Role of Green Services in Developing Asia’s Growth

Submitted by: ADB
Role of green services in developing Asia’s growth
Session 4A

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: Asia’s need for rebalancing

● Role of services in rebalancing Asia

● Greening Asia’s services sector

● Pro-environment business models

● Concluding observations and policy implications
1 Introduction: Asia’s need for rebalancing

- Developing Asia was hit hard by global crisis, especially in 4Q 2008 and 1Q 2009.
  - Trade, especially exports to industrialized economies, was the primary channel.
  - Growth was flat in Korea and negative in HK, Taipei, Singapore, Malaysia and Thailand, and others.
- Crisis highlights the risks of excessive dependence on external demand, and hence need for rebalancing.
  - Strengthen domestic demand as well as adjust output mix toward domestic demand.
    - Both final and intermediate demand
    - Case of Korea ⇒ over-dependence on manufacturing

![Aggregate and household saving rate, Korea](image_url)

Source: Cho (2009)
1 Introduction: Asia’s need for rebalancing

- Korea’s current account balance has been more or less balanced.
  - Savings rate has been falling.
    - In fact, concerns about savings rate being “too low”.
  - Bottom line: Domestic demand is already robust.

- On the other hand, Korea’s services sector is under-developed relative to its manufacturing.
  - In particular, plagued by low productivity levels.
    - 2nd lowest among OECD countries, after Poland.
    - Entry and exit barriers, mandatory licensing, pro-manufacturing policy discrimination, and so forth.
  - Microeconomic structural policies are required to boost productivity of service industries.

Source: Cho (2009)
2 Role of services in rebalancing Asia
- In Asia, vitalizing the lagging services sector is vital for rebalancing output mix.
  - Wholesale and retail trade, transport, public service, financial, professional, personal services – education, health care and real estate
  - Directly consumed and also a complementary input into manufacturing and agriculture.
- Services matter a lot for employment, which matters a lot for labor-abundant Asia.
  - In the long run, a clear tendency for capital to substitute for labor in manufacturing.

2 Role of services in rebalancing Asia
- The distinction between goods and services is blurred in modern economies.
  - E.g. handsets and telecom services
  - Such packages of hardware and software are called product-service systems (PSS)
    - Especially prevalent in the advanced economies
  - Well-functioning PSS are vital for growth.
    - Airports --- Hard infrastructure is easy to build but world-class airports require soft infrastructure as well.
    - Same goes for financial systems.
- A number of factors suggest that developing services sector will be a core ingredient of sustaining growth in Asia.
  - Also, regional integration of service markets – e.g. ASEAN has made service integration a priority area since 1995
2 Role of services in rebalancing Asia

China faces an urgent need to develop services.

China’s services face a number of challenges.
- Relatively small services sector
  - In 2008, accounts for 43% of GDP and 35% of employment vs 55% and 54% average for middle-income economies.
- Market concentration and entry barriers
- Pro-manufacturing incentive bias
- Inefficient allocation of capital
- Incomplete urbanization and labor mkt rigidities
- Low investment in human capital
- Weak intellectual property rights protection

Policy options for boosting China’s services
- Reduce market concentration
- Promote SMEs
- Review incentive bias and grant equal footing to services
- Liberalize financial sector and develop capital markets
- Accelerate labor market reform to generate employment and foster urbanization
- Reform education to support innovation
- Strengthen protection of intellectual property rights
3 Greening Asia’s services sector

While Asia has grown rapidly for decades, environmental sustainability has not always been a high priority.

However, many economies have reached income levels – e.g. NIEs – where demand for clean environment typically emerges and grows.

Even in middle income economies – e.g. China – both policymakers and general public are recognizing the costs of environmental destruction.

Consequently, environmentally sustainable growth has reached the top of Asia’s development agenda.

3 Greening Asia’s services sector

On the face of it, services-led growth would appear to promote environmental sustainability.

- Smokestack factories vs university classrooms

However, transition to services-led growth does not automatically green the overall economy.

- Service economy and industrial economy are deeply integrated with each other. E.g. telecom and PC
- There is an environmental regulatory vacuum.
  - Most regulations are targeted at large manufacturers.
- Product-service systems (PSS)
3 Greening Asia’s services sector

- If services-led growth is based on business-as-usual production modes, environmental performance (EP) improvement will be limited.
- A more promising market solution to improve EP is environmentally sound business models that reduce the environmental cost of producing goods and services.

4 Pro-environment business models

  - A service provider is engaged to deliver a result to a customer, without reference to a specific technological system.
  - The customer does not specify the precise means or technology by which the result is achieved, but leaves this to the provider.
    - The example of Integrated Pest Management (IPM) services, in which, instead of selling pesticides, IPM providers assess a fee in return for which they promise to keep farmer’s losses to an agreed minimum.
4 Pro-environment business models

- When a business procures environmentally problematic goods and services such as chemicals, energy, pesticides, distribution, or waste disposal, the supplier derives its profit from the volume of chemicals sold, energy supplied, freight hauled, or waste removed.
  - Suppliers thus have little incentive to help customers reduce their demand.

- However, functional procurement/efficiency services business models can transform the procurement of these environmentally problematic goods and services into performance-based service arrangements.
  - The provider is incentivized to reduce the customer's consumption of the good or service in question—e.g., by retaining as profit some of the cost-savings achieved for the customer via efficiency gains.
  - Suppliers thus have little incentive to help customers reduce their demand for these goods and services.
  - These arrangements are implemented via performance contracts that embody these incentives.
4 Pro-environment business models

- But how can the service provider find efficiency gains that the customer cannot? Experience shows that there are at least three reasons:
  - Specialized expertise
  - Focus
  - Scale

- The best known example of such business models is the energy service company (ESCO) model which has consistently delivered EP improvements and profited both supplier and client.

---

4 Pro-environment business models

- Benefits of efficiency services models
  - Improve the competitiveness of key export and domestic production sectors by reducing total unit costs of production via significant energy, water, and resource efficiency improvements.
  - Help position Asian exporters as part of a green, carbon-efficient supply chain.
  - At high levels of adoption, significantly improve the efficiency with which the economy utilizes the goods and services delivered by key infrastructure (such as energy, water, and transport).
  - In some cases, provide significant direct employment benefits, and in all cases, develop a pool of “systems optimization specialists” skills—a key type of human capacity.
4 Pro-environment business models
- Beyond energy service companies (ESCOs), other efficiency services models are also viable.
  - 3PL – Third-party logistics
  - CMS – Chemical management services
  - RM – Resource management

5 Concluding observations
- To conclude, functional procurement/efficiency service models
  - Have a potentially large customer base among larger firms in Asia’s more developed economies.
  - Support export competitiveness and enhance efficiency of infrastructure utilization
  - Help ensure that the service sector develops in such a way that it contributes to a green overall economy.
5 Concluding observations

- Policy intervention is required to realize the potential of efficiency services models.
  - Poor market information and lack of a performance track record are typical barriers to market adoption for new business models.
    - Without supported pilots, case studies, and/or similar policy engagement, the efforts of individual provider companies alone tend to overcome these barriers only slowly.
  - A number of these models have “less green” variants. While 3PL tends to have intrinsic fuel efficiency benefits, policy intervention is driving the development of “green 3PL” (e.g., in Japan and Korea).
  - Need for policy intervention is larger in developing economies.

5 Concluding observations

- Policy intervention should prioritize areas with highest returns.
  - E.g. 3PL has a large and growing presence in much of Asia ⇒ greening a business that is already viable
  - RM faces fewer barriers than ESCO and CMS.
- Policy interventions combine explicitly environmental interventions with the tools used for industry development.
- Government needs to be early adopters and pilot programs should target as high-visibility large firms.
References