Second Meeting of the Regional Trade Group

Services: A Key Driver of Growth, Development and Diversification

Implementing the CAREC Integrated Trade Agenda 2030

A Scoping Study[1]

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I. Introduction

Economic analyses of countries and regions typically divide the production side of an economy into distinct sectors. These comprise agriculture, mining and natural resource extraction, manufacturing and services. All too often the sectors are treated as discrete segments of economic activity, subject to separate scrutiny and distinct policy frames. This is understandable considering the varied features and operating environments characterizing the activities of each sector. But the individual contributions of different sectors is only part of the story. Activities across the spectrum are intimately linked and interactive in ways that define outcomes for the entire economy – be it a country or a region – and its relationships with the rest of the world.

This is nowhere more true than in the case of the services sector. Yet until comparatively recently services have been neglected in both analysis and policy. There are many reasons for this. It is partly historic, when physical accumulation was considered the sole source of value and the perceived lack of storability in the case of services made them seem worth little or nothing. The inherent intangibility of services added to the difficulty of paying attention to them as a source of value.

Unlike physical output, services often cannot be readily identified and counted. The identification challenge is further magnified because unlike physical goods, what is actually produced often comes in non-standardized, situation-specific or customized form. Further difficulty with identification and measurement arises from the fact that services are often inputs rather than final products. In practical terms, these services inputs are often bundled together statistically with the goods whose value they add to, thus obscuring the true sources of value in the economy.

Virtually all the input or so-called producer services that economies rely upon – such as Information and Communications Technology (ICT), transport, finance, business services, logistics and distribution – are indispensable to every aspect of economic activity.[2] Such interlinkages are also important for the agriculture, natural resource and manufacturing sectors, but they are simply not so far-reaching. Services, by contrast, are everywhere.

Reliance upon services of various descriptions for production, trade and consumption has been a feature of organized economic activity since earliest times. More recently, however, producer services have been progressively transformed by technological advances, notably in communications and transport. Combined with government policies oriented towards international trade and investment openness – which only recently have become compromised by more restrictive and inward-looking policies in some countries – these new technologies have supported a dramatic expansion of vertical integration across many parts of the global

[2] It should be emphasized that while most attention might naturally fall on producer services, they are not the only ones that can contribute to national value-added, increased income, jobs and growth. Consumer services can also play a valuable part. Tourism services are an obvious case in point.

economy. This in turn has contributed to even greater reliance on services as a component of overall economic activity.

Global value chains (GVCs) have given rise to many new opportunities for specialization and efficient exchange, contributing to increased output, income, development and employment in many economies through international trade and investment. For emerging economies seeking additional growth and income through diversification, participation in new industries can be more easily achieved by supplying components to industries that see an advantage in locating parts of their production process in the economy concerned.

Over time, success in this kind of participation in regionalized or globalized value chains will lead to higher domestic value-added contributions across a wider array of economic activities. In some cases, where value chains originate in a particular economy to take advantage of natural resources or raw materials, the challenge is to acquire a growing share of value-added activity arising from resource endowments as product elaboration occurs along the value chain.

As a general proposition, it seems that for many economies, including in some CAREC members, early stage diversified engagement in GVCs – beyond simply providing primary physical inputs at the start of value chains – is to be found in the services sector. This is in part because of the sheer ubiquity of services activities across all sectors and activities. It is also because at the early stages of diversification processes, services often do not require economies of scale to be competitive. Nor are they necessarily capital-intensive, relying more on labour and human capital. As skill sets grow and new sources of value-added come into play, services are likely to remain an important part of the story and can increasingly contribute to innovation and productivity growth. Innovation involving services is sometimes of a process variety, but also relates to new services and services supplied jointly with physical products.

As income grows and development progresses, the sources of growth change. In the early stages of diversified development, key sources of growth are increases in labour and capital in production. Subsequently, however, the importance of adding factors of production into the mix recedes and innovation and productivity growth take centre stage.

With opportunities for progress, however, come greater risks associated with not taking advantage of them. Failure to profit from these new possibilities means being further left behind in relative terms, resulting in widening income and development gaps and missed chances for progress. Many elements enter the equation – both of a long-term and short-term nature. In the longer term, remoteness, population sparsity, a lack of infrastructure and low skill levels can take time to remediate or compensate for. But both long-term and short-term prospects are inevitably influenced by one factor – the effectiveness of governments, along with the quality of the policies they pursue.

What are the implications of all this for the present paper and the CAREC region? The purpose of the work proposed in this scoping paper is to focus on one vital element in the

equation – that of recognizing and nurturing services as a crucial contributor to progress and growing prosperity. The way production and consumption have been internationalized across frontiers today creates inseparable links between trade and investment. There was a time when trade and investment were often thought of more straightforwardly as substitute means of accessing foreign market. That can still be true, but increasingly economic actors invest to trade and trade to invest. This makes successful engagement at the national and regional levels dependent on sound and mutually supportive policies on both trade and investment.

CAREC economies have made considerable strides in recent years, but significant challenges remain. In what follows, the paper will examine in a bit more depth some of the propositions outlined above. It will consider the status of the services economy among CAREC members. This is in specific relation to sectors and policies that may be of interest in the context of the work of the Regional Trade Group under the umbrella of the CAREC Integrated Trade Agenda (CITA) 2030. Data are not always easy to come by in the region, posing some challenges for analysis, as well as for policymakers and business. In what follows, Section II will take a brief look at the broad economic context of the region. Section III will follow with a closer look at services in particular. Section IV will then discuss aspects of policy affecting services, followed by some preliminary conclusions in Section V.

II. The broad economic context

Most CAREC economies have enjoyed above-average growth performance in the last decade or so, albeit from a relatively low base in many cases. Apart from People's Republic of China (PRC), the CAREC economies represent very small shares of global GDP. The other members of the grouping register less than 0.01 percent of world GDP, except for Azerbaijan (0.1 percent), Kazakhstan (0.2 percent), Pakistan (0.4 percent) and Uzbekistan (0.1 percent).[3]

Table 1 looks at growth in real domestic product for selected years from 2005 to 2017. Figures are present for GDP as well as for the agricultural, industrial and services sectors. A notable feature of growth performance in the region is that notwithstanding the dynamism displayed by many CAREC economies over the period, high growth variance has been a noticeable feature of overall performance. With the exception of PRC, Pakistan and Uzbekistan, all CAREC members experienced negative growth either in particular sectors or in overall GDP at some point during the period.

This vulnerability to gyrating growth performance is a reflection of economic size, sparsity and a narrow production and export base, often dominated by natural resources. The three economies that avoided negative growth performance altogether over the period are the largest and most diversified within the CAREC grouping. A core element of the prevailing development challenge in the region is to diversify the sources of production, employment and growth, while at the same time moving towards progressively higher levels of value content in what is produced.

[3] World Development Indicators, World Bank (2019)

Given their prevalence as inputs across all economic sectors, services play a crucial role in this process. Indeed, services either surpassed or matched growth performance in relation to the other sectors featured in **Table 1**. This can be seen from the final column in the table which records real average compound growth rates over the period 2005-2017.

A further indicator of shifting economic structures in the CAREC region can be seen from **Table 2.** It looks at employment shares in agriculture, industry and services, comparing the year 2000 with 2017. Most economies saw large shifts in employment over the 17-year period covered by the data, away from agriculture and towards either industry or services, or both. Notable outliers are Azerbaijan and Tajikistan, which experienced relatively modest structural shifts in employment over the period. The most significant shifts in job composition in Georgia, Pakistan and Uzbekistan were towards industry rather than services. By contrast, services received proportionately more additional workers than industry at the expense of agriculture in Afghanistan, PRC, Kazakhstan, the Kyrgyz Republic, and Mongolia. Data for making these comparisons were absent in the case of Turkmenistan.

In sum, this aggregated look at the evolution of different sectors in the CAREC economies suggests that overall, the services sector has been growing as fast or faster than other sectors in the last decade and a half or so. Bearing in mind the earlier discussion of the role of services in development and growth, this may be seen as a promising sign where it has occurred. However, a closer look is required to understand what precisely growth in services portends. It could represent growing demand for producer services such as finance, infrastructure, logistics, transport, distribution, education and business in a diversifying economy. Or it could reflect more on the consumption side, such as increases in certain categories government expenditure that are not necessarily associated with productivity growth and economic dynamism.

III. Services in CAREC regional and national economies

As noted already, services play key roles across the entire economy. Yet for a variety of reasons touched upon in Section I, their contribution can be hard to identify. One particular challenge is that services content is frequently attributed to goods production instead of being broken out separately. **Box 1** elaborates in this point.

Box 1: 'Bundling' and the identification of value attributable to services

Services are harder measure than goods. Data are relatively scarce, and when used to make comparisons among different economies, they tend to be more highly aggregated than is the case for goods. In addition to other considerations regarding measurement also discussed briefly above – such as the invisibility of services and their heterogeneity – a further challenge concerns 'bundling'. Almost by definition, any product that goes to market either as an intermediate input or as a final offering for consumption will be a bundle of goods and services.

In statistical terms, these disparate sources of value are frequently aggregated up, and if the services input contributes to the value of a good, that service will frequently be classified as part of the value of that good. Think, for example, of the machinery repair

and maintenance services, along with in-house services such as accounting and advertising that go into a business that runs a clothing factory. Unless those services are supplied by arms-length providers and are recorded separately as final products, they will be bundled as value attributable to clothing. Because of this, data are sensitive to changes in economic structures, and to the degree of specialization that occurs.

The same can occur in reverse when the final product is a service. It all depends on what value chain is being looked at, but as a general rule it may be argued that in terms of statistical recording, fewer goods enter services production in this way. Think, for example, of a bakery making bread and cakes owned by a hotel and supplied on its premises. With services value chains, however, the same aggregation problem presents itself. Products into which a services enter are also likely to be misclassified and attributed to the final output, in this case a different service.

Accurate information about the sources of value in recorded trade flows can present a particular challenge. This is because of differences in the way goods and services are by convention statistically recorded. One way of measuring Gross Domestic Product (GDP) is as follows:

GDP = C + I + G + X – M,

where C is consumption, I is investment, G is government expenditure, X is exports and M is imports. Consumption, investment and government expenditure are all measured in terms of the value that each of these elements of national economic activity was worth in the year concerned – in other words, they are value-added numbers. The values entering the national accounts for exports and imports, however, are gross values.

From the national economy perspective, the export figure includes value that was imported, so it does not accurately reflect what exports have contributed to the domestic economy. It is inflated by the value of imports contained in exports – hence the need to subtract imports in the national accounts calculation. But that is an aggregated figure. Until recently, very little disaggregated, product-level information was available.

New datasets (OECD-WTO, 2103; University of Groningen, 2012) based on value-added measures identify the services content of production, trade and consumption by identifying precisely the sources of value. Measured in the traditional way, services are estimated to account for some 25 percent of trade. When sources of value are broken out, however, this number doubles, and because of disaggregation challenges is likely to still be an under-estimate. Case study work that seeks to disaggregate further than is possible with the macro-datasets, demonstrates how significant the services components of production and trade can be. In a sample of firm-level case studies undertaken in Asia over a period of some two years (Low and Pasadilla, 2016), it was shown how some 22 firms in a wide array of different industries had supply chains in which anything from 37 to 74 discrete service activities added value. Services value frequently exceeded the share accounted for by goods on the production side.

The Chart below, based on the same sample of 22 case studies, illustrates how services are spread across all aspects of manufacturing operations.

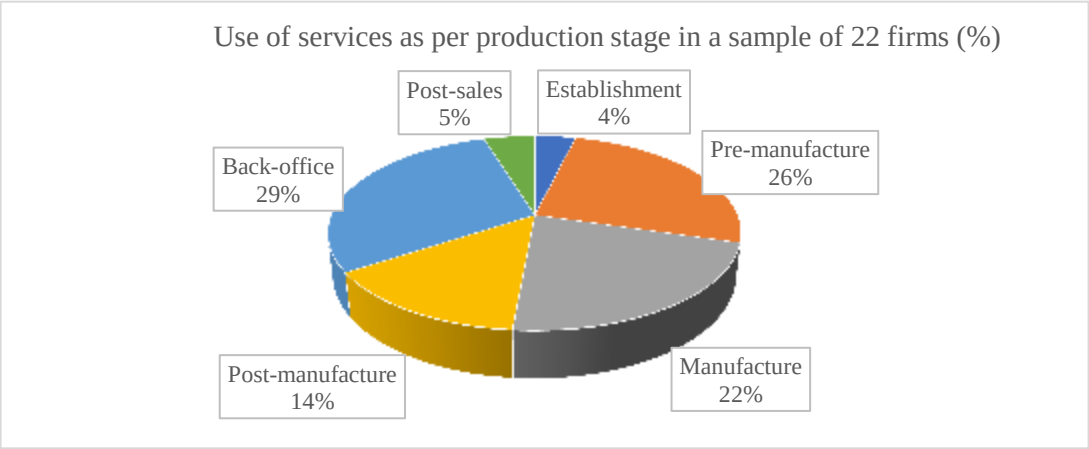

Table 3 uses a value-added approach to identify the growth rate of services from 2013 to 2017 in CAREC economies. Measured in this way, growth rates tend to be a bit lower than those reported in **Table 1.** They also fluctuate somewhat from year-to-year in most of the economies, and particularly so for Mongolia and Tajikistan. PRC, Turkmenistan and Uzbekistan registered higher growth rates than the rest of the CAREC economies. Perhaps the most interesting aspect of **Table 3** is its final column which records the sector share of services in value-added terms in each of the economies.

According to World Bank figures for 2017 (World Bank Indicators, n.d.), the global share of value-added attributable to services in high income economies is around 70 percent, some 55 percent for the upper middle income group, around the 50 per cent mark for low and middle income economies, and some 40 per cent for those with low income. The percentage shares for CAREC economies recorded in Table 3 for 2016 range from 36 percent to 66 percent. These numbers fall within an expected range for the CAREC economies compared to global averages.

There is no perfect correlation between the GDP of an economy and the share of services in income. Numerous specificities will influence the relationship. It is clear, however, that a reasonably strong correlation exists between income levels and dependency on services for added value in the economy. There are reasons for this on both the demand and supply sides. In the case of demand, as individuals become richer, they tend to expand their consumption baskets beyond the basic needs of existence to services-intensive activities such as education, entertainment, tourism, travel, and restaurants, which are typically services-intensive.

On the supply side, we have already noted that as economies diversify and grow, they will become increasingly dependent on services A major reason for this is that many services, especially producer services such as financial services, transport, professional services and distribution are needed in all sectors of activity, leading to a greater than proportional growth in the supply of services. This is why the neglect of services, or reliance on policies that impose

unnecessary and costly regulatory burdens on service-related activities, will weigh with increasingly deleterious effect on growth, jobs and prosperity.

Turning to the composition of services trade in the CAREC region, **Table 4** shows the sectoral composition of services exports among the member economies for the years 2016 and 2017. The service sectors identified in the table are taken from a World Trade Organization (WTO) database of balance-of-payments data comprising gross trade flows. They do not identify the services components of value-added that are embedded as inputs into exported manufacturing, mining or agricultural products. In this sense, they understate the true value of services exports. The data are nevertheless instructive in terms of the relative importance of the listed producer services. Among the so-called commercial services, transport and travel are fairly consistently among the highest value exports. Other business services is also significant for a few of the CAREC economies. Certain services that seem important to trade in general are exported very little by most CAREC countries, but once again, these data do not reflect all the services value that is actually in exports.

One of the variables that is important to understand is the degree to which services are traded among CAREC economies as they seek to deepen their cooperation through intensified economic linkages. The necessary data are scarce. It would seem to be the case according to Asian Development Bank Data (Key Indicators, 2018) that only some CAREC economies count their fellow members among their top 10 traders, be it exports and/or imports. The one exception to this observation is PRC, which figures as a top 10 exporter and importer for all other CAREC traders. Unsurprisingly, given the relative sizes involved, the reverse does not hold.

The economies that do not include any other CAREC economy besides PRC in their top 10 importers or exporters are Azerbaijan, Kazakhstan, Mongolia, and Pakistan. Georgia (*Azerbaijan*), the Kyrgyz Republic (*Kazakhstan, Tajikistan, Uzbekistan*), Tajikistan (*Pakistan, Kazakhstan, Georgia*), Turkmenistan (*Afghanistan, Kazakhstan, Georgia*) and Uzbekistan (*Kazakhstan, Afghanistan, Tajikistan*) all count one or more of their CAREC partners among their top 10 exporters and/or importers, as indicated in parentheses.

Table 5, **Table 6** and **Table 7** each address aspects of the direction of trade of CAREC economies. They also share one drawback in common, namely that they are tables covering merchandise trade and not services trade. This is because of data availability and adopting this approach is predicated on the notion that services trade is sufficiently tied up with goods trade for the direction of merchandise trade flows to correspond with reasonable closeness to services trade.

Table 5 deals with merchandise exports from CAREC members to the various continents and mega-regions that make up the rest of the world. Asia has dramatically increased its share of total exports originating in CAREC economies. This has risen from 27 percent in 2000 to 46 per cent in 2017. The Kyrgyz Republic and PRC are the only ones not to have found proportionately larger markets in the rest of Asia over the period. The increase in the rest of Asia as a CAREC

export destination is on average reflected largely in the reduction of Europe's share as a destination for CAREC economies' exports. An interesting angle here would be to consider how far these shifts in exports towards Asia involve heightened engagement in regional value chains, or rather reflect an increased Asian appetite for natural resources.

Table 6 looks at the merchandise imports of the CAREC economies by continental origins in 2000 and 2017. Quite a bit of directional change has occurred during the 17 years to 2017. Just over half of the CAREC members have shifted a significant amount of their imports to the Asia-Pacific region. Exceptions to this are Afghanistan, PRC, and Tajikistan, with Turkmenistan staying relatively constant in terms of import shares going to Asia and the Pacific.

Afghanistan has shifted its trade to the Middle East. PRC has diversified to different continents, and Tajikistan has intensified its trading relationship with Europe and Africa in particular. Europe has lost trade share with the CAREC region, as have North and Central America and the Middle East to a degree. It would be useful, data permitting. to have an idea whether these directional shifts represent significant structural changes in the content of merchandise trade and whether there are implications for services.

Finally, **Table 7** considers the flow of exports of 9 CAREC economies by destinations defined in terms of the stage of development of the economies involved. Exports are distributed by percentage share in 2007 and 2017 among three categories of economy – low- and middle-income economies within the same region, the same economies located outside the region, and high-income economies. It seems that over the 10-year period, low and middle-income economies within the region are taking less of CAREC economy imports on average, even if they still account for the largest overall share.

Low- and middle-income economies outside the region have increased their share of CAREC economy exports accordingly. The high-income country share has not changed much, serving as a destination for around one-third of CAREC economy exports. These figures are difficult to interpret without additional information on the composition of exports and the nature of the commercial engagement behind them. It would seem to be the case, however, that the pattern is not that uniform in terms of the situation facing individual CAREC economies.

IV. Policy issues relevant to CAREC economies

In broad terms, government policies can focus on improving three aspects of the environment in which participants in markets operate. They include: (a) managing the external environment faced by firms; (b) the efficient manage of the policy environment; and (c) creating the appropriate trade policy conditions for competition. These are not only relevant to services, but also to other sectors where services play key enabling roles. Taken together, government actions can be an important element in determining the comparative advantages enjoyed by different sectors. Government action, or the lack of it, is by no means the only determinant of competitiveness, but it is a key element in the mix. **Table 8** contains data prepared by the Asian

Development Bank on revealed comparative advantage (RCA) in five CAREC economies in 2010 and 2017.

Revealed comparative advantage (Balassa 1965) is a simple index that calculates the competitiveness of a product (or sector) in world markets by comparing an economy's exports to world exports of the same product. A coefficient in excess of unity in the resulting calculation "reveals" competitiveness in global markets. This is because a country's exports in this case are proportionately higher than what an economy would sell in the absence of a comparative advantage. A value below one indicates the contrary – that the economy is not internationally competitive in the product concerned. **Table 8** shows that PRC's RCA is positive in the low technology sector as well as the medium- and high-technology sector, and not in business services, personal services and the primary sector.

Notably, Kazakhstan developed competitiveness in the business services sector between 2010 and 2017, but otherwise its competitiveness resides strongly in the primary sector. Given this natural resource dependency, which is likely to dissipate in the short- to medium-term, an interesting question is what could be done to foster more value-added opportunities along the value chain in relation to oil, ferrous metal and other primary product activities. Where such opportunities exist, there can be no doubt that the competitive supply of services will be a major component in ensuring success.

The Kyrgyz Republic has increased its competitiveness in the personal services sector over the period and maintained its primary sector advantages, albeit with a lower coefficient. Mongolia' revealed comparative advantage resides exclusively in the primary sector, relying on a range of natural resources. Finally, Pakistan retained competitiveness in the low-technology and personal services sectors. While the RCA index represents an easy rough guide to an economy's strengths in international trade, it says nothing about the determinants of competitiveness.

This brings us to the three aspects of policy mentioned above, where effective enabling policies can make a significant difference to an economy's competitive standing. The RCA index is only partly determined by geography and natural resource endowments, and even then, these influences are less important over time and in the presence of modern technology.

a) *Improving the external operating environment for business*

The first policy area relates to the external operating or production environment in a broad sense. Government policies can be supportive by shaping that environment through focusing on such issues as the adequacy of infrastructure, access to finance and the flow of knowledge and information. Numerous analyses point to these elements as key to growth and development. An increasingly important aspect of modern economy is the emerging role of digitization. **Table 9** contains information on a range of e-trade readiness indicators relating to the years 2014 to 2016 that help to reveal how far an economy is prepared to take advantage of digital opportunities.

The table includes data for all the CAREC economies on a range of variables linked to connectivity and preparedness for a digitally inclined economy – an economy that offers a range of new possibilities in production and trade. Much of the opportunity implicit in the virtual economy rests on seizing new opportunities that are heavily reliant on services sectors. The indicators in **Table 9** largely speak for themselves and it is not surprising that there is a certain variance in the different indicator score among CAREC economies.

b) Government policy affecting services

The second aspect of government that has an important influence on conditions in the marketplace is the design and implementation of policies. A wide array of policies that exert an influence on business prospects are in play. In contrast to trade in goods, services tend to be subject to greater degree of regulation. This is attributable to a number of factors intrinsic to the nature of services that were briefly mentioned in Section I.

It is noteworthy that the provisions on domestic regulation contained in Article VI of the General Agreement on Trade in Services (GATS) are still under negotiation after more than two decades of the existence of the Agreement. These provisions relate to qualification requirements and procedures, technical standards and licensing requirements. The regulations seek to address both the design and implementation of regulations. Even the best designed regulations can become trade barriers and sources of cost and frustration if they are not administered with efficiency and integrity.

As far as economies in the CAREC region are concerned, approaches to regulation affecting services are varied. One indicator of this is the World Bank's Doing Business Index, a part of which is reproduced in **Table 10** for the CAREC economies that are part of the dataset.

The Table has rankings for all the CAREC economies except Turkmenistan. Doing business rankings are out of the 190 economies in the dataset, and the CAREC countries vary in terms of the overall scores from 6 in the case of Georgia to 167 in the case of Afghanistan. In addition to the overall rankings, **Table 10** has included four other rankings (out of a total of 10 data points). These deal with starting a business, getting credit, trading across borders and enforcing contract – all of which are key to a healthy business environment.

These rankings for the ease of doing business vary considerably among the different CAREC economies, although Georgia is consistently the best performer on all criteria. It is notable that according to the World Bank analysis, three CAREC economies were among the top 10 out of 190 to have made the greatest improvement compared to the data for the previous year. The economies concerned are Afghanistan, Azerbaijan and PRC.

c) Creating market access conditions for competition

In order for CAREC economies to prosper, governments must create appropriate conditions of competition. This does not mean uncritically opening markets to foreign competition in the name of free trade. But it does mean ensuring adequate competition both domestically and internationally for services suppliers to operate efficiently and competitively in terms of costs and service delivery. A failure to do so implies additional economy-wide costs in all the areas where these ubiquitously used services are key inputs.

On the trade front, one indicator of potential competitive discipline for domestic services sectors for those CAREC members who have joined the WTO is the level of market access commitments undertaken in the GATS. **Table 11** sets out the commitments for each CAREC member of the WTO, including Afghanistan, PRC, Georgia, Kazakhstan, Kyrgyz Republic, Mongolia, Pakistan and Tajikistan.

The Table breaks down services subsectors into business, communications, construction and related services, distribution, education, environmental services, financial services, health-related and social services, tourism and travel, recreational and cultural and sporting services, and transport services. The final row of **Table 11** records the number of commitments taken by each CAREC WTO member out of the total of 165 possible subsectors identified in the table.

Without closer analysis of multiple data points it is not possible to say authoritatively how far-reaching these commitments are. Nor, without further analysis, is it possible to say which modes of supply have been committed, nor whether the commitments are predominantly in the nature of market access or national treatment commitments. The GATS identifies four modes of supply by which exchanges can occur in services.

Mode 1 deals with cross-border services delivered from the country of production to the country of consumption, often delivered digitally (e.g. banking services). Mode 2 delivery requires that consumers travel to the territory of the producer (e.g. tourism services). Mode 3 requires that the supplier of the service establishes a commercial presence in the economy of the consumer in order to deliver the service. This is conceptually equivalent to foreign direct investment. Finally, Mode 4 deals with the movement of individual service suppliers ('natural' as opposed to 'juridical' persons to cross a frontier in order to deliver the service. This is sometimes referred to as the movement of people for production (as opposed to consumption) purposes.

Market access commitments involve the conditions under which foreign supplies or suppliers are permitted to sell in another market. This is akin to tariffs in the case of goods, but typically takes a regulatory form rather than a price measure like a tariff. Of course, the analogy with goods is also only partial, since there is nothing in the sphere of goods under the WTO that deals with the cross-border flow of the means of production – namely capital and labour – which are addressed by GATS Modes 3 and 4. As for national treatment, this requires that once a service or its supplier has crossed the frontier, it is entitled to equivalent treatment to that provided to domestic services or service suppliers.

As already mentioned, without a more forensic look at individual commitments, it is difficult to judge the quality of GATS commitments or how far GATS they are instrumental on the front line of policy formulation. As in many countries, they could set a baseline for access which governments improve upon in practice. On the one hand that is positive in the sense that conditions of competition are improved practice exceeds obligation. On the other hand, the improved situation may prove less stable because it is not legally bound under the GATS.

In any event, there is one important observation worth making about the general level of most CAREC economy commitments under the GATS. In terms of their sheer numbers, they are high by international standards. This is demonstrated in **Table 12** and **Table 13**.

Table 12 shows the distribution of GATS commitments by groupings of WTO members – least developed, developing and transition economies, transition economies only, developing economies only, developed economies only, and members who have acceded since 1995 (when the WTO entered into force as the successor to GATT). The picture is clear. Some transition economies – the name accorded to many CAREC members in the WTO context – have GATS commitments which to appear to exceed those assumed by developed economy members. Another major contributor to a higher level of GATS commitments is that with the exception of Pakistan, all CAREC members who have acceded to the WTO did so post-1995. **Table 11** clearly reveals that post-1995 acceding members made higher commitments on average than those who were in the WTO from the beginning.

Table 13 reinforces the impression of a high level of commitments. It shows the commitments of four CAREC economies (Georgia, Kyrgyz Republic, Kazakhstan and Tajikistan) in terms of the shares of these that are free of any restrictions, partially restricted, and entirely unbound (i.e. without any commitments). Although the comparators are not in the Table, the number of entirely unrestricted sectors is likely to be on the high side in comparison to the commitments of the majority of other WTO members.

Finally, the World Bank has developed a Services Trade Restrictiveness Index (STRI), some of which is reproduced in **Table 14**. Data are available for five CAREC economies and the table is split into seven major sectors – financial, banking, insurance telecommunications retail, transportation and professional services. An overall restrictiveness coefficient is also provided. The coefficients are calculated for each of the modes of supply used by the GATS, as described above. The higher the coefficient, the more restrictive is the policy, on an ascending scale of restrictiveness starting at zero and going to 100.

Certain modes of supply are inapplicable to particular sectors, as is the case with Mode 4 (movement of people) that only applies to professional services. In the case of telecommunications and retail, no Mode 1 (cross-border supply is contemplated. It should be noted that although the STRI relies on the four modes of supply spelled out in the GATS, the index is still calculated in the same way even if the economy concerned is not a WTO member, as is the case here with Uzbekistan.

Certain patterns are discernible in the data, with a higher tendency across the board to restrict various kinds of financial services (financial, banking and insurance). This reflects a common pattern across the world and may in part have to do with prudential concerns. This cannot, however, necessarily explain fully the degree of restrictiveness. The Kyrgyz Republic, for example, has no restrictions on the banking sector and relatively modest levels on insurance.

These numbers purport to reflect actual levels of trade restrictiveness. In this they are unlike the GATS commitments discussed earlier that reflect maximum protection levels and not necessarily actual policy. For this reason it may be in the interests of governments to examine the results and evaluate the case for policy changes. On the other hand, it is worth bearing in mind there is not necessarily a one-to-one relationship between restrictions on trade and uncompetitive domestic markets.

In a market of reasonable size with multiple players, without significant economies of scale in the sector concerned, and with government policy that effectively controls anti-competitive behaviour by local firms, it may be that open international trading arrangements are not essential for competitiveness. Such a situation would break any straightforward correlation between trade openness, efficiency and competitiveness. The question might then be, however, why a government would not in any event welcome some foreign competition – there would be no domestic interest to protect. Besides that, the conditions necessary to ensure a competitive market behind trade barriers are on the stringent side.

V. Concluding remarks

a) Summary observations

In summary, until relatively recently a generally held view was that services were at the margin of economic development. They were considered merely supportive of other economic activities – essential, but not in themselves significant contributors to dynamism and productivity growth.

That view of services as the 'poor relation' of economic activity has been modified more recently, with growing appreciation of the vital contribution services make to economic progress in societies. This realization has been facilitated by growing availability of data, which has opened a wider window on the true sources of value and made it possible to isolate the services contribution with greater precision.

Services play what might be called a multi-functional role in modern economies. First, they are the dominant source of value creation globally and become increasingly important in individual economies as they grow, develop and diversify.

Secondly, services are essential in one form or another to every other activity that takes place in an economy. The services that matter the most in this context are often referred to as producer services, including information and communications technology (ICT), finance (including banking, insurance and securities-related services), transport, logistics, business services, and distribution. These are the key services whose quality and competitiveness are among the most important components of economic activity and progress. Some consumer services are also key sources of income and growth, the most notable of which, perhaps, is tourism.

Thirdly, it is in the nature of services that they frequently play a key role in lubricating and enabling interactions among multiple economic actors in different sectors separated through time, distance and activity. Technological advantages in recent years, particularly in the form of digitization, have also stimulated reliance on services while at the same time creating new opportunities for large and small enterprises.

Another issue that is important for the creation of new growth opportunities is the increased tendency for production processes to be spread across multiple jurisdictions. These value chains may be regional or global, serving markets in relatively close proximity as well as at greater distance. Often referred to as global value chains (GVCs), these structures potentially offer new opportunities for suppliers of goods and services to specialize and secure market shares in narrowly defined segments of activity. These opportunities are often in services sectors and the challenge over time is to upgrade on GVCs, gradually producing more sophisticated inputs with higher value-added.

b) The positioning of CAREC economies

Sections II and III above have attempted a preliminary assessment, with readily available data, of the role of services in production and trade in the CAREC economies.

The 11 CAREC economies are quite different in a number of ways, but in addition to geographical proximity and elements of a shared past, are also structurally quite similar in some cases. On average CAREC economies have grown faster in the last decade or so than the global average. This has been from a relatively low base in some cases, and challenges remain in diversifying away from dependence on raw material extraction. For a number of the economies concerned, a dependency on natural resources as a leading source of income poses a diversification challenge – to develop more varied output sources and higher levels of value content in production and exports.

This process is already under way, with services providing an increasing share of income – ranging anywhere between a one-third and two-thirds share of services in GDP by 2016. The global average is around 70 per cent, but the shift is indicative of a diversification process. In addition, discernible shifts in employment towards industry and services are also a further indication of a deepening and broadening production base.

In terms of the contribution of commercial services to exports, Transport, travel and business services feature with comparative frequency in the data for CAREC economies. This is only a partial take, however, since more information is needed to obtain a fuller picture in terms of the services embedded in exports but not identified as such.

c) Policy perspectives

Section IV above has briefly outlined some of the policy issues and outcomes that shape prospects for service suppliers in CAREC economies. Governments play a crucial role in determining how far services are able to realize their full potential as contributors to income, growth, diversification and development. Their actions can contribute significantly to progress. Actions to support firms, large and small, through coordination, the provision of information, support of knowledge and learning networks and the development of infrastructure can make a significant difference.

In terms of their own policies in pursuit of administrative tasks and public policies, these can help and hinder. They can be an additional source of unnecessary cost. When policies are designed poorly or administered in ways that engender uncertainty, they change the risk profiles of firms and reduce their competitiveness. Available evidence suggests a mixed picture among CARAC economies in this domain.

Another way governments influence the conditions of competition for firms, including in services sectors, is what they do to shape the trade policy environment in which they work. On this front, evidence suggests that many CAREC governments have been active in creating favourable market conditions for services, at least in terms of their home markets. This is especially apparent in CAREC members that have joined the WTO.

d) Future work on services in the CAREC economies

More attention is needed to opportunities offered by the General Agreement on Trade in Services and its implications for policy. The same holds for regional trade agreements and other forms of cooperation with neighbouring economies. This requires greater familiarity with what various service sectors can bring to national and regional growth and development opportunities.

Among possible tasks in this context are:

- The Identification of priority service sectors in terms of their current and future role in the broader economy. This would involve a closer examination – to the degree permitted by data availability – of the extent to which particular services:
    - Account for significant shares of output and exports in the economy, including indirect exports in both the present and future;
    - Are “essential” as competitively supplied services without which the economy’s larger export prospects are compromised;

    - Have the most inter-sectorial linkages, and generate the highest levels of integration across different sectors in CAREC economies;
    - Are particularly active in GVC participation and by implication possess strong growth prospects.

- Services and investment are often closely linked in economies open to trade, as well as a result of vertical integration through value chains. These links require some analysis in order to appreciate better the role of services in the economy.

- To the extent that opportunities exist for participating in regional and global value chains, evidence suggests that services are a major part of the story. Analysis is needed to understand these relationships better and what options there may be for supportive policy.

- As CAREC deepens intra-regional relationships, an obvious question concerns the possible synergistic roles that services might play in solidifying these linkages for the benefit of all parties involved.

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