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Four Big Misconceptions About The Services Trade in Africa

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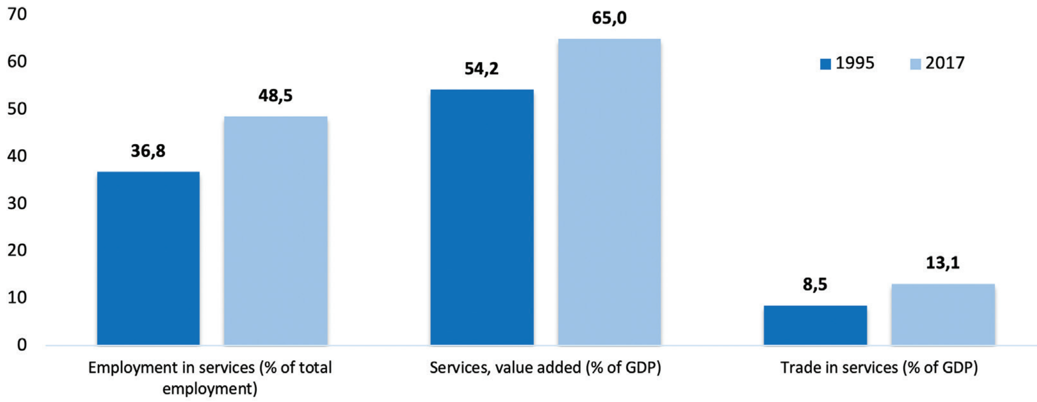
Summary

The Service sector is central to economic growth, trade and employment across the world. Trade in services has increased from 8.5 per cent of global GDP in 1995 to 13.1 per cent of GDP in 2017. However, Africa is taking less advantage of these opportunities than others. In this policy brief we highlight important misconceptions that may be holding back services exports in Africa. The potential for services sector growth and services exports from low levels in Africa is large. Policies that can remove impediments to export services growth and thus promote growth in Africa are discussed.

The services sector is a vital part of any economy and is increasingly a driver of structural transformation. Services account for 65% of global GDP and 48% of employment, and trade in services increased from 8.5% of global GDP in 1995 to 13.1% of GDP in 2017 (Figure 1). Even in economies where manufacturing is growing most rapidly, as in China and parts of Asia, services account for by far the largest contribution to economic growth and employment. Services trade now accounts for the largest share of world trade in value added. However, Africa is lagging in international trade in services. The newly agreed African Continental Free Trade Area envisages negotiations in key services sectors which, if successfully concluded and implemented, could help invigorate this crucial sector.

Figure 1: Global services: Employment, Value Added and Trade



Source: World Bank, World Development Indicators.

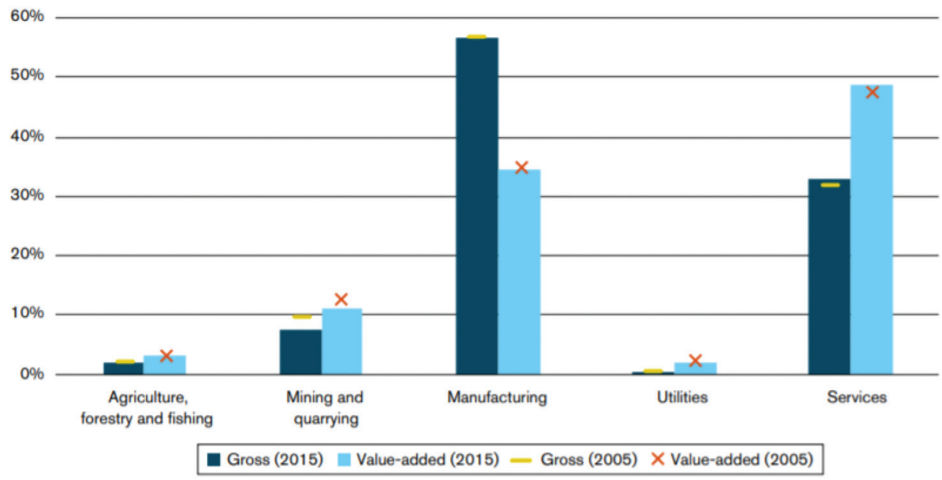
Services can deliver large welfare gains because they represent an important part of personal consumption (for example: medical services, education, tourism), they are essential contributors to the efficient functioning of the entire economy (for example: transport and ICT services), and they generate large numbers of jobs (for example: retailing). Trade in services can also open up vast new markets, generating foreign exchange, and is more resilient than trade in goods to external income shocks (Ariu, 2016).

Services trade in Africa lags behind in part because policymakers do not pay it sufficient attention. This, in turn, arises from major misconceptions about the role of services. It is time to dispel these misconceptions and to systematically explore how policy can remove impediments to the growth of services. Even in countries that have a comparative advantage in manufactures, the efficiency of the service sector is often the key to success.

First Misconception: Services Offer Limited Export Opportunities

The mistaken belief that services are inherently domestic activities and offer few opportunities to earn foreign exchange arises in part from statistical misrepresentation of the effects of services on the exports of other sectors. Exports should be measured in value added terms, not gross terms, and the contribution of a given sector needs to account for its intermediate contribution to all exports, not only its direct contribution. On that basis, exports of services, direct and indirect, account for a larger share of exports than do manufactures.

Figure 2: World Trade Sectoral Structure (2015)

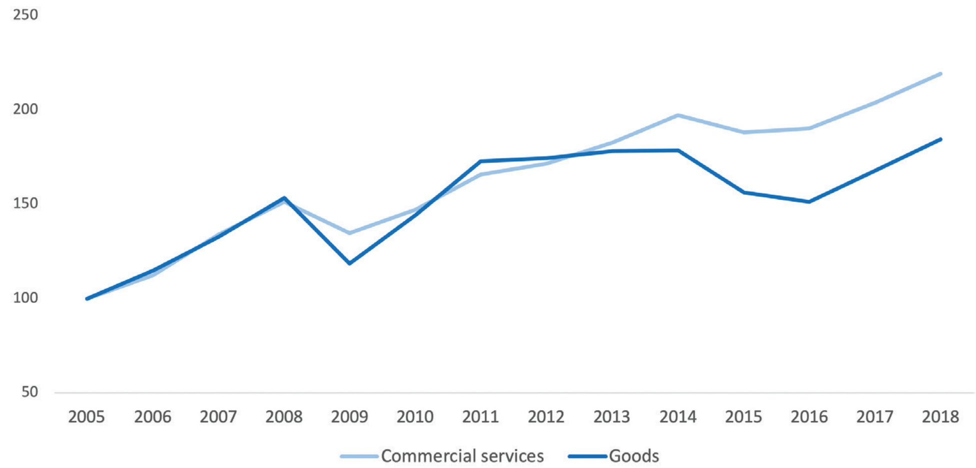


Source: WTO, World Trade Report 2019.

Another reason for the misconception is the speed at which the service sector has changed with the advance of technology and of globalization over the last forty years. The four modes of international provision of services (foreign establishment, movement of consumers, movement of providers, and remote provision) have all seen major expansion, and have each been transformed by ICT. Indeed, remote provision, such as the internationalization of back-office functions, call centers, and even taxi services, was hardly possible before the internet became widely available. With rising living standards and the falling cost of air transport, tourism has become one of the world's largest growth industries. Professional services, supplied by engineers, doctors, accountants, management consultants, lawyers, and academics, make up another of the world's fastest growing sectors. All these services rely increasingly on the internet and cheap communications for information and coordination. Foreign direct investment is crucial in building and operating global value chains that entail an international division of tasks enabled by ICT. As Figure 3 shows, since the outbreak and spread of the global financial crisis in 2008, trade in services has grown much faster than trade in goods. Commercial services grew by 6.2% per year on average between 2005 and 2018, while goods grew only by 4.8%.

Figure 3: Growth of World Trade in Goods and Commercial Services (index 2005=100)

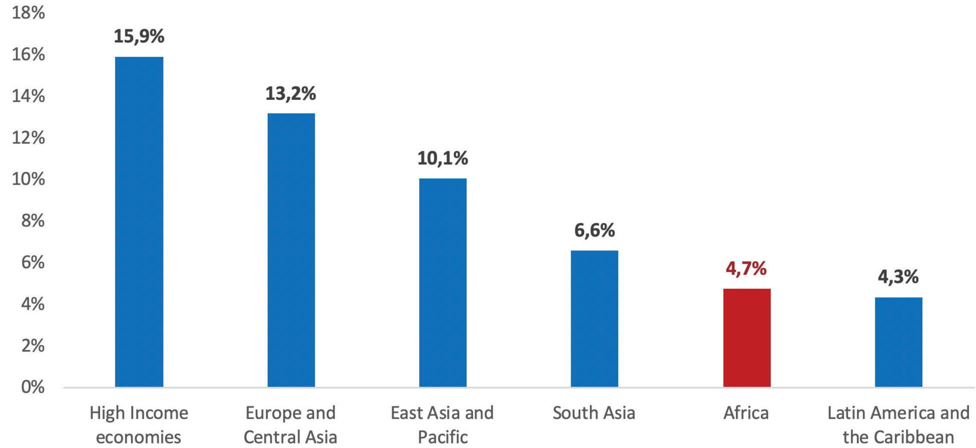
Source: UNCTAD and authors' calculations.



Unfortunately, Africa has lagged behind other regions in this respect. Africa's services exports, measured in gross terms, represent just over 4.7% of GDP, the lowest of any region (Figure 4).

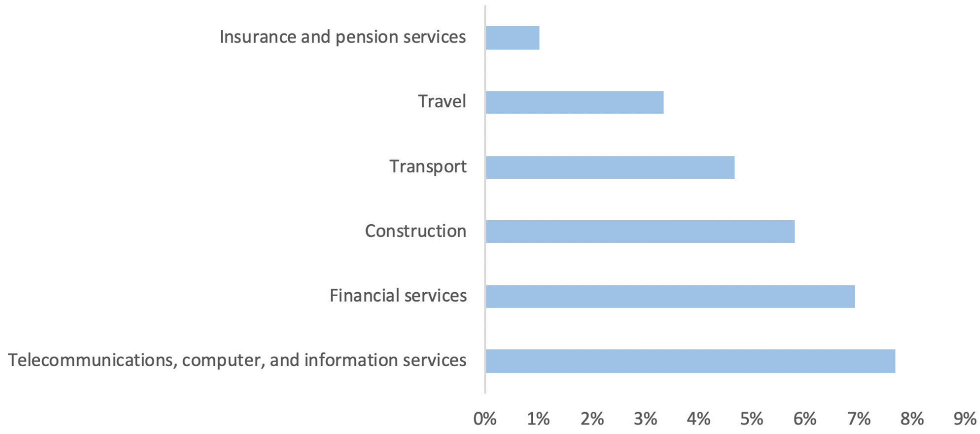
Figure 4: Services Exports (Median Shares of GDP)

Source: World Trade Organization and authors' calculations.



Yet there is already significant growth in services exports in some services sectors in Africa, such as telecommunications, and financial services, which grew at CAGRs[1] in excess of 7% between 2005 and 2017 (Figure 5).

Figure 5: Services Exports in Africa (Average Growth Rate 2005-2017)



Source: World Trade Organization and authors' calculations.

Countries including Egypt, Morocco and South Africa outstrip other African countries in most services sectors. Thus, even though Morocco represents only about 5% of Africa's GDP, it accounts for 10% of its exports of transport services, 17% of its exports of travel services, 7% of its insurance services, 25% of telecommunications and ICT services, and 28% of its exports of construction services.

Table 1: Top 5 Services Exporters in Africa (% of total category; Average 2015-2017)

Rank	Transport		Travel		Insurance and pension services	
1	Egypt	32.3	South Africa	21.3	Libya	15.9
2	Morocco	10.2	Morocco	17.3	South Africa	13.9
3	Ethiopia	8.7	Egypt	14.1	Egypt	13.8
4	South Africa	8.5	Tanzania	5.4	Kenya	10.6
5	Kenya	6.2	Mauritius	4.1	Morocco	7.2

Rank	Financial services		Telecommunications, computer, and information services		Construction	
1	South Africa	33.9	Morocco	25.4	Morocco	28.5
2	Kenya	11.0	Egypt	13.9	Egypt	24.9
3	Algeria	11.0	South Africa	10.6	Tunisia	13.9
4	Nigeria	10.7	Kenya	8.6	Algeria	10.1
5	Egypt	7.7	Tunisia	5.4	Uganda	4.3

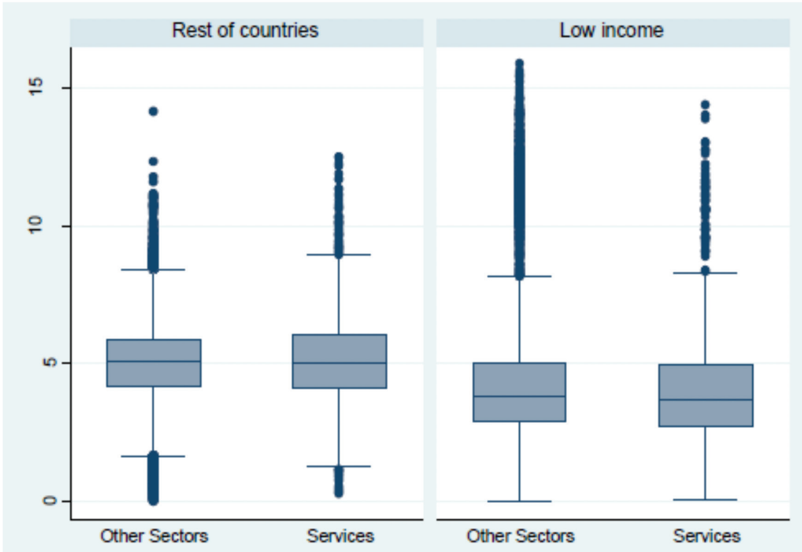
Source: World Trade Organization and authors' calculations.

1. Compound annual growth rates.

Second Misconception: Services Offer Few Opportunities for Productivity

This misconception is also rooted in an outdated view of services. Balchin et al (2016) showed that labor productivity in services is about the same as labor productivity in other sectors, and that this is true equally in low-income countries (where productivity is 40% lower across the board), and in other developing countries. Figure 6 shows the median (line in the box) level of productivity and the upper and lower quartiles (the size of the box), as well as outliers shown as dots.

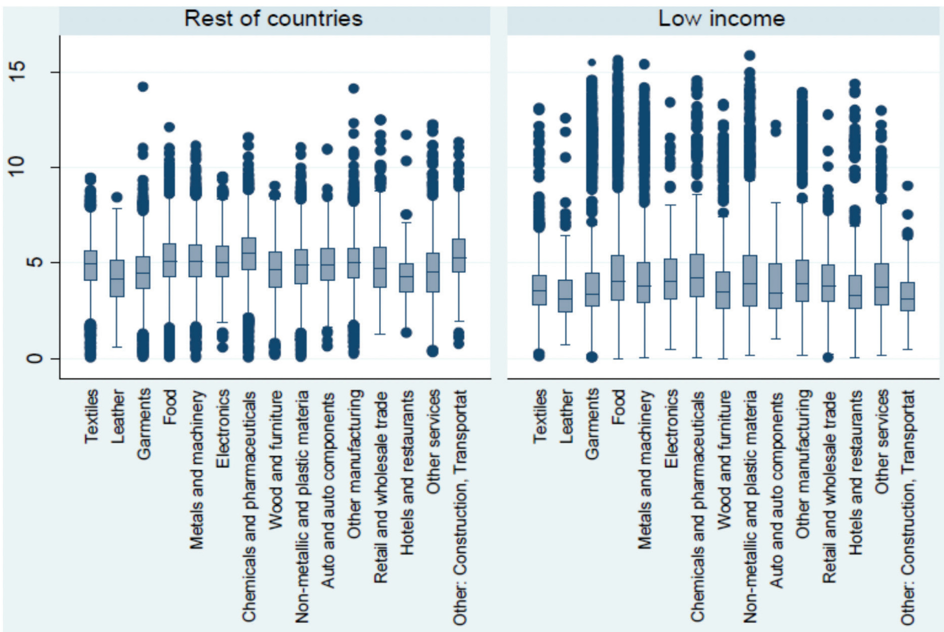
Figure 6: Labor Productivity Differentials in the Services Sector by Income Level



Source: Balchin et al (2016).

While some manufacturing sectors, such as pharmaceuticals, exhibit much higher labor productivity than the average, other manufacturing sectors, such as garments and leather, show very low labor productivity. In services, sectors such as transport and finance show much higher productivity than average, while the labor productivity of hotels and restaurants is lowest across the whole economy. In the global economy, trade in services is undergoing an era of rapid expansion at a faster pace than goods (Figure7).

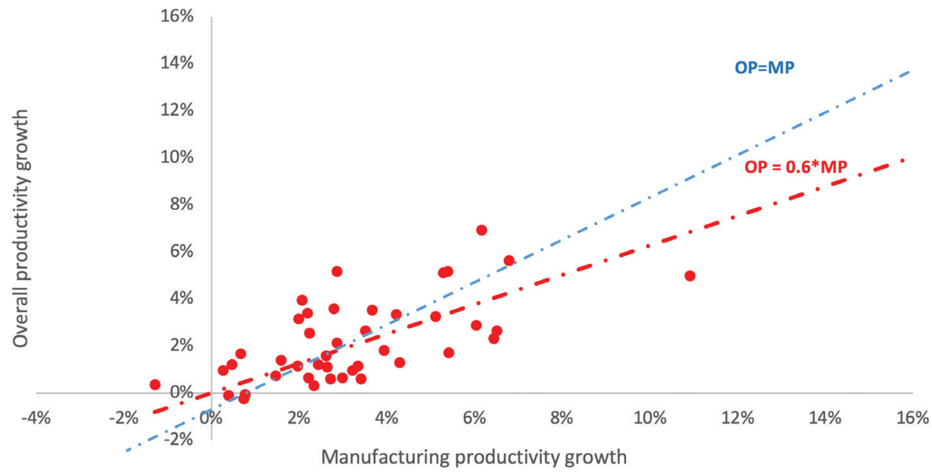
Figure 7: Labor Productivity by Sector in LICs and in All Other Countries



Source: Balchin et al (2016). Note: The horizontal line in each box shows the median level of productivity; the top and bottom of each box indicate the upper and lower quartiles. Dots show the outliers.

While labor productivity in services tends, on average, to be the same as in other sectors, it is true that productivity growth in services tends to lag behind manufacturing. As Figure 8 shows, for a number of countries[2] in which manufacturing plays a large role, labor productivity in manufacturing is on average about 40% higher than labor productivity in the economy overall. However, as Figure 8 also shows, that is not universally the case. In several countries, those above the 45 degree line, productivity growth is higher in the rest of the economy than in manufacturing. Most are middle-income countries, including some of the fastest growing countries in Asia, including China, Indonesia, Thailand, Bangladesh, and Viet Nam. In these rapidly industrializing economies, the surge in manufacturing is only one aspect of a profound economy-wide transformation that affects labor productivity in other sectors as much as it does in manufacturing. This shows that there are clearly circumstances in which developing economies can adopt modern techniques and methods as rapidly in services and agriculture as in other sectors.

Figure 8: Comparing Manufacturing (MP) and Overall Productivity (OP) Growth in % (43 Countries)



Source: Ait Ali & Dadush (2019).

There are many examples of total factor productivity in services growing faster than in manufacturing, especially in sectors most affected by ICT. Productivity in the ICT services sector itself grew faster than manufacturing productivity from 2005 to 2015 in Germany, India, the United Kingdom, and the United States (WTO, 2019). Productivity of professional services also grew faster than manufacturing productivity in the UK and the US. In India, productivity growth in financial and insurance activities outstripped manufacturing productivity growth.

But for most services sectors, productivity growth has been lower than in manufacturing. The lower growth of labor productivity in services is a cloud over the sector, but it also has the proverbial silver lining. Since services tend to be the fastest growing sector of the economy in the long-run, and thus tend to become the dominant sector of the economy at higher levels of per-capita income, while also tending to exhibit lower labor productivity growth, services provide the majority of new jobs. In fact, even at relatively low levels of per-capita income, services tend to provide all of the net new jobs in most countries (Ait Ali and Dadush, 2019). Policymakers in countries where unemployment and underemployment are high should pay particular attention to the job-creating capacity of services.

Third Misconception: The Main Barriers to Services Trade are Those Intended to Keep Out Foreigners

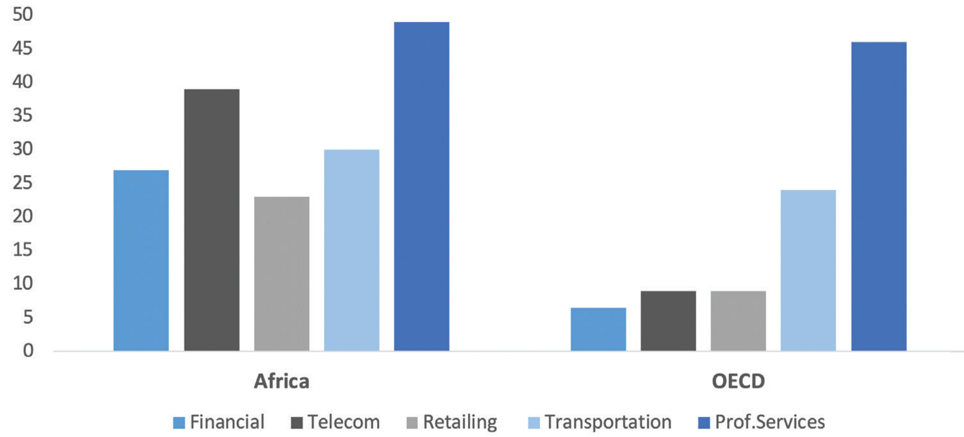
Restrictions in trade and services are high across the world, and trade in services in Africa is highly protected compared to Organization for Economic Co-operation and Development countries. This is especially the case for telecommunications, retailing, and financial services. However, unlike goods, services are not prevented from crossing borders by tariffs, quotas, customs procedures, or even—most of the time—the high cost of transport. Instead, barriers to services trade stem mainly from domestic regulatory frameworks, which have been established for a variety of reasons, mostly well-

2. 43 countries where employment in manufacturing exceeded 1 million in 2001.

intended but sometimes designed to restrict competition and favor certain constituencies. The intention of these regulations is not, for the most part, to keep out foreign firms, though that is often their effect. Thus, certification requirements for doctors and lawyers—established to ensure a quality service and to correct for information asymmetries—can prevent the recognition of foreign qualifications. Licenses of all kinds—including for restaurants, telecommunications operators, and retail chains—may prevent the entry of foreign firms. Some forms of regulations, such as visas, directly restrict travel by foreign suppliers and tourists. Monopolies in communications can raise prices and prevent or deter the remote provision of services by foreigners.

In order to quantify the extent to which regulatory frameworks constrain services trade, the World Bank and the OECD have created Services Trade Restrictiveness Indices (STRI). Africa has higher STRI scores than OECD countries in all sectors. Some 'backbone' services, such as transport, have to cope with some of the highest restrictions in both Africa and the OECD.

Figure 9: Services Trade Restrictions Index (STRI) by Sector in Africa and OECD Countries



Source: Borchert et al (2012).

Often the impediments to international trade in services are the same that hamper the domestic growth of the services sector and the provision of services within national territories. It follows that, in services, the trade agenda and the domestic reform agenda often must go hand-in-hand. The widespread—and often well justified—use of licensing and permits in service provision means that corruption and weak governance can become the single biggest obstacle to growth in the services sector, whether services are supplied domestically or by foreigners.

One consequence is that trade liberalization in the services sector often requires a parallel effort of domestic regulatory reform, making the process far more complex than liberalization of trade in goods. Equally, insofar as these reforms ease the operation of domestic and foreign players, the welfare gains associated with a more open and efficient service sector can be far-reaching.

Fourth Misconception: To Liberalize Services You Need a Trade Agreement

A more liberal regime in services trade bring major benefits (Amin and Mattoo, 2006). By increasing the supply of world-class services, liberalization can help increase productivity in the services sector, creating new opportunities to attract foreign direct investment, and stimulating all other economic sectors—manufacturing, agriculture, and construction—potentially boosting an economy's competitiveness, including in terms of services exports (Balchin et al, 2016). According to the WTO (World Trade Report, 2019), 59% of world traded services was supplied through FDI by implementing Foreign Owned Affiliates. This is either because some services must be produced locally, for technological reasons, or because there are incentives to be close to the customer.

Participation in global value chains depends on trade costs (time and money required) involved in moving goods across borders. For instance, high transport costs are a major impediment keeping many Sub-Saharan African countries out of manufacturing value chains, especially land-locked countries (Arvis et al, 2010). Considering the importance of these constraints, countries depend increasingly on efficient services to be able to compete in the production of goods through a combination of outsourcing and offshore processes.

Trade agreements, whether bilateral or multilateral, can facilitate the political economy of liberalization of imported services by strengthening the export lobbies that will benefit from reciprocity. But the benefits of services liberalization are significant even when if there is no reciprocity. Moreover, given the complexity of regulatory reform that must often accompany liberalization of services, there is an advantage to being able to carry out reforms at the country’s own pace and at a time of its choosing.

Like liberalization of the goods sector, there is no guarantee that liberalization of the trade in services will lead to the desired outcome of a more competitive services sector, able to hold its own on domestic and foreign markets. Competitive advantage in services is determined by a combination of structural factors (including the availability of skills and natural resources), infrastructure, and appropriate policies and regulations. Together, these determine the investment climate and the ease of doing business in a particular sector and in the economy as a whole. Trade policy plays a crucial role in determining the competitiveness of services by allowing access to world class inputs—both goods and services—at a competitive price.

Conclusion

As argued in a recent WTO report (WTO, 2019), trends that will drive increased trade in services include digitalization, which reduces the cost of providing many services; demographics as aging populations require more healthcare and consume more services including entertainment and tourism, while young populations in developing countries require more education rising incomes; and climate change, requiring—for example—increased insurance against flood risks, construction services for relocation and protection against rising sea levels, and financing for adaptation.

The four misconceptions about services and the services trade we have identified—that services fail to provide for export opportunities and do not increase productivity, that barriers to the services trade consist mainly of measures to deter imports, and that services liberalization requires a trade agreement—are holding the services sector back in Africa, as in many other regions. The opportunities to grow the services sector and the export of services from low levels in Africa are especially significant.

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