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Services and GVCs

Submitted by: ICTSD

Public-Private Dialogue on Building Asia Pacific Partnership Through Global Value Chains Collaboration
Qingdao, China
12 May 2014

Services Network

APEC Public Private Dialogue on building Asia Pacific partnership through Global Value Chains Collaboration

Qingdao, 12 May 2014

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New Structure of World Trade

The new structure of World Trade :

- **Moving toward more trade in intermediates than final products**
- **Comparative advantage determined by "tasks" rather than by final products**
- **Services allow for this production fragmentation to take place**

Services play a key role in comparative advantage and explaining trade patterns

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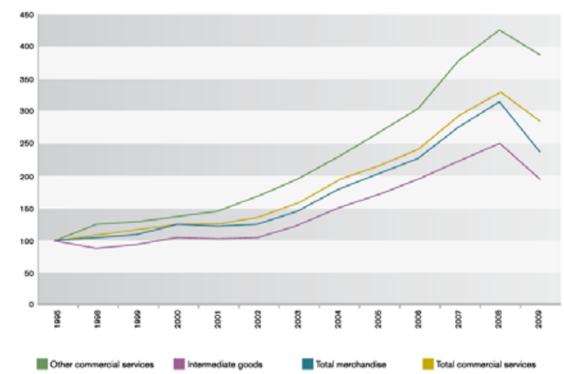
Commercial Services are Fastest Growing Component of World Trade and underpin Production Fragmentation & Intermediate Trade

Trends in world trade in merchandise and commercial services, 1995-2009 (Index, 1995=100)



- Other Commercial Services (i.e. business support services) are the fastest growing component of world trade – much faster than Goods

Sources: UN Comtrade Database and WTO estimates

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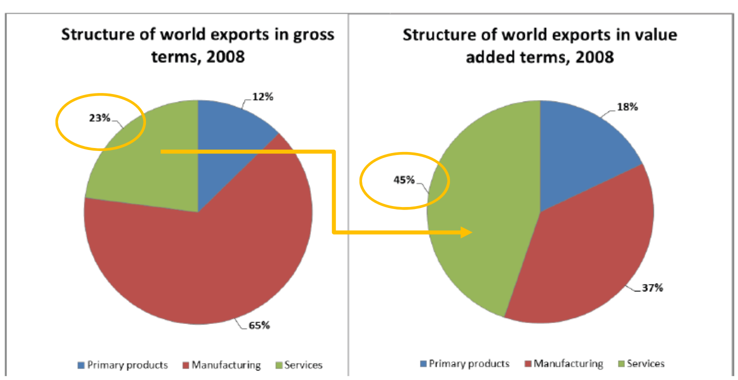
Services' share in World Exports is higher than understood on a value-added basis - 45%

WTO-OECD Value-Added Database Structure of World Exports (2008)



Value Added Terms → Services embodied in the trade of primary and manufactured products

Drivers of Global Value Chains

- The reduction of transportation costs,
- IT and telecommunications improvements,
- Technological innovation,
- Human capital availability,
- Competitive labor costs,
- Proximity to supply sources or to final markets because short lead times or customization required by costumers

Many of these factors have to do with SERVICES

Domestic value-added content has fallen as production continues to fragment on a global basis

1995

Major trade flows were between the EU(27), North America and Japan.
Trade showed a **high domestic content in exports, over 90% for North America and Japan, and over 85% for China.**

2005

A much higher degree of fragmentation in world production, with significant flows between China and all other major regions, and the emergence of a production hub in Asia.

The domestic value-added content of Chinese exports has fallen to around 70% (so 30% is constituted by imported components / services)

Production and Trade patterns have followed FDI flows to create supply chains

FDI Flows in Services driving GVCs

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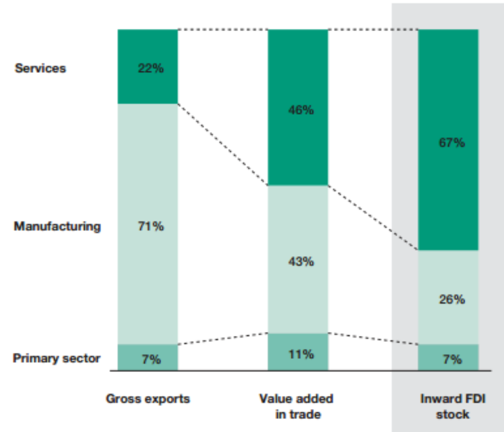
Services weight in Trade (in gross and value added terms) and Inward FDI Stock (2010)



Source: UNCTAD-Eora GVC Database, UNCTAD FDI Database.

GVCs make extensive use of services

- **SERVICES →** Playing a **key role in GVCs**, which is shown when measuring trade in value-added terms
- **Services** account by far for the majority of **Investment FDI stock**

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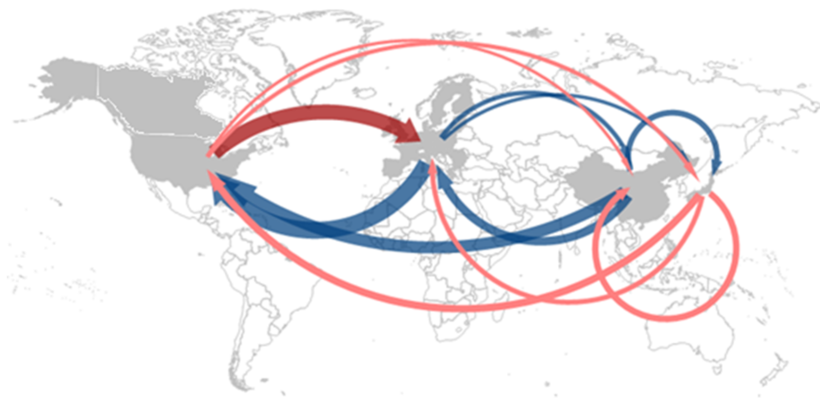
Figure 1: Exports (of domestic value-added and gross) between major regions, 1995

Source: www.oecd.org/trade/valueadded

Figure 2: Exports (of domestic value-added and gross) between major regions, 2005



Domestic value added shares 90% or more
Domestic value added shares between 80-90%
Domestic value added shares 80% or less

Source: www.oecd.org/trade/valueadded

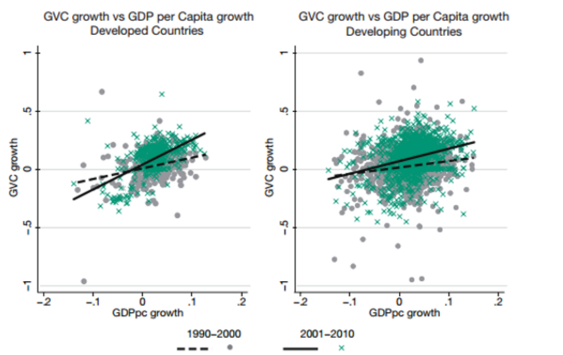
Taking part in Supply Chains is not just for developed economies

Evolution of the developing economy share in Global Value Added Trade

20% (1990) → 30% (2000) → 40% (Today)

Source: UNCTAD (2013). "Global Value Chains and Development. Investment and Value Added Trade in the Global Economy". Available at: http://unctad.org/en/publicationslibrary/diae2013d1_en.pdf

Positive Correlation between Growth in GVC participation and GDP per capita

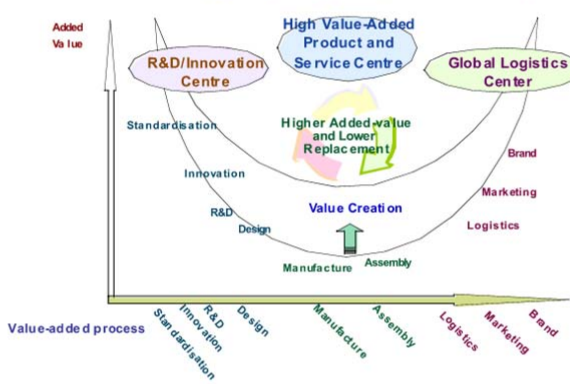


Source: UNCTAD-Eora GVC Database, UNCTAD analysis.
Note: the regression between the annual GDP per capita (in PPS) growth and annual GVC participation index growth, in logs, shows a positive and significant correlation, at the 5% level. This relation also holds, at the 5% level, dividing the sample in developed and developing countries, and in two time periods (1990-2000 and 2001-2010). To avoid picking-up a compositional effect resulting from the correlation between a country' s total value added (used as a component to calculate the GVC participation index) and its per capita GDP, all regressions use lagged (one year) GVC growth rates.

- Economies with the fastest growing GVC participation have GDP per capita growth rates some 2% above the average
- economies that increased their participation in GVCs and their domestic value added in exports experienced GDP per capita growth of 3.4%, compared to 2.2% for economies that only increased their participation in GVCs without "upgrading"

SERVICES are what adds most Value to Output

"Smiley Face": conceptual model of the shift to a high value added, globally integrated, services economy

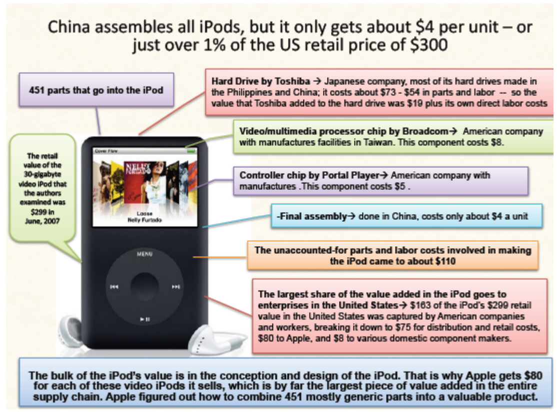


A particularity of SERVICES →
They are not as visible as intermediate goods but they are also embodied along production adding high value

Source: Business Week Online Extra, May16, 2005

Embodied Services in the iPod

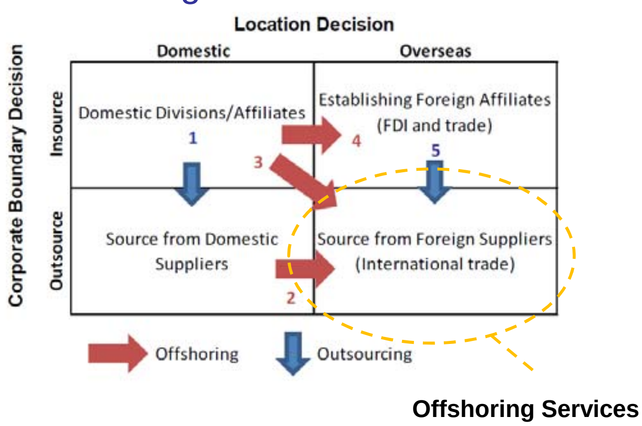
More than 50% of the iPod's value has nothing to do with merchandise components and all to do with services activities involved in conception, design, software development



2. Many off-shored services go into Value Chains

Firms have many options now for Outsourcing & Off-shoring Services

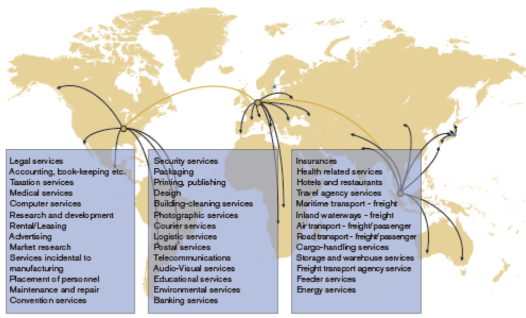
- Possibilities are vast and will depend on each particular business strategy, cost structure and attractiveness of outsourcing options



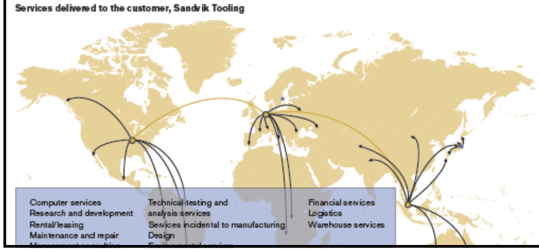
Source: Sako, Mari. (2005). Outsourcing and Offshoring: Key Trends and Issues. Paper presented at the Emerging Markets Forum.

Case Study: Services used by Sandvik Tooling

Figure 1: Services needed for effective supply chain and delivery of goods, Sandvik Tooling



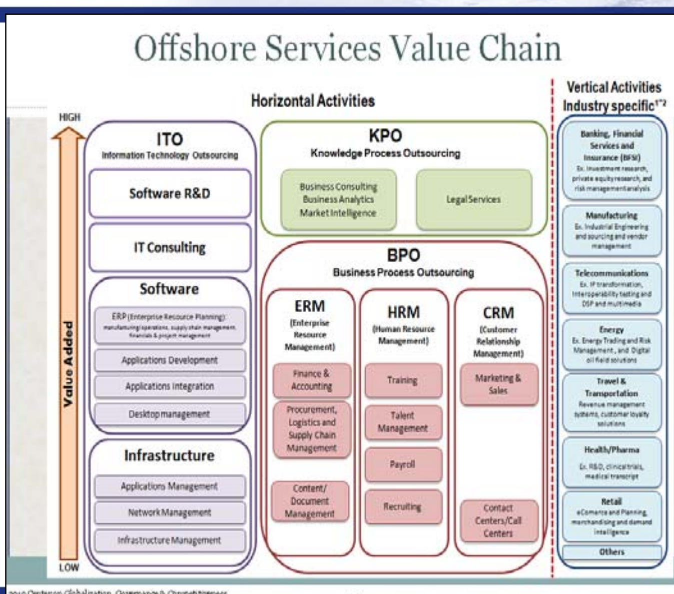
Services delivered to the customer, Sandvik Tooling



- Sandvik Tooling, a high-technology goods manufacturer, needs 40 different services to deliver products globally
- The company supplies 15 services themselves
- SERVIFICATION → Good producing companies increasingly buy, produce, sell and export services

Source: "Global Value Chains and Services". Kommerskollegium 2013:1. National Board of Trade. Available at: http://www.kommers.se/Documents/dokumentarkiv/publikationer/2013/rapporter/report-global-value-chains-and-services-an-introduction.pdf

Offshore Services going into Value Chains



Horizontal Activities:

- BPO
- ITO
- KPO

Vertical Activities:

Industry Specific

Source: Gary Gereffi (2010). Center on Globalization, Governance & Competitiveness at Duke University

Upgrading along Offshore Services Value Chains

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- **Policies first focus on ENTERING GVCs through capturing off-shoring services activities; then focus on UPGRADING in next phase**

Different education levels, revenue and salary per employee for a types of services off-shoring activities

Segment	Activities	Most populous position within segment	Average education level for employees	Average revenue per employee[a] (US$)	Median salary per employee[a]
BPO	Call Centers	Call center agents & technicians	High School / Bachelors degree	$19,720	$17,280
ITO	IT Infrastructure	Computer technician	High School/technical institute	$20,704	$16,932
	Software Development	Programmers	Bachelors / Masters Degree	$36,788	$28,065
	IT Consulting	Systems analysts	Bachelors / Masters Degree	$55,956	$45,455
KPO	Business and Financial Services	Financial analyst	Bachelors Degree in Business Administration	$127,081	$47,150
Vertical Activities	Engineering Services	Engineer	Bachelors Degree	$103,844	$53,514

+ while upgrading

Note: [a] This information is drawn from a confidential study published by Mercer 2008 for a certain country in Latin America.

Sources: Fernandez-Stark et al., 2010b; IDC Latin America, 2009; Meller & Brunner, 2009; Mercer, 2008; Wadhwa et al., 2008.

Source: Fernández-Stark, K., P. Bamber y G. Gereffi (2011). "The Offshore Services Global Value Chain. Economic Upgrading and Workforce Development". Center on Globalization, Governance & Competitiveness. Duke University. (2011). P. 12.

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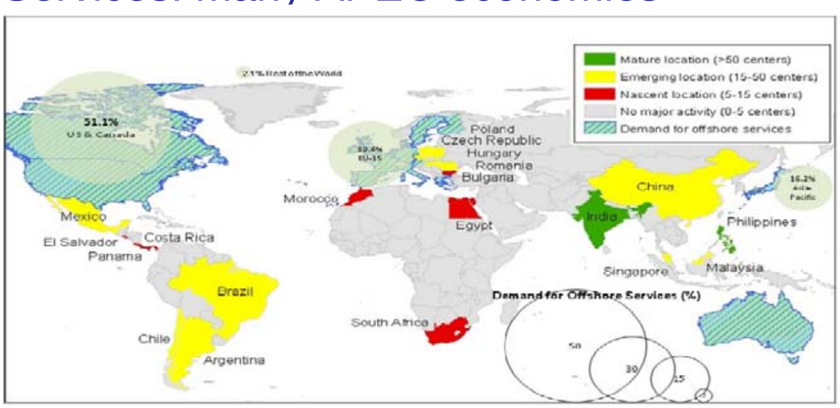
Supply and Demand Centers for Offshore Services: many APEC economies



Source: CGGC, Duke University based on data from Everest and Datamonitor.

APEC → Good potential for offshoring services

The AT Kearney Global Services Location Index 2011

Rank	Country	Financial attractiveness	People skills and availability	Business environment	Total score
1	India	3.11	2.76	1.14	7.01
2	China	2.62	2.55	1.31	6.49
3	Malaysia	2.78	1.38	1.83	5.99
4	Egypt	3.10	1.36	1.35	5.81
5	Indonesia	3.24	1.53	1.01	5.78
6	Mexico	2.68	1.60	1.44	5.72
7	Thailand	3.05	1.38	1.29	5.72
8	Vietnam	3.27	1.19	1.24	5.69
9	Philippines	3.18	1.31	1.16	5.65
10	Chile	2.44	1.27	1.82	5.52
11	Estonia	2.31	0.95	2.24	5.51
12	Brazil	2.02	2.07	1.38	5.48
13	Latvia	2.56	0.93	1.96	5.46
14	Lithuania	2.48	0.93	2.02	5.43
15	United Arab Emirates	2.41	0.94	2.05	5.41
16	United Kingdom	0.91	2.26	2.23	5.41
17	Bulgaria	2.82	0.88	1.67	5.37
18	United States	0.45	2.88	2.01	5.35
19	Costa Rica	2.84	0.94	1.56	5.34
20	Russia	2.48	1.79	1.07	5.34
21	Sri Lanka	3.20	0.95	1.11	5.26
22	Jordan	2.97	0.77	1.49	5.23
23	Tunisia	3.05	0.81	1.37	5.23
24	Poland	2.14	1.27	1.81	5.23
25	Romania	2.54	1.03	1.65	5.21
26	Germany	0.76	2.17	2.27	5.20
27	Ghana	3.21	0.69	1.28	5.18
28	Pakistan	3.23	1.16	0.76	5.15
29	Senegal	3.23	0.78	1.11	5.12
30	Argentina	2.45	1.58	1.09	5.12

- 8 of the top 10 locations for services off-shoring are in APEC:

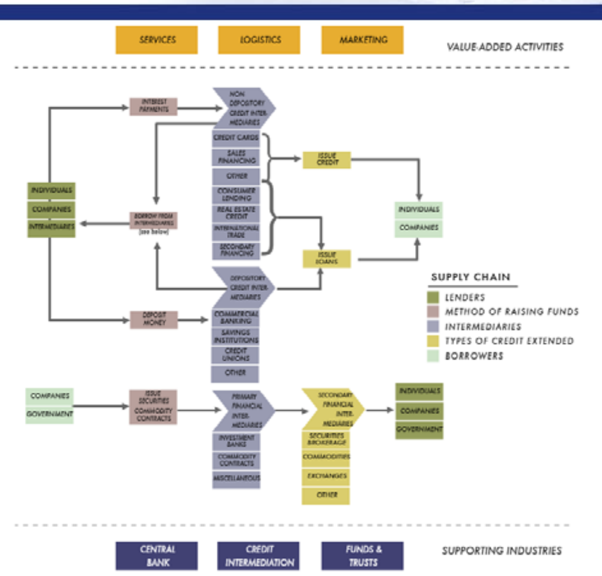
-China
-Malaysia
-Indonesia
-Mexico
-Thailand
-Vietnam
-Philippines
-Chile

Source: The AT Kearney Global Services Location Index 2011

Services have a double role in Supply Chains

1. **They are enablers of GVCs, acting as the glue among the different productions segments: many off-shored services go into GVCs**
2. **They constitute Services Value Chains on their own**

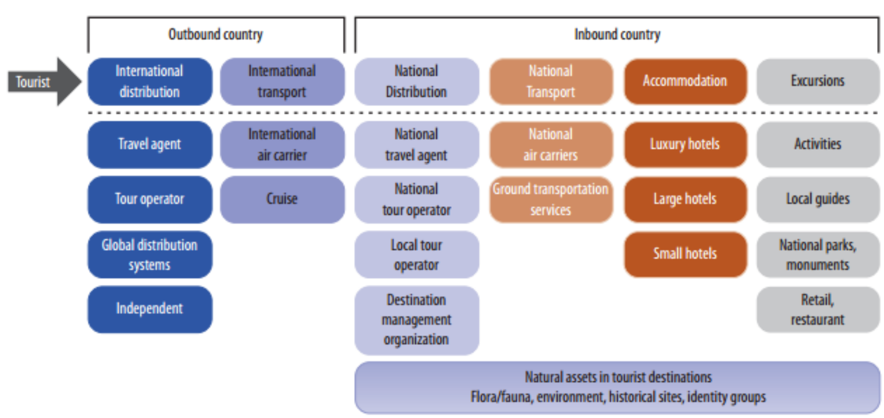
3. Services constitute Value Chains on their own



Banking & Financial Services Value Chain

Source: Fernández-Stark, K; P. Bamber y Gary Gereffi (2011). "The Offshore Services Global Value Chain. Economic Upgrading and Workforce Development". Duke University, Center on Globalization, Governance and Competitiveness.

Tourism Value Chain



Source: World Bank.

Policy Lesson 1: Services and Value Chains: Barriers no longer Protect

- With trade in intermediates and services –the cost of protectionism is magnified and higher than is generally understood since goods and services cross borders several times during GVC operations.
- It is therefore critical to maintain open markets for cross border trade in goods and services & FDI.
- In a world of Global Value Chains, tariffs & services restrictions punish domestic producers who use imported "inputs" because those inputs are re-exported.

With GVCs → "Trade Barriers no longer Protect"
The world effectively becomes the market!!

Policy Lesson 2. Supply chains shift Focus from Tariffs to Logistics where Services are Key

- **The operation of supply chains in goods shifts focus on trade barriers from tariffs to logistics**: recent WEF-World Bank report showed that improving logistics halfway to world best practice (Singapore) could increase world GDP 6 times more than removing tariffs
- Among the logistics barriers, **efficient services play a key role, especially telecoms and transport**

Policy Lesson 3. It is easier to capture a Services 'Task' in a Supply Chain

- It is no longer necessary to "build" an entire supply chain at home; economies can **capture one 'task'** of the supply chain

Often easier to do in services than goods – Why

- Because **services require less capital intensive investments: the greatest investment is in human capital**
- Services are also suited to output on smaller economies of scale and especially to **SME** operations

To capture services tasks in a supply chain, it is essential to focus on services efficiency & competitiveness

Policy Lesson 4. Government policies can do a lot for services efficiency & to promote participation in Value Chains

Factors affecting COMPETITIVENESS IN SERVICES:

1) Human Capital (talent, education, skills, ideas)
2) Cost considerations (financial attractiveness)
3) Enabling Digital Infrastructure – efficient telecoms
4) Investment in Intangible Assets (copyright, business methods, brands)
5) Quality of Institutions and Policy Focus
6) Open trade and investment framework
7) Efficiency of Domestic Regulation

Policy Lesson 5: Gains from Participating in Value Chains can be Widespread

- Joining a value chains is not a zero sum game ; many economies can provide services off-shoring tasks as these are highly differentiated
- All economies and economic activities can benefit; possibilities are vast if the fundamentals in place
- There is still a huge potential for expansion of services trade within APEC which could also reinforce its position in supply chains

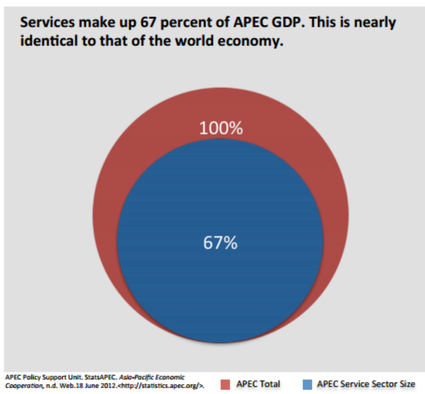
This argues for a great focus on SERVICES within APEC at level of the SOM

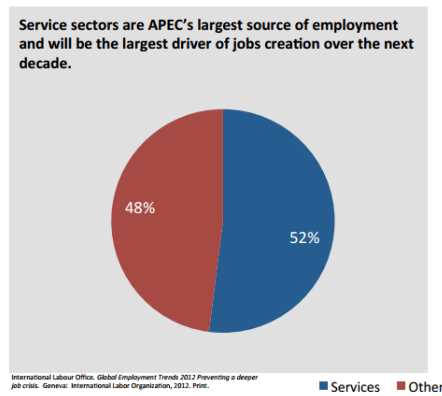
Services in APEC not as important as they could be

Despite prominence of GVCs in APEC, services still underperform

1. **Trade in services (as measured) remains low**
2. **Many behind the border barriers affect trade in services**
3. **Value chain operation could be much higher in region**

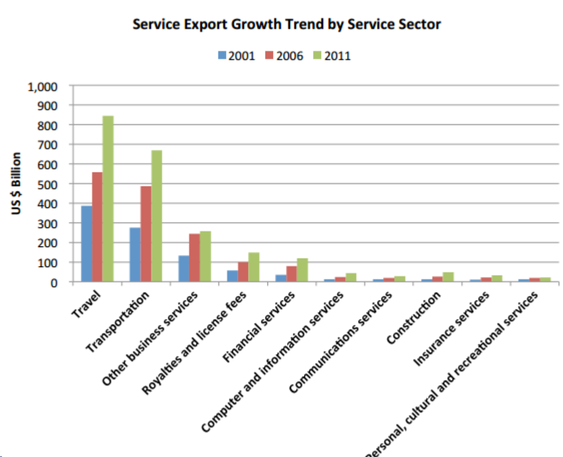
Services contribute significantly to GDP (67%) and Employment (52%) in APEC





Source: "Trade in Services in the APEC Region". The University of Southern Carolina Marshall School of Business. September 2012. Available at: http://www.keidanren.or.jp/abac/report/20120918_USC_Report.pdf

Service Export Growth in the past 10 years in APEC has been mainly in only 2 sectors



- Growth in Service Exports for most service sectors has been minimum within APEC
- Travel & Transport remain most important services traded

Source: "Trade in Services in the APEC Region". The University of Southern Carolina Marshall School of Business. September 2012. Available at: http://www.keidanren.or.jp/abac/report/20120918_USC_Report.pdf

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Trade in Services in APEC is low in comparison with Trade in Goods (2010)

Services Exports / Services Production	→	6%
Goods Exports / Goods Production	→	63%

Consequently there is a large potential for expansion of services trade within APEC

Source: "Trade in Se 2012.
Available at: http://www.keidanren.or.jp/abac/report/20120918_USC_Report.pdf

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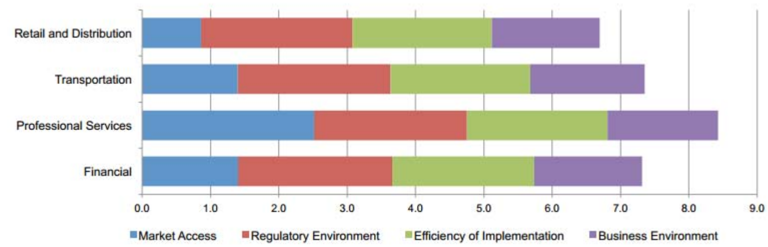
Behind-the-border Regulatory Barriers are impeding Services Exports in APEC

- Behind the border barriers and impediments are the most significant obstacles for trade in services.
- Domestic regulations, industry standards, professional requirements and efficiency of government agencies have larger impact than market access barriers.
- These are still quite present in APEC region.

Many Trade Impediments affect Services Sectors

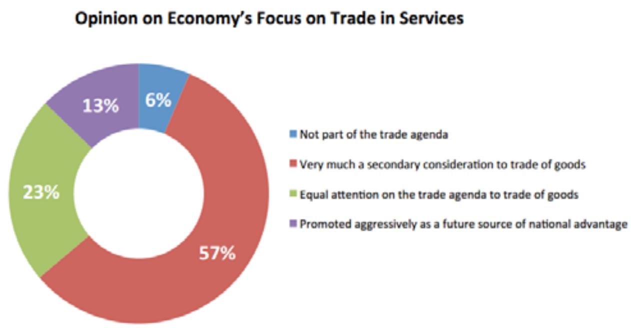


While Market Access index varies across services sectors, **the other category level impediments are comparable in importance and cover behind the border impediments to services trade in APEC.**

Other Challenges: Data Availability and Depth of Services Agreements in APEC

- **Scarcity of data on trade in services** → implications for policy making
  - Differences in definitions, measurement and the lack of detailed service trade statistics for all economies → difficulty to identify trade pattern trends / difficulty to measure the effectiveness of policies
- **Service provisions within FTAs lack depth**
  - Among the APEC FTAs, 80% of service provisions focus on market access barriers while only 20% focus on behind the border issues such as regulatory heterogeneity between economies.

Opinions are aligned for Need of Greater Focus on Services in APEC



Most of those interviewed criticized services trade being dealt with as a secondary matter to goods trade in APEC's trade agenda, in spite of the fact that services constitute the majority of GDP among most APEC economies

- As part of the research by USC Marshall School of Business, they carried out 231 interviews with business executives, government officials, academics and thought leaders knowledgeable about trade in services in APEC to canvas their opinions on services focus

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Thank You

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