
UNIT 18 INTERNATIONAL TRADE IN SERVICES

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18.0 OBJECTIVES

After studying this unit, you should be able to :

- describe the concept of trade in service;
- explain the role of trade in services in economic development;
- describe changes in value and pattern of world services trade;
- explain the direction and composition of world trade in services;
- discuss the role, performance and prospects of trade in services in Indian context.

18.1 INTRODUCTION

Interest in the services sector at both the global and national levels has considerably increased in recent years. Apart from being a major contributor to the gross domestic product and employment, the services sector has emerged as an important foreign exchange earner for the developed as well as the developing countries. More than one-fifth of the world trade is currently accounted for by international transactions in services. Since January 1995, world trade in services has been brought under the surveillance of the General Agreement on Trade in Services (GATS). GATS is a part of WTO and aims at liberalisation of trade in services.

Services play an equally important role in the Indian economy. Because of proven advantages in several areas, Indian firms too can immensely gain from liberalisation of trade in services. In this unit, you will learn the conceptual aspects of trade in services, the role of trade in services in economic development and the recent trends in world trade in services and prospects. You will also be acquainted with the recent trends in India's trade in services.

18.2 TRADE IN SERVICES: CONCEPTUAL ASPECTS

Services — also referred to as invisibles — have been defined differently by different persons. The majority view, however, is that services are activities which are essentially invisible, intangible and perishable in nature. Furthermore, as the services are not inventoriable, their production and consumption take place simultaneously. From the point of view of national income accounting, services are defined as activities not included in the primary and secondary sectors, and as such comprise of the activities like transport, travel,

communication, trade, finance, construction, public utilities, public administration as well as professional, community, social and personal services.

Concept of trade in services or invisible trade is not as straight forward as the concept of trade in goods. While the goods can be supplied or transported abroad, services by nature need to be delivered on the spot, and in most cases require a close proximity between the service provider and consumers. Movement of labour and capital (usually in the form of foreign direct investment), therefore, becomes the major mode of supply of services in the international context. Whether movement of capital and labour and such factor incomes are part of trade in services or not have for a long time remained a controversial issue. While the most developed countries have been of the view that capital movement is a legitimate mode of trade in services, developing countries in general have objected to this contention, and have instead demanded inclusion of movement of labour as an alternative mode of trade in service.

With the evolution of GATS in December 1993, the controversy has largely been set aside. According to the GATS provisions, trade in services now means supply of services through any one of the following four modes:

- (i) **Cross-border movement:** This includes supply of services from the territory of one country into the territory of any other country (e.g., services that can be transmitted through telecommunications or services embodied in a consultant report or a software on a diskette). These are also referred to as 'separated services'.
- (ii) **Movement of consumers:** This entails supply of services in the territory of one country (that is country of service supplier) to the service consumer of any other country (e.g., tourism).
- (iii) **Commercial presence abroad:** This means supply of services by a service supplier of one country through commercial presence in the territory of any other country (e.g., banking).
- (iv) **Presence of natural persons abroad:** This implies supply of services by a service provider of one country through the presence of natural persons of the country in the territory of any other country (e.g., a doctor goes abroad to provide medical services).

Trade in services thus encompasses now not only cross-border transactions in separated services and transportation, but also activities that require temporary physical movement of producer (e.g., an engineer working as a consultant in a foreign country for a limited period of time) or the consumer (as in the case of tourism across national borders).

Balance of payments statistics provided by the IMF constitute the basic source of information regarding trade in services. For balance of payments purposes, a cross-border transaction is defined as an exchange between residents and non-residents, either firms or persons. Until now, IMF did not have any explicit definition of what constituted trade in services. Rather the current account was divided between merchandise and non-merchandise items - the latter being often referred to as invisibles. The problem with the balance of payments approach is that it includes items such as other official goods, services and income (consisting of diplomatic expenditure and certain other adjustment transactions) and non-remittances components of private transfers also. These are strictly speaking not trade items and as such do not constitute trade in services. If these items are excluded, we find that two terms 'trade in services' and 'invisible trade', become synonyms and can be used interchangeably.

GATT (and now WTO) publications also contain statistical information on services trade. These publications, however, use the term 'commercial services' as comprising of shipment, other transportation, travel and other private goods; services and income such as subscriptions to periodicals; income from non-financial assets (i.e., royalties and licence fees) and labour compensation. A comparison of the items used in GATT/WTO documents with those reported in the current account in the balance of payments statistics reveal that GATT/WTO's definition is narrower in coverage in as much as it excludes the items 'investment income' and 'other official goods, services and income' which form part of the non-merchandise trade in balance of payments account.

1. What is cross-border movement?

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2. What do you mean by services?

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3. Enumerate two problems of the balance of payments approach to trade in services.

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18.3 ROLE OF TRADE IN SERVICES IN ECONOMIC DEVELOPMENT

There was hardly any mention of trade in services in the economic and trade literature during the sixties and early seventies. Trade theorists and policy makers remained besieged with issues relating to trade in manufactures. Services being a 'tertiary' sector and invisible in nature were cut off from the mainstream of discussions at the national and international levels.

The past few years, however, have witnessed a rapid growth of interest in trade in services and its role in economic development. A variety of reasons are responsible for this phenomenon. First, services have emerged as an important source of foreign exchange earnings for both the developed and developing countries. Today cross-border transactions in services alone exceed US\$ 1 trillion per annum and these account for about 20 per cent of the total world trade. Look at Table 18.1 which shows percentage share of goods and services in total trade of selected regions. Exports of services such as tourism, shipping, telecommunications, insurance, banking, software and project exports including technical consultancy and legal management have come to occupy a strategic position in the world markets. Especially in the case of many developing countries, surplus in the invisible account have greatly helped them in mitigating deficit problems in their balance of payments account.

Service sector is also economically important for providing jobs to the millions of people. Because of being relatively more labour intensive, larger services exports mean greater employment opportunities for the workforce. Services already account for about 60 per cent of the employment in the developed countries, and about 27 to 30 per cent and 30 to 50 per cent in the case of low income and middle income developing countries respectively.

Tourism, hoteling, manpower, software and turnkey project exports and consultancy assignments are of prime interest to the labour abundant developing countries and can greatly help them in solving their unemployment problems.

Besides being the source of foreign exchange and employment generation, service sector plays a catalytic role in the industrialisation process and economic development of the

countries by way of providing necessary infrastructure and basic inputs for material production in other sectors. It is through the provision of financial services that the industries mobilise resources for procuring raw materials, labour and equipments. Services such as transportation, consultancy and telecommunications enable the firms to set up the production facilities and utilise resources. Technological services help in resource creation. Services like marketing research, retailing, advertising, etc., help identifying and generating markets and disposing of products. Taken together, these *producer services*, i.e., services which serve as inputs to other economic activities, constitute a vital part of the country's infrastructure and are a prerequisite for economic development. It is largely because of the availability of these services in an efficient and adequate manner that the developed countries have been able to attain higher levels of economic development.

Table 18.1: Percentage Share of Goods and Commercial Services in Total Trade of Selected Regions in 1998

Region	Percentage share	
	Goods	Services
North America	76.7	23.3
Latin America	84.4	15.6
Western Europe	78.4	21.6
Africa	82.5	17.5
Asia	84.8	15.2
World	80.4	19.6

Source: WTO, *Annual Report: 1999*, Geneva.

The developing countries, on the other hand, have been severely hamstrung in their development efforts because of the absence of infrastructural facilities. In most of the developing countries, these services are monopolised and are in the hands of poorly run public utilities. Of late, however, the developing countries have realised the negative impact of inefficient infrastructural facilities on their competitiveness and development prospects, and have started making efforts to upgrade their services sector so as to accelerate their development process.

It is precisely due to the importance of services sector in the economic development and their heavy dependence on it that the developed countries during the eighties proposed for including trade in services in the Uruguay Round of Multilateral Trade Negotiations. Initially developing countries were not in favour of a liberalised trade regime in services because of a lack of competitiveness of their services industries. They feared that the developed countries with their competitive strength would swamp their nascent services sector. Developing countries also had the apprehension that liberal imports of services and larger imports of foreign direct investment into their economies would not only undermine their indigenous technologies but would also aggravate their balance of payments deficits.

Debate over liberalisation of trade in services continued for some time. Eventually in 1993 as a part of the Final Act of the Uruguay Round of Multilateral Trade Negotiations a consensus was reached and an agreement — called General Agreement on Trade in Services (GATS) — was evolved. GATS is a part of WTO and came into force from January 1995. GATS is a multilateral treaty and contains rules, disciplines and commitments for progressive liberalisation of trade in services.

Besides ensuring transparency in international transactions in services, GATS is very much concerned with the development dimension of services, especially from the point of view of the developing countries. To assuage the feelings of the developing countries and dispel their fears of adverse impact of liberalisation of trade in services on their economies, GATS provides for their enhanced participation in world trade in services. GATS entails negotiated commitments on access to technology, improvement in access to distribution channels and information networks and liberalisation of market access in sectors and modes of supply of export interest to the developing countries.

Trade in services, according to Article 1.2 of the GATS agreement, encompasses all the four modes of supply, viz., cross-border transactions, movement of consumers commercial

presence abroad and movement of natural persons. Commercial presence abroad is akin to foreign direct investment and has been included at the insistence of the developed countries. Inclusion of movement of natural persons abroad is of significance to many developing countries including India because of the presence of skilled professionals in these countries.

GATS has already come into operation and efforts are underway for opening up of the services sector. It is obvious that in the liberalised trade regime only those firms would be able to survive which gear themselves up to the level of efficiency achieved by the most successful players in the world. A certain degree of openness in the developing countries would ensure that the quality of services which are domestically available are not inferior to those available abroad. The global market would serve for them as a vital source of acquiring appropriate know-how and technology needed to upgrade their domestic industrial and technological capabilities.

Economic development means not only economic growth but also efficient utilisation of resources and betterment of various sections of the society. Liberalisation of services trade would allow countries to pursue liberalisation in harmony with their comparative advantages. In a liberal environment, resources will be employed in those activities where they can be more effectively and efficiently utilised. Manufacturing industries and other sectors would also gain from liberalisation by having access to most efficient service providers in the world. Provision of adequate and efficient producer services shall bring down the manufacturing cost and would add to their international competitiveness. Gains would also accrue to consumers because of their access to cheaper, better quality and a wide variety of services.

Check Your Progress B

1. What is trade in services?

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2. What do you mean by General Agreement on Trade in services?

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3. What do you mean by commercial services?

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4. State whether following statements are **True** or **False**.

- i) Income from royalties is an example of commercial services.
- ii) Services fall under primary sector.
- iii) Technological services help in resource creation.
- iv) Services account for 20% employment in developed countries.
- v) Services serve as inputs to other economic activities.

18.4 RECENT TRENDS IN WORLD TRADE IN SERVICES AND PROSPECTS

18.4.1 Overall Trends

In value terms, world trade in commercial services has grown considerably over the years. Export of commercial services in the year 1988 was of the order of US\$ 600.1 billion which has increased to US\$1317.8 billion in the year 1998. The import of commercial services has also increased from US\$ 618.2 billion in the year 1988 to \$1306.2 billion in the year 1998. In relative terms, however, share of services exports has been hovering around 20 per cent of the total world exports for the last several years. Look at Table 18.2 which shows the shares of commercial services in total trade.

Table 18.2: Exports and Imports of World Commercial Services

Value in billion dollar

Year	Exports	Imports
1988	600.1	618.2
1989	658.1	678.8
1990	783.2	811.2
1991	826.9	841.7
1992	923.1	932.0
1993	942.1	949.8
1994	1037.5	1032.1
1995	1188.1	1190.3
1996	1270.8	1255.2
1997	1320.9	1296.2
1998	1317.8	1306.2

Source: WTO Annual Report 1999.

18.4.2 Direction of Trade in Services

A direction wise break-up of world trade in services in recent years is provided in Table 18.3. It can be observed that the European region dominates the scene, accounting for about 48 per cent of world commercial services exports in 1998. North American regions, and Asian Regions with shares of about 21 per cent and 19 per cent respectively, come next in order of importance. The share of western Europe has come down from 53.3% in the year 1990 to 48.3% in the year 1998. The share of North America has gone up from 19.2% in the year 1990 to 20.5% in the year 1998. The share of Asian Region has also increased from 16.8% in the year 1990 to 19.4% in the year 1998. The strong economic growth during 1995 had led to the increased share of export from Asian Region in the year 1995 (22.2%). It has decreased in case of Western Europe and North America during 1995. On the import front also the Western Europe is the leading importer of commercial services accounting 45% in the year 1998. Asian Region is the second largest importer of commercial services about 25% in the year 1998 followed by North America about 15% in the year 1998. The import of Western Europe has decreased from 48.4% in the year 1990 to 45.4% in the year 1998. The import of Asian Region has gone up from 22.0% in the year 1990 to 24.5% in the year 1998. The import of third largest importer has also marginally gone down from 15.5% in the year 1990 to 15.4% in the year 1998. Like the export import has also increased in the Asian Region during 1995. Where as it has decreased in case of Western Europe and North America during 1995. An interesting feature of world trade in services is that the developed countries are both the major exporters and importers of commercial services. A combined share of about 74 per cent of North America, Western Europe and Japan — constituting developed countries — is a pointer to the fact.

When examined from the point of view of growth, it can be discerned that the Asian region has experienced the highest growth; and if the present trends continue, this region shall be at the centre-stage of developments in the services sector in future.

Table 18.3: Direction of World Trade in Services*(Percentage)***International Trade in
Services**

Region	Exports			Imports		
	1990	1995	1998	1990	1995	1998
North America	19.2	18.0	20.5	15.5	13.6	15.4
Latin America	3.8	3.4	4.0	4.3	4.2	5.3
Western Europe	53.3	49.6	48.3	48.4	46.6	45.4
Africa	2.4	1.9	2.0	3.3	2.7	2.9
Asia	16.8	22.2	19.4	22.0	26.3	24.5

Source: WTO Annual Report, 1999.

Table 18.4 provides the countrywise statistics relating to top fifteen services exporting and importing countries in the world. Like trade in goods, world trade in services depicts a highly skewed pattern. The top fifteen services exporting and importing countries account for more than two-thirds of world trade in services. The leading exporters of commercial services are United States, United Kingdom, France, Germany, Italy and Japan. The leading importers are United States, Germany, Japan, United Kingdom, France and Italy. United States are the top exporters and importers of commercial services. The combined contribution of the leading six exporters countries is 48.0% in the total export and 46.6% in the total import of commercial services.

Table 18.4: Leading Exporters and Importers of Trade in Commercial Services: 1998

Value: Billion US\$

Rank	Exporters	Value	Share	Rank	Importers	Value	Share
1	United States	240.0	18.2	1	United States	165.8	12.7
2	United Kingdom	100.5	7.6	2	Germany	125.0	9.6
3	France	84.6	6.4	3	Japan	110.7	8.5
4	Germany	78.9	6.0	4	United Kingdom	78.8	6.0
5	Italy	66.6	5.1	5	France	65.4	5.0
5	Japan	6.8	4.7	6	Italy	62.9	4.8
7	Netherlands	51.6	3.9	7	Netherlands	46.6	3.6
8	Spain	48.7	3.7	8	Canada	35.2	2.7
9	Belgium-Luxembourg	35.4	2.7	9	Belgium-Luxembourg	33.9	2.6
10	Hong Kong, China	34.2	2.6	10	Austria	30.1	2.3
11	Austria	32.4	2.5	11	China	28.8	2.2
12	Canada	30.3	2.3	12	Spain	27.5	2.1
13	Switzerland	27.1	2.1	13	Korea, Rep. of	23.8	1.8
14	China	24.0	1.8	14	Taipei, Chinese	23.3	1.8
15	Korea, Rep. of	23.9	1.8	15	Hong Kong, China	22.7	1.7

Source: WTO Annual Report, 1999.

18.4.3 Composition of Trade in Services

In the absence of detailed itemwise statistics, it is not possible to attempt an in-depth analysis of the composition of trade in services. However, based on whatever little statistics available it can be observed that significant changes have taken place in the composition of world trade in services. Transport services which held the top position in 1970 lost their prominence during the eighties and nineties. It has further gone down from 28.4% in the year 1990 to 23.3% in the year 1998. The contribution of travel export in the commercial services has also gone down from 33.7% in the year 1990 to 32.5% in the year 1998. The contribution of other commercial services has increased from 38.0% in the year 1990 to 44.2% in the year 1998.

Table 18.5: Composition of World Exports in Commercial Services

(Percentage)

Item	1990	1998
Transportation	28.4	23.3
Travel	33.7	32.5
Other Commercial Services	38.0	44.2

Source: WTO Annual Report, 1999.

Exports of other services and income in contrast exhibit a rising trend and have emerged as the key foreign exchange earning services sectors.

18.4.4 Future Trade Prospects

World trade in services is already on the rise and is likely to get a further boost in coming years with the opening-up of the national services markets under GATS. Initiatives taken at the level of regional economic grouping such as adoption of 'open sky policy' in European Community shall also pave way for expansion of trade in services.

Economic and technological changes would foster the demand for a variety of services. Technological and telecommunication developments shall not only provide a fillip to demand for a variety of services, but would also help in speedier and efficient delivery of services.

Prospects of trade in services thus appear quite bright in future. Gains from such trade expansion, however, shall primarily accrue to those nations which make a timely move to acquire international competitiveness through opening up of their service sector and induct latest technologies.

18.5 INDIAN PERSPECTIVE

In the Indian economy too, services occupy an important place. Because of rapid growth, share of services (exclusive of construction, electricity, gas and water supply) in the country's GDP has increased considerably over time.

Like in the case of other countries, commercial services hold a vital position in India's foreign trade. Look at Table 18.6 which shows India's trade in commercial services. As per the latest available figures, India's exports and imports of commercial services in value terms were US\$ 3.2 billion and US\$ 3.82 billion in 1985, and these increased to US\$ 11.1 billion and US \$ 14.2 billion respectively in the year 1998. In relative terms, shares of commercial services in India's total exports and imports were 33 per cent and 34 per cent respectively in the year 1998 and these compare well with those of other countries.

When compared with shares of other countries, India's position in world services market does not seem to be satisfactory. Like in the case of trade in goods, India's performance in world trade in services is utterly poor. In 1998 while total world exports of commercial services were US \$ 1317.8 billion, India's commercial services exports of US \$11.1 billion constituted just 0.8 per cent of world commercial services exports. This is quite in contrast to as high shares as 18.2 per cent of the United States, 6.4 per cent of France and around 7.6 per cent of the United Kingdom. Even shares of some of the developing countries like Hong Kong, China (3 per cent), Singapore 1.4% per cent), Republic of Korea (1.8 per cent and China (1.8) per cent are much higher compared to India's share.

One important reason for India's poor position in the world services market is less attention paid to the proper development of services sector in the country. And it is primarily due to the nascent stage of the Indian services sector and fear of getting exposed to competition from global companies that the Indian government as well as service firms have been averse to the idea of opening up of the domestic services sector to foreign competition. Of late, however, an awakening has taken place among the policy makers that India too can gain from liberalisation by consolidating its position in areas where it possesses basic advantages and skills.

Table 18.6: India's Trade in Commercial Services 1988-99

Value Billion US \$

International Trade in
Services

Year	Exports	Imports
1988	3.7	5.2
1989	4.1	5.7
1990	4.6	5.9
1991	4.9	5.8
1992	4.9	6.6
1993	5.0	6.4
1994	6.0	8.0
1995	6.8	10.1
1996	7.2	11.0
1997	8.9	12.3
1998	11.1	14.2

Source: WTO Annual Report 1999.

While the industrialised countries have comparative advantage in the capital and technology intensive services, developing countries like India possess comparative advantage in the labour intensive services. Professional skilled manpower, computer software, legal counselling, accountancy, construction, engineering and design services, health care, tourism, etc., are the areas where Indian firms have already shown their capabilities and possess potentials for further export expansion provided steps are taken to overcome the problems such as high cost of finance, complex procedures, organisational weaknesses and poor quality inputs.

Check Your Progress C

1. Name 5 leading exporter countries of trade in commercial services.

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2. Identify two leading items of world trade in commercial services.

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3. Name three importers countries of commercial services.

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4. State whether following statements are **True** or **False**.

- i) Western Europe accounts for 48.3% of world commercial services exports in 1998.
- ii) Developing countries are both the major exporters and importers of commercial services.
- iii) Asian region has experienced highest growth in trade in services.

- iv) Japan was the 2nd leading exporter and Sixth leading importer of trade in commercial services in the year 1998..
- v) The share of services in India's GDP has increased substantially.

18.6 LET US SUM UP

Services have gained considerable importance in both the developed and developing countries. Besides being a major contributor to GDP and employment, international transactions in services account for about 20 per cent of total world trade. Services also play a vital role in the industrialisation process and economic development of the countries. In the absence of adequate and efficient provision of producers services such as banking, insurance, transportation, warehousing and telecommunications, no country can think of attaining efficiency in the manufacturing and other sectors. These services are must even for promotion of a country's manufacture and service exports. Import of services and foreign direct investment in services can be immensely helpful in filling up the infrastructural gaps and providing the needed fillip to the development and industrialisation process, especially in the developing countries.

Trade in services has grown rapidly over the years. European region dominates the world trade in commercial services, followed by American regions and Asian Region. Composition of world trade in services has also undergone significant changes during the last three decades. Transport services which used to be the largest item of services exports during the 1970s have given way to 'other services and income' during the nineties. Since January 1995, trade in services is governed by General Agreement on Trade in Services (GATS). GATS is a multilateral treaty and aims at progressive liberalisation of trade in services.

Services are important in the Indian economy too. Despite rapid growth of India's services exports, India's share in the world trade in services is abysmally low at just 0.8 per cent. Since Indian firms enjoy considerable advantages over their competitors in several areas, they can seize a major share in world markets by evolving appropriate production and marketing strategies.

18.7 KEY WORDS

Services: Services — also called as invisible goods — are activities which are essentially invisible, intangible and perishable in nature, and require simultaneous production and consumption.

Producer Services: Producer services are the services such as banking, transportation, insurance, telecommunications, warehousing and technical consultancy which act as inputs to the manufacturing and other industries.

Commercial Services: It is a term used in GATT/WTO publications for referring to services comprising of shipment, other transportation, travel and other private goods, services and income such as subscription to periodicals, income from non-financial assets (e.g., royalties and licence fees) and labour compensation.

Trade in Services: Trade in services refer to international transactions in services and involve supply of services in any one of the following four modes: cross-border movement of services, movement of consumers, commercial presence abroad and presence of natural persons abroad.

GATS: GATS is an acronym for General Agreement on Trade in Services and is a part of World Trade Organisation (WTO). It is a set of mutually agreed upon rules and disciplines applicable to international trade in services.

18.8 ANSWERS TO CHECK YOUR PROGRESS

- B 4 i) True ii) False iii) True iv) False v) True
- C 4 i) True ii) False iii) True iv) False v) True

1. What do you mean by trade in services? Enumerate difficulties encountered in defining trade in services.
2. What are the four alternative modes of international transactions in services? With the help of suitable examples, describe each one of them.
3. Discuss the role of trade in services in economic development.
4. Why were the developing countries initially against the inclusion of trade in services in the Uruguay Round of Multilateral Trade Negotiations? Discuss.
5. What is GATS? Discuss its salient features and benefits to the developing countries.
6. Why is service sector important to the Indian economy? What are the major service areas in which Indian firms possess export potentials? Discuss.
7. Describe the direction and composition of world trade in services. Explain the future prospects of trade in services.