SERVICES AND DEVELOPING COUNTRIES

Why would developing countries benefit from liberalising their own markets in services?

1. Like trade in goods, freer trade in services raises the growth of GDP.

2. There is an added twist for services. Many services are inputs into production. Inefficient production of such services acts as a tax on production. Thus, goods trade liberalisation in the absence of service trades liberalisation could well result in the competitiveness of the country's producers of goods being hampered by this "tax".

3. Well functioning service industries contribute to growth in different ways:-
   - an efficient financial sector allows resources to be deployed where they have the highest returns;
   - improved telecom efficiency generates economy-wide benefits as telecoms are a vital intermediate input and are crucial to the diffusion of knowledge (itself a vital component of growth in modern economies);
   - transport services contribute to the efficient distribution of goods within a country and greatly influence its ability to participate in international trade;
   - business services such as accounting and legal services are important in reducing transaction costs;
   - education and health services are necessary in building up the stock of human capital, which is a key ingredient in long-run growth performance.

4. A country that liberalises its services sector is likely to liberalise its stock of capital. This is not only through increased FDI but also through the transfer of skills or technology that is embodied in or associated with such FDI.

What evidence is there to support these arguments?

5. At an aggregate level, there has been a lot of research on the relationship between the degree of openness in an economy and its growth rate. (To a great extent this reflects openness in goods markets, because barriers to trade in goods are easier to measure than those in services and historically liberalisation has concentrated on goods, but there is no reason why the conclusions should not be applicable to services, and for the reasons above liberalisation may have more impact for services). With relation to developing countries, the most comprehensive of recent studies found that developing countries with "open" economies grew by 4,5% per annum but those with "closed" economies by only 0.7% over the period studied.

6. Similar studies for services' liberalisation are few. Recent academic studies have tried to find links between financial services liberalisation and different growth rates between countries, and have found that the more openness is positively related to growth. The World Bank has extended this to telecommunications and financial services and its (yet unpublished) findings confirm this link

7. There have been various studies of the internal effects of liberalisation of individual services in developing countries. Last year, The WTO Secretariat had

identified about 40 of these. (These are concerned with internal liberalisation but their conclusions would be applicable to reforms undertaken under GATS).

8. One is worth noting because it is relevant to the basic fear of some developing countries- namely that liberalisation means the demise of their industries and the loss of employment. A study by the ITU and World Bank compared telecommunications reforms in 26 Asian and Latin American countries over 1990 to 1994: it showed that telecom employment rose by over 20% in markets allowing for various degrees of competition compared to 3% in monopoly markets. Papers on individual countries presented at the WTO/World Bank Conference on “Liberalisation and Internationalisation of Financial Services” in 1999 show similar positive effects.

9. The benefits of FDI have been extensively studied. It is worth noting that approximately 60% of current FDI is in services. At an aggregate level, studies have found a positive relationship between the FDI/GDP ratio in different economies and their growth rates. One cross-sectional study found that each % point increase in the FDI/GDP ratio increased the rate of growth in the host country by 0.8%.

10. There is evidence that FDI is often more productive than domestic investment, and produces technology spillovers. There is also evidence of how it also builds up a general expertise in the host country of how to do things better, in terms of matters such as marketing, and training of labour.