in structural change

- In industry, Asia’s labor productivity is catching up with OECD levels.
  - In richer economies, already quite close to OECD.
  - China is far behind but productivity is rising fast.
- In services, there is more limited evidence of convergence in labor productivity.
  - Caveat – difficulty of measuring labor productivity in services.
  - HK and Taipei are at or close to OECD.
  - Korea and ASEAN lag behind and are not catching up.
  - For China and India, catch-up is glacial.
- Overall, the evidence points a need for Asia to improve labor productivity in services.

3 Role of services in structural change

- Contribution of services to labor productivity growth has been substantial.
  - Contribution depends on share of output as well as sector-specific productivity growth.
  - In some cases – e.g. India, Taipei and Philippines – higher contribution than industry.
- Within-sector productivity growth dominates Baumol’s structural bonus.
  - Services account for large share of within-sector productivity growth.
  - Same goes for Baumol’s structural bonus.
- Again, strengthening services sector will yield major dividend for Asia’s growth.
3 Role of services in structural change

- Walking on two legs, with industry and services moving forward, is future of Asia’s growth.
  - Vital complementarities between the two
- Services has long been a critical “safety valve” source of jobs, mostly low-productivity jobs.
- Widest productivity gap is in services and closing it would give a big boost to growth.
- However, this requires a profound shift in the mix of services toward high-productivity services.
- Economy-wide benefits of high-productivity IT and BPO enclaves have been limited.
  - e.g. India and Philippines

4 Role of services in rebalancing Asia

- Global crisis highlights the risks of excessive dependence on external demand.
  - Global crisis was a trade crisis rather than a financial crisis from Asia’s perspective.
- Global current account imbalances contributed to the crisis.
  - Large and persistent surpluses of Asia and oil exporters counterbalanced by US deficits.
- Obvious solution to reducing excessive external dependence is to strengthen domestic demand.
  - Rebalancing economy toward domestic sources of growth – ADB (2009)
  - Size of surplus and need for rebalancing varies widely across economies.
4 Role of services in rebalancing Asia

- Imbalance between domestic output and demand is due to either under-investment or under-consumption.
- In Asia’s case, the output-demand gap is driven primarily by under-consumption.
  - Investment rate is more or at less “right” levels.
  - We find much stronger evidence of over-saving, especially for China.
- Therefore, strengthening consumption has to be a central element of rebalancing process.
  - e.g. Strengthening social protection and social safety nets to ease household uncertainty

4 Role of services in rebalancing Asia

- However, another key dimension of rebalancing is the supply-side.
  - In particular, output mix geared toward external demand. ⇒ producing goods for which there is little or no domestic demand
  - However, Asia is now a middle-income region with large and growing middle-class and purchasing power
- Rebalancing output mix toward domestic demand will have to involve strengthening services industries.
  - Services industries are typically oriented toward domestic demand and are dominated by SMEs.
  - As noted earlier, better and cheaper services and greater variety of services can stimulate private consumption.
4 Role of services in rebalancing Asia

- Stronger domestic demand in Asian economies will benefit intra-Asian trade.
  - This is already large, both in absolute and relative terms, but this partly reflects trade in parts and components for eventual exports to outside region.
  - Stronger domestic demand will give rise to intra-regional trade in final goods.
    - China exporting clothes to and importing clothes from Korea

- It will also benefit services and intra-regional trade in services.
  - Services are an integral component of consumption.
    - E.g. China’s rise as a major source of tourists in Asia

5 Concluding observations

- Asia has always had a big services sector and it has played a major role in Asia’s growth.

- Nevertheless, as a result of a growth strategy which favored export-oriented manufacturing, services lag behind manufacturing.

- This suggests that unleashing the full potential of the services sector can serve as a new engine of growth for the region.

- Unleashing the potential requires, above all, various policy distortions which have stunted the growth of services.
  - E.g. pro-manufacturing policy bias and various regulations which limit competition in services industries
5 Concluding observations

- One especially harmful barrier to growth of services has been limits on foreign competition.
  - Foreign competition, in the form of both FDI and trade, can boost productivity of services industries.

- Therefore, liberalization of trade in services and FDI in services is helpful for productivity growth in services and hence economic growth.

- One structural challenge for Asian services is to move up the value chain.
  - But this requires large investments in human capital, infrastructure and other areas.

---

5 Concluding observations

- In the post-crisis world, Asia may have to modify its export-led growth model.
  - Asia will retain its fundamental openness and outward-looking orientation.
  - However, growth of exports to G3 will slow down.

- More broadly, Asia will have to adjust from growth based on exports, investment and capital to growth based more on domestic demand, consumption and labor.

- Such adjustment is conducive for more inclusive and sustainable growth.
  - Services will be at the front and center of the adjustment process.
References