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Can Service Be a Growth Escalator in Low Income Countries?

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Abstract

Several high-level reports have raised the concern that low-income countries, especially in Africa, are experiencing premature de-industrialization. Have the latecomers to development missed the boat? Are they growing without any structural transformation? Not really. Although their manufacturing sector is not growing, they are benefitting from the Third Industrial Revolution which has enabled them to catch up faster. As services produced and traded across the world expand with advances in technology and globalization, the possibilities for low-income countries to grow faster based on their comparative advantage increases. That comparative advantage can just as easily be in services as in manufacturing. Growth escalators faced by the Lions in Africa may turn out to be different than that experienced by the East Asian Tigers.

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Can Service be a Growth Escalator in Low Income Countries?

Ejaz Ghani and Stephen D. O'Connell[1]

Key words: economic growth, macroeconomic and structural policies, private sector development, trade, job.

JEL: O14, 024, 040, 047, 055, 024.

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1. Introduction

It has been argued for more than 200 years that economic growth is associated with the manufacturing sector (Baumol 1967, Dercon 2014, Gelb 2014, Kaldor 1966, Rodrik and McMillan 2011, De Vries et al 2013, Winters 2010, UNIDO 2009). Services have been considered non-tradable, menial, low productivity, and low-innovation (McCredie and Bubner 2010). The East Asian Tigers are the classic success stories about how the conventional path to growth goes through industrialization.

However, this conventional path to development seems to have hit a road block in other regions, especially low income countries in Africa and South Asia. Indeed, several high level reports on Africa—the 2014 African Transformation Report, the African Union's Agenda 2063, the African Development Bank's long-term strategy, the UN Economic Commission for Africa's 2013 report, and UNCTAD's 2012 report—have all raised concern about limited industrialization and technological progress. Indeed, in many African economies, manufacturing—the sector that led rapid development in East Asia—is declining as a share of GDP. The worry is that without a major transformation, Africa's recent growth spurt may soon run out of steam.

The marginalization of Africa during a period when the East Asian Tigers grew rapidly has led some to wonder if the low income countries in Africa are doomed to failure. It has been argued that the "bottom billion may be trapped in poverty" (Collier 2007). They will have to wait for their turn, until the giant industrialisers like China become rich and uncompetitive in manufacturing. While these concerns are commendable, insightful, and well placed, the growth experience of low income countries suggest that manufacturing is not the only growth game in town. Services can also be dynamic and contribute to growth and jobs. Indeed, services are now contributing more than manufacturing to growth and jobs in both low and high income countries.

Technological changes have made manufacturing more capital and skill intensive. So, it is creating fewer jobs. Some form of pre-mature deindustrialization seems to have set in (Rodrik, 2013, Subramanian 2014). This might be because consumers and households in developed countries now spend a lot less on manufactured goods than they do on services. This can put a limit to how fast the latecomers to development can grow through industrialization. But there is no such limit in services.

Indeed, the globalization of services is a tip of the iceberg (Blinder 2006). While jobs in the industrial sector are shrinking globally, jobs in services continue to expand. There remains huge room to benefit from large services sectors. This does not mean that latecomers to development should give up on industrialization. They could pursue both.

The Third Industrial Revolution led by services can upset five long-held tenets of economic development.

- First, services have long been thought to be driven by domestic demand. They could not by themselves drive growth, but instead followed growth. Service trade was limited because it required close proximity and face-to-face interaction between the buyer and the seller. However, this is no longer the case, as

technology allows services to be produced and traded just like goods (Bhagwati, 1984).

- Second, global trade in service has exploded, and it is growing much faster than trade in goods (Ghani 2010). The cost of trading services that could be digitized has fallen dramatically and services do not have to confront customs and other logistical barriers.
- Third, services were considered to have lower productivity than manufactures, and concentrated in informal sectors. However, technology, trade and supply chains have altered the characteristics of services. Innovations in communication and transport have contributed to global supply chains being extended into services, just as they have been extended into parts and components of manufactured goods.
- Fourth, it was thought that good jobs were created only in the manufacturing sector. This is no longer the case, be it in high or low income countries.
- Fifth, a service led growth is compatible with greener, inclusive, and more gender friendly growth.

The fact that service is no longer characterized by low productivity has been well documented in the growth literature on developed economies. Wölf (2005) shows that in 30 OECD member countries, services value added share have steadily increased. While traditional service (social and personal services and hotels and restaurants) have registered weak productivity growth rates, modern services (transport, financial intermediation, and telecommunication services) have registered growth rates comparable to those of some high-growth industries within manufacturing.

The heterogeneity of the services sector is also confirmed in the work by Jorgenson and Timmer (2011) for a sample of European Union countries, the U.S.A. and Japan. Maroto-Sánchez and Cuadrado-Roura (2009) have also identified important disparities in terms of productivity levels and performance across services sectors, with communications and transport in the European countries or wholesale and retail and financial services in the United States showing improvements comparable to those of manufacturing. There is similar evidence that services are now contributing more than manufacturing to growth, jobs and poverty reduction developing countries, although this has still not been widely accepted (*Economics* focus: The *service* elevator | The *Economist*, 2011).

What does all of this mean for the late comers to development in Africa? The promise of the service revolution is that the latecomers to development do not have to wait for their turn to get started, after China and other East Asian Tigers have become uncompetitive. The globalization of service provides another opportunity for them to find niches, beyond manufacturing, where they can specialize, scale up and achieve explosive growth, just like the East Asian Tigers did in manufacturing. The core of the argument is that as the services produced and traded across the world expand with globalization, the possibilities for low income countries to develop based on their comparative advantage expand. That comparative advantage can just as easily be in services as in manufacturing.

Although the same set of general non-distortionary policies is as important for services as for manufacturing, specific strategies for services matter. Services, just like manufacturing, need more investments in physical infrastructure (a stronger communication/transport backbone), human infrastructure (skills and education), good entrepreneurship, and trade connectivity.

Services are becoming an active component of industrial policy in many developing countries. Local industry associations now give services a seat at the policy table. Policy makers are no longer one-dimensional and just focused on manufacturing-based growth. So the latecomers to development also need a much broader growth agenda than the East Asian Tigers did.

Some caution, however, should be exercised in how one interprets the evidence presented here.

- First, the dividing line between manufacturing and services is becoming increasingly blurred. There is an increased unbundling of manufacturing and the divestiture of services that were once included in manufacturing value added. But this cannot explain why service sector is growing much faster compared to the manufacturing sector.
- Second, this paper does not argue that service is superior to manufacturing, or the other way round. The latecomers to development now have many more levers to pull. It might be the case that the service growth surge in Africa and in other low income countries is merely reflecting a *catch-up* given that services were more backward to start with.
- Third, the landscape on the effects of technology on growth and employment patterns across different sectors is still at an early stage and rapidly evolving (Autor, 2014).

While the effect of trade competition is growing over time, the effect of technology has shifted from automation of production activities in the manufacturing sector towards computerization of information-processing tasks in the service sector. Technology does not necessarily imply fewer jobs, if it makes more goods and services tradable. The key policy message of this paper is that the low income countries now need a broader agenda on growth. They need not be a one-trick pony.

The rest of this paper is organized as follows. Section 2 examines the growth escalators in low income countries during the last two decades. Section 3 links growth to structural transformation. Section 4 switches to jobs, and examines evolving trends in jobs in both manufacturing and services sectors. Section 5 focuses on entrepreneurship, as most jobs are created by young and new firms that take advantage of technology, better infrastructure and an enabling business environment. Section 6 examines the changing face of globalization and compares trade policy with trade outcomes. Section 7 explores the link between growth and poverty. Section 8 concludes with a policy agenda.

2. Growth Escalators, Convergence, and Divergence

The literature on growth convergence and divergence is vast and deep. Some have argued that divergence is persistence. Lant Pritchett in his paper, “Divergence, Big Time” has argued that

backwardness appeared to carry severe disadvantages that generated long-term divergence between the growth in per capita incomes of developing countries compared to rich countries. Others have found evidence in favor of convergence. Arvind Subramanian, in his paper, "The hyper-globalization of Trade and its Future", has argued in favor of convergence, since the number of developing countries experiencing catch-up has more than trebled (from 21 to 75 countries) and the rate of average catch-up has doubled from 1.5 percent per year to over 3 percent.

However, what has been overlooked in this debate is the role that different sectors have played in growth convergence. Do manufacturing or services play a greater role in growth convergence? Data shows that global growth convergence has continued unabated during the last two decades. Just like the East Asian Tigers, the Lions of Africa are growing faster than the developed economies. However, the growth escalators for the Lions in Africa are turning out to be different compared to the East Asian Tigers. The East Asian Tigers benefitted from the manufacturing sector. The latecomers to development have benefitted more from the service sector.

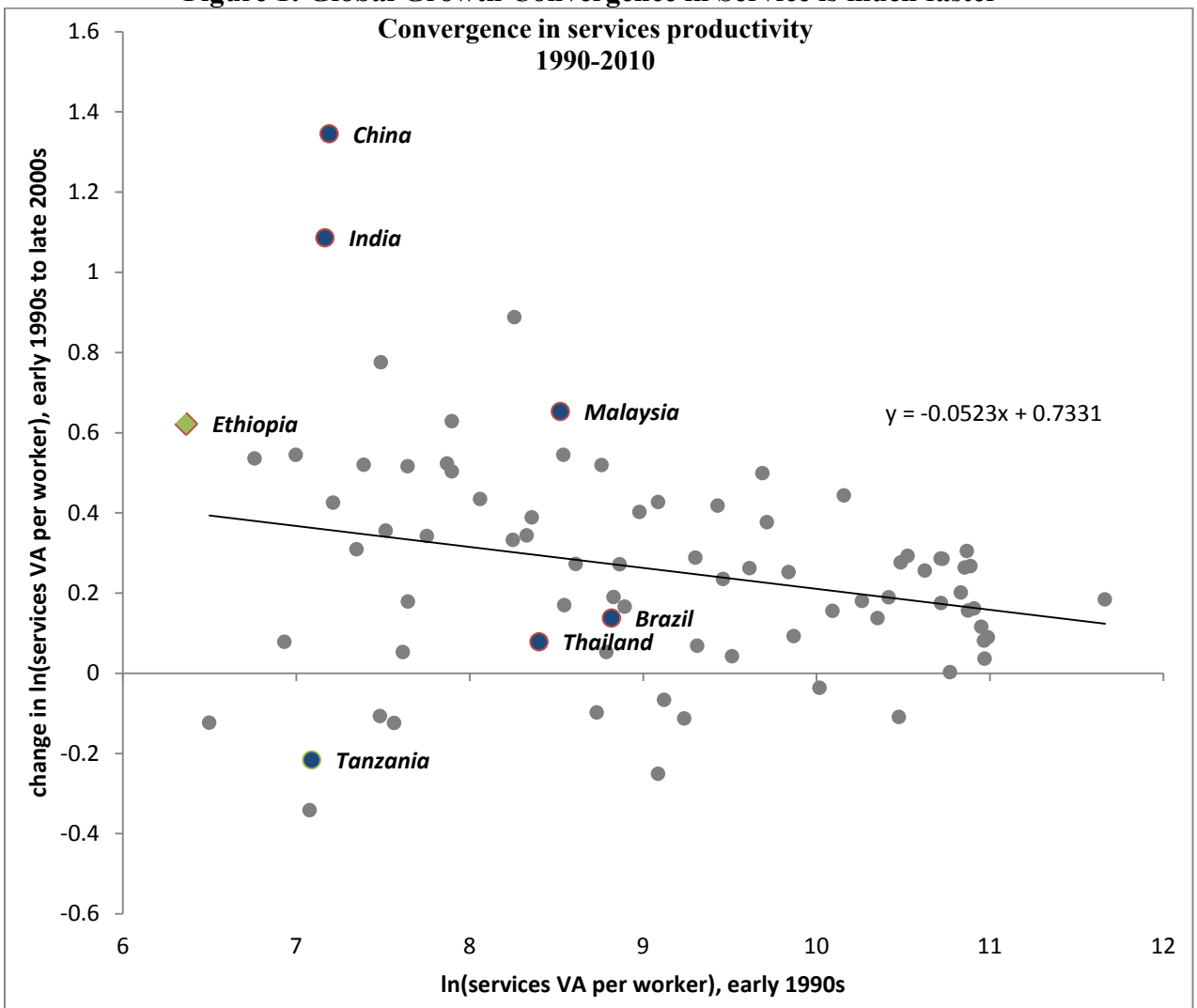
Figure 1 plots growth in service labor productivity for 100 countries--both developed and developing--on the vertical axis, and initial service labor productivity on the horizontal axis. The fitted line is a downward sloping line implying that low income countries in Africa that started with a lower level of labor productivity in services, and were further away from the global labor productivity frontier, have experienced a much faster catch up and growth in service labor productivity. Take Ethiopia for example, a latecomer to development in Africa. It is above the trend line, as are China and India. Ethiopia remains above the trend line even when estimates are changed from linear to non-linear regressions. This is good news for low income countries. They have more room to catch-up, and they are doing it faster, quicker, better, and smarter.

Figure 2 plots growth in manufacturing labor productivity on the vertical axis and initial labor productivity on the horizontal axis. The fitted line is also downward sloping implying that latecomers to development that started with a lower level of labor productivity in manufacturing have also experienced a faster growth in productivity. Unfortunately, many latecomers to development in Africa are well below the trend line, implying a much slower progress in the manufacturing sector compared to the East Asian Tigers which are above the line.

What is striking when one compares figures 1 and 2 is that the growth convergence story in services is comparable to, if not stronger than manufacturing, i.e., the convergence line is much steeper in service than in manufacturing. This would suggest that growth escalator and catch up in services can be much stronger than in manufacturing. Latecomers to development stand to benefit much more from services sectors.

However, the latecomers to development should not ignore other sectors. The global growth convergence narrative on agriculture is distressing. There is no growth convergence in agriculture. The fitted line linking productivity growth in agriculture with initial productivity level is flat or even upward sloping. This means that labor productivity growth in agriculture has remained low in Africa and in other low income countries, and is not catching up with more developed economies, unlike in services or manufacturing sectors. This is a big concern.

Figure 1: Global Growth Convergence in Service is much faster



Source: World Development Indicators. Ethiopia data from Martins (2014). Labor productivity calculated by the ratio of total sector value-added employment in sector. Underlying accounts are in 2005 constant international USD. Values taken from earliest year available from 1990-1993 and available from 2005-9. Overall conclusions do not change if line is quadratic or cubic in ln(initial VA per worker).

Figure 2: Global Convergence in Manufacturing is a bit slower

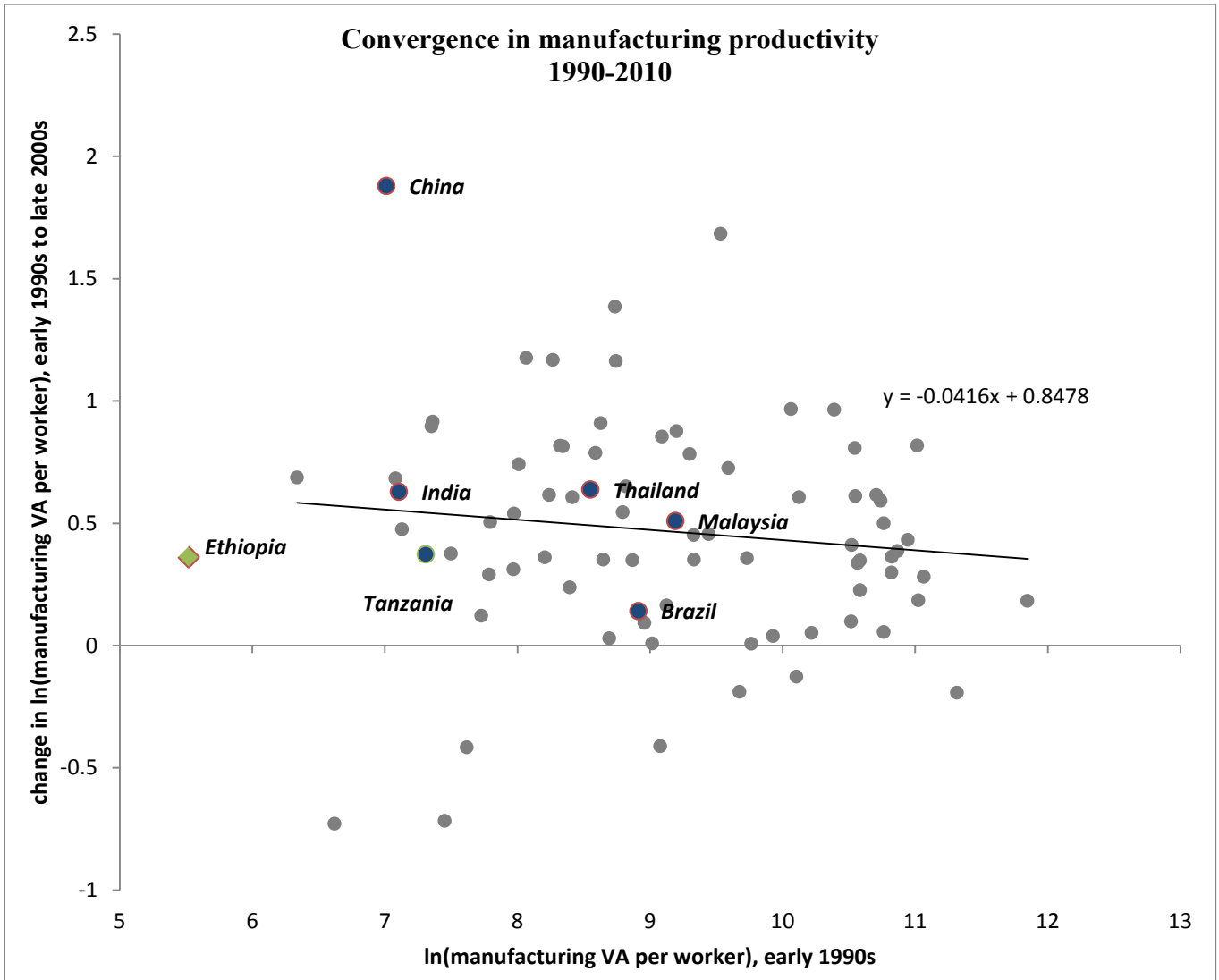


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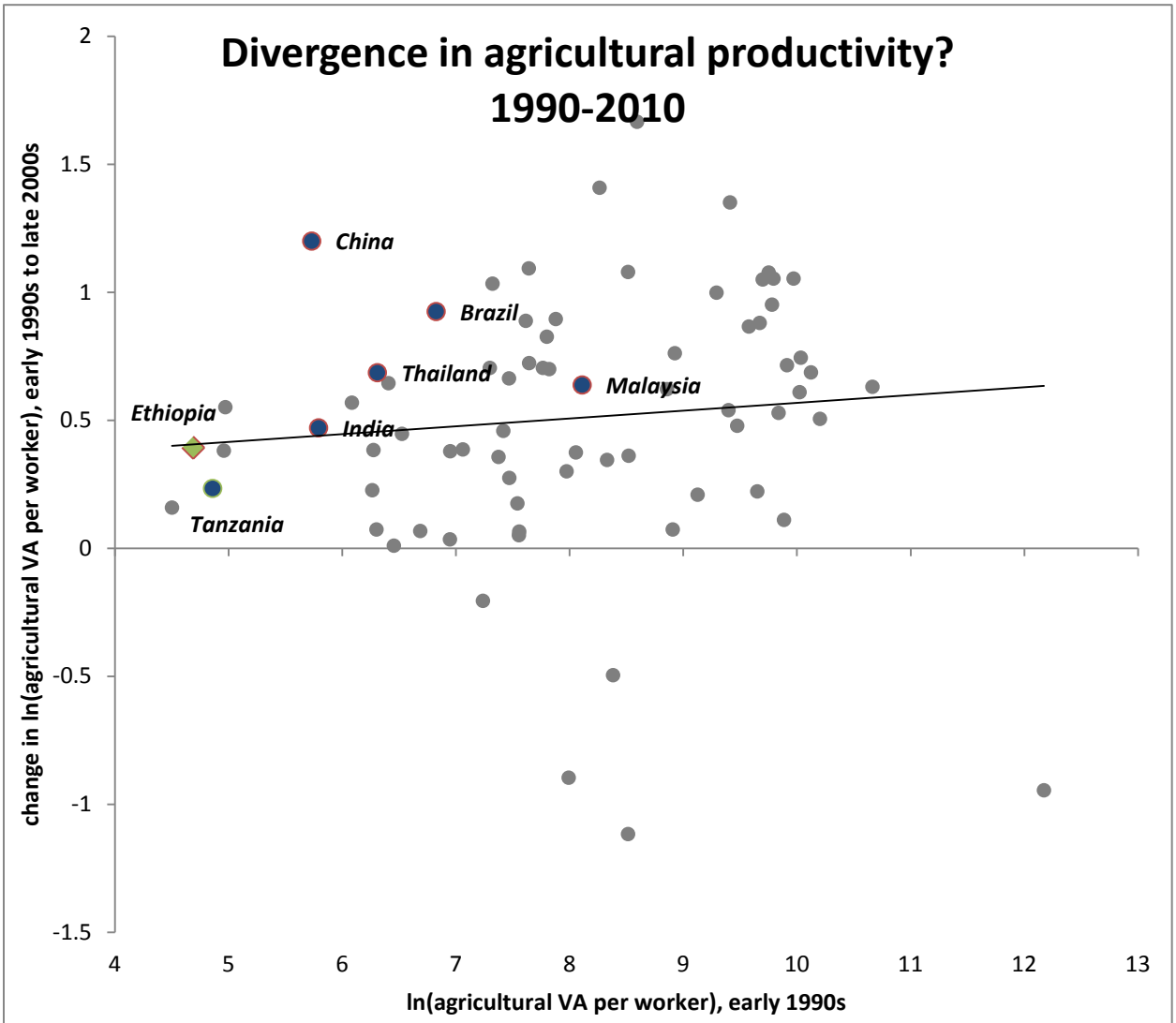
Figure 3: No Global Growth Convergence in Agriculture



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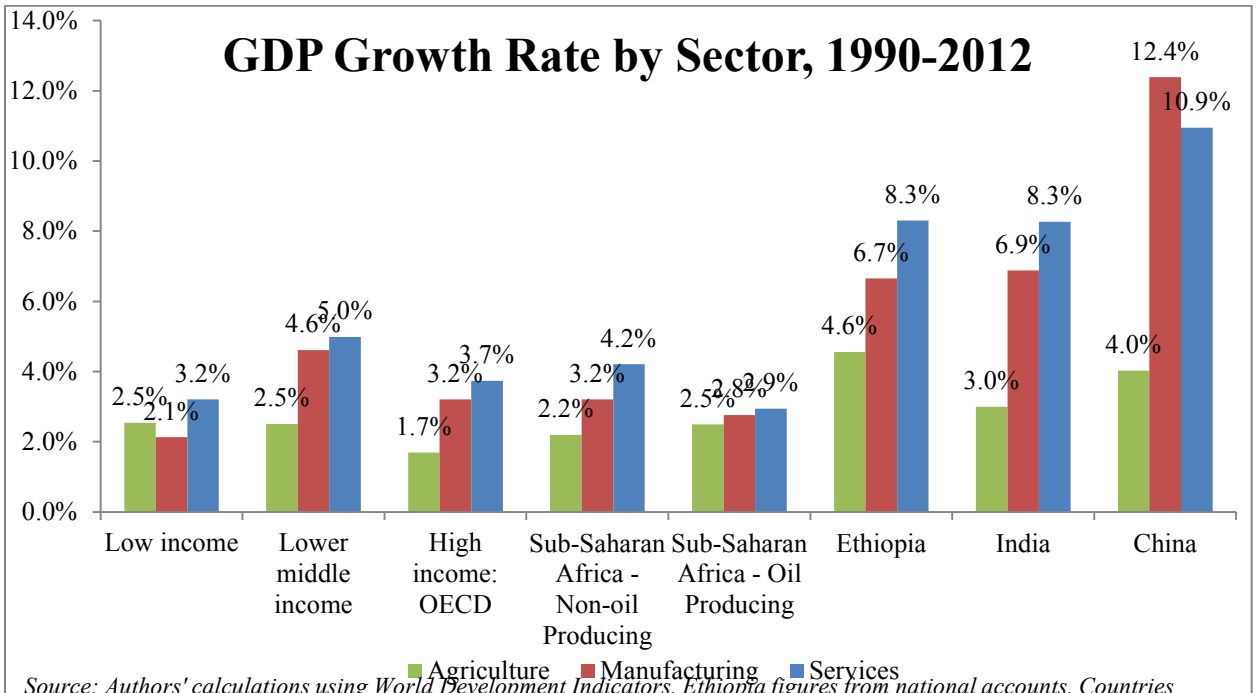
Africa has about 60% of the world's uncultivated cropland. The sector has the potential to become a major part of the global agricultural value chain through continued expansion of commercial farming onto uncultivated land, shifting some production from grain crops to higher-value crops such as horticulture and biofuels, and by improving the productivity and yields of smallholder finance. However, yields per hectare have been stagnating in much of Africa (Stiglitz, 2013).

3. Growth and Structural Transformation

Although many African countries have been recognized as among the best-performing growth countries, with GDP growing by roughly 10% annually during the last decade (Stiglitz, 2013),[2] the popular narrative is that they are "growing rapidly but transforming slowly". As mentioned earlier, in many African economies, manufacturing—the sector that has led rapid development in East Asia—is declining as a share of GDP. The worry is that without a major transformation, Africa's recent growth spurt may soon run out of steam.

Figure 4 compares economic growth rates by sectors in 100 countries during the last two decades. It shows that non-agricultural sectors have grown much faster in low income countries. Both manufacturing and services sectors have experienced faster growth rate than agriculture. Service has experienced the fastest growth rate. This is true for all low income countries, from Ethiopia to Kenya to Zambia. The exception to this trend is China where manufactures have grown much faster than services.

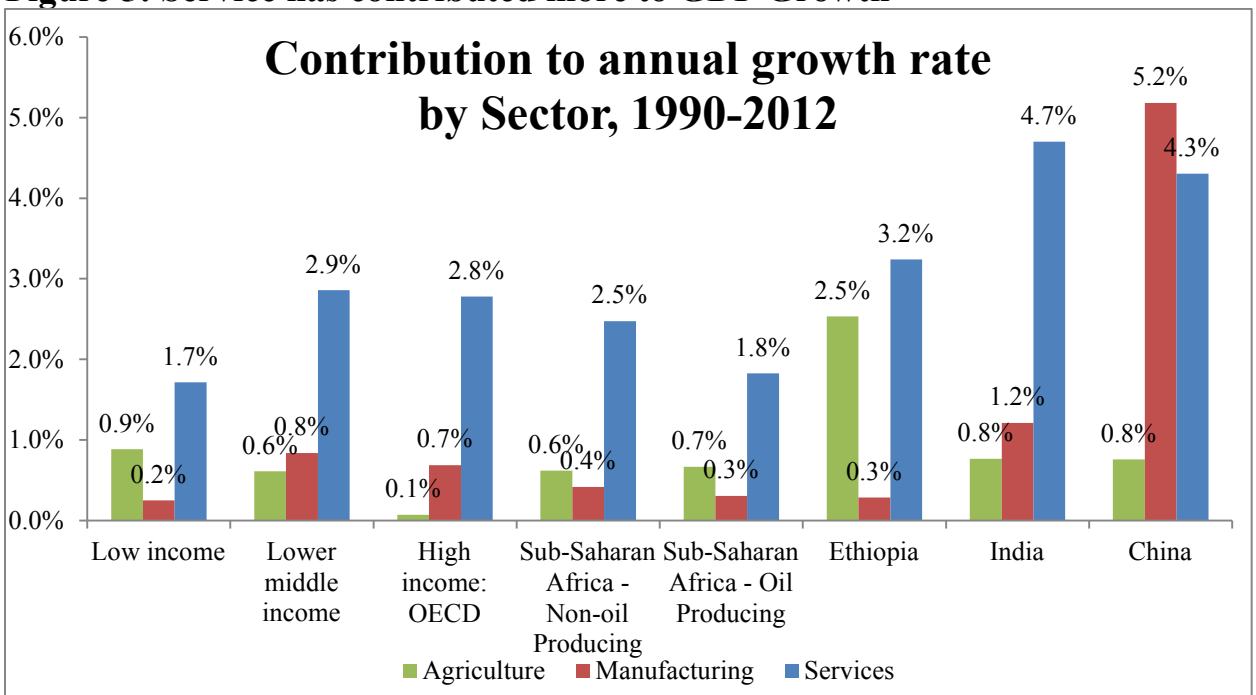
Figure 4: Service has experienced higher growth rates than manufacturing



Source: Authors' calculations using World Development Indicators. Ethiopia figures from national accounts. Countries grouped based on World Bank definitions. "Growth rate" calculated as compound annual growth rate based on constant GDP at PPP.

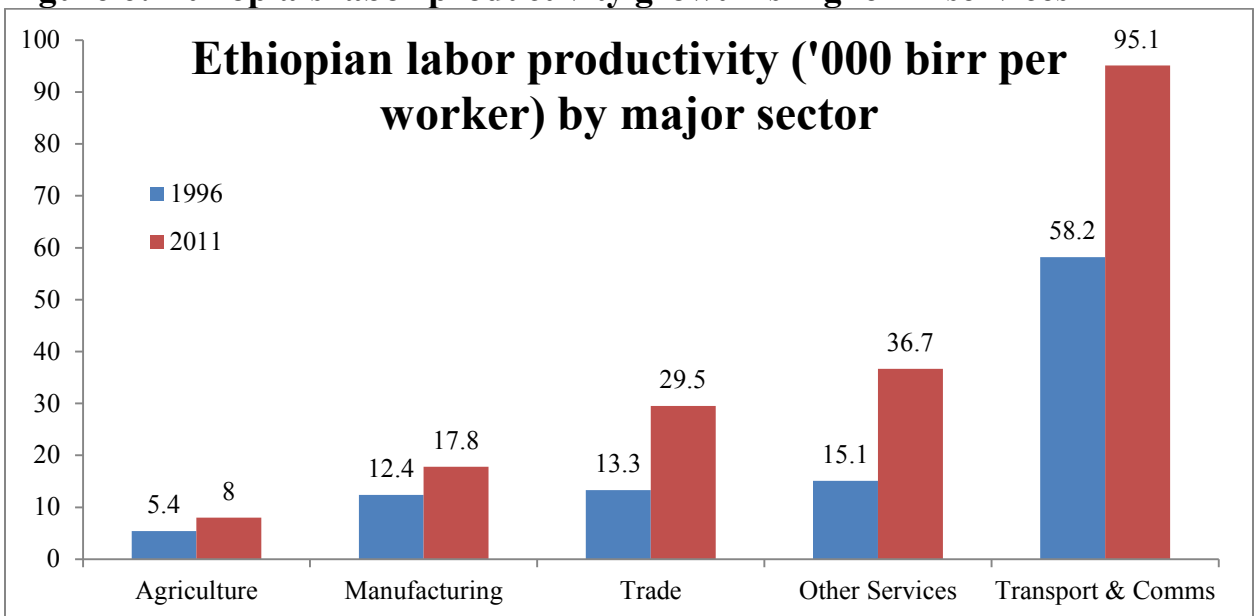
[2] http://www.theguardian.com/global-development/2013/apr/17/imf-africa-economic-growth-surging; http://www.mckinsey.com/insights/economic_studies/whats_driving_africas_growth; Radelet (2010) http://www.cgdev.org/files/1424419_file_EmergingAfrica_FINAL.pdf; Leipziger and Yusuf (2012) http://policydialogue.org/files/events/TICAD_Africa_revised-1_Yusufliepziger.pdf; http://www.imf.org/external/pubs/ft/survey/so/2010/BOK111610A.htm; http://www.imf.org/external/pubs/ft/survey/so/2010/BOK111610A.htm

Figure 5: Service has contributed more to GDP Growth



Source: Authors' calculations using World Development Indicators. Ethiopia figures from national accounts. Countries grouped based on World Bank definitions. "Contribution to growth" calculated as compound annual growth rate based on constant GDP at PPP multiplied by period average sectoral GDP share.

Figure 6: Ethiopia's labor productivity growth is higher in services



Source: Martins (2014). Values in constant 2010/11 prices. Labor productivity calculated as output per person.

Figure 5 compares the contribution of different sectors to growth in low income countries. Services have made the largest contribution to growth in low income countries, just like it has in the high income OECD countries. Indeed, services have made the largest contribution to growth in both developing and developed economies. Once again, China is an exception to this trend.

Figure 6 compares labor productivity in different sectors in Ethiopia, a typical latecomer to development in Africa. Ethiopia's labor productivity has improved in all sectors during the last two decades. It has increased the most in services, like transport and communication which exhibit much higher productivity compared to the manufacturing sector.

Growth occurs as workers and farmers move from traditional, low-productivity sectors (such as agriculture and petty services) to modern factory work and modern services. As this takes place, two things happen. First, the economy's overall productivity increases, because more of its labor force becomes employed in modern sectors. Second, the productivity gap between the traditional and modern parts of the economy shrinks, and dualism gradually diminishes.

4. Jobs

Policy makers around the world have put jobs at the center of the growth debate (WDR 2013). Jobs matter. The financial crisis in 2009 resulted in massive job losses in both developed and developing countries. In developed economies, concerns have remained about a jobless recovery. In developing countries, there is rising concern about jobless industrialization.

Jobless growth is potentially a bigger concern for latecomers to development, which will face a massive demographic dividend, and where millions still need to be moved from low productivity to high productivity activities to eliminate poverty.

Figure 7 compares the relationship in the share of a country's total employment in the industrial sector against its stage of development for some 100 countries (see Subramanian, 2014). This relationship is shown for three different points in time, 1988 (blue), 2000 (green), and 2010 (red). It shows that the job curves in industry have shifted downwards over time. This means that industrial sectors are creating fewer and fewer jobs over time.

Put another way, the point at which de-industrialization begins is happening earlier in the development process. Improvements in technology have made manufacturing much more capital-intensive. This is happening even at the low-quality end of the spectrum (Rodrik, 2012). So the capacity of the manufacturing sector to absorb labor is shrinking over time.

Figure 7—Jobless Industrialization

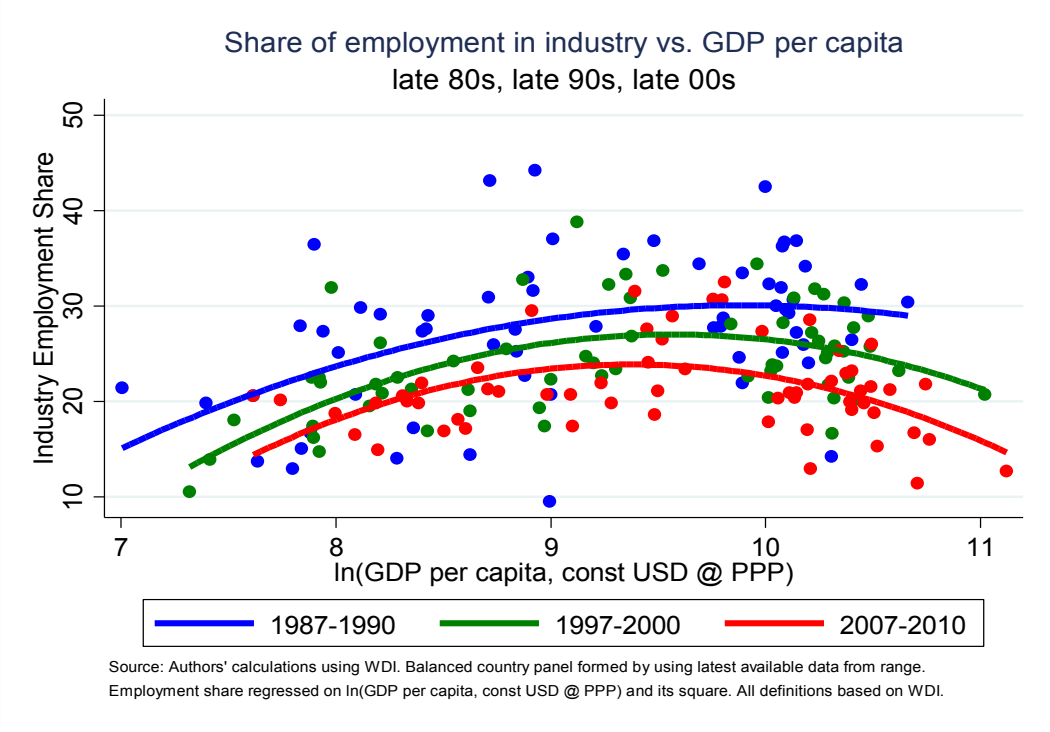


Figure 8—Job Growth in Services

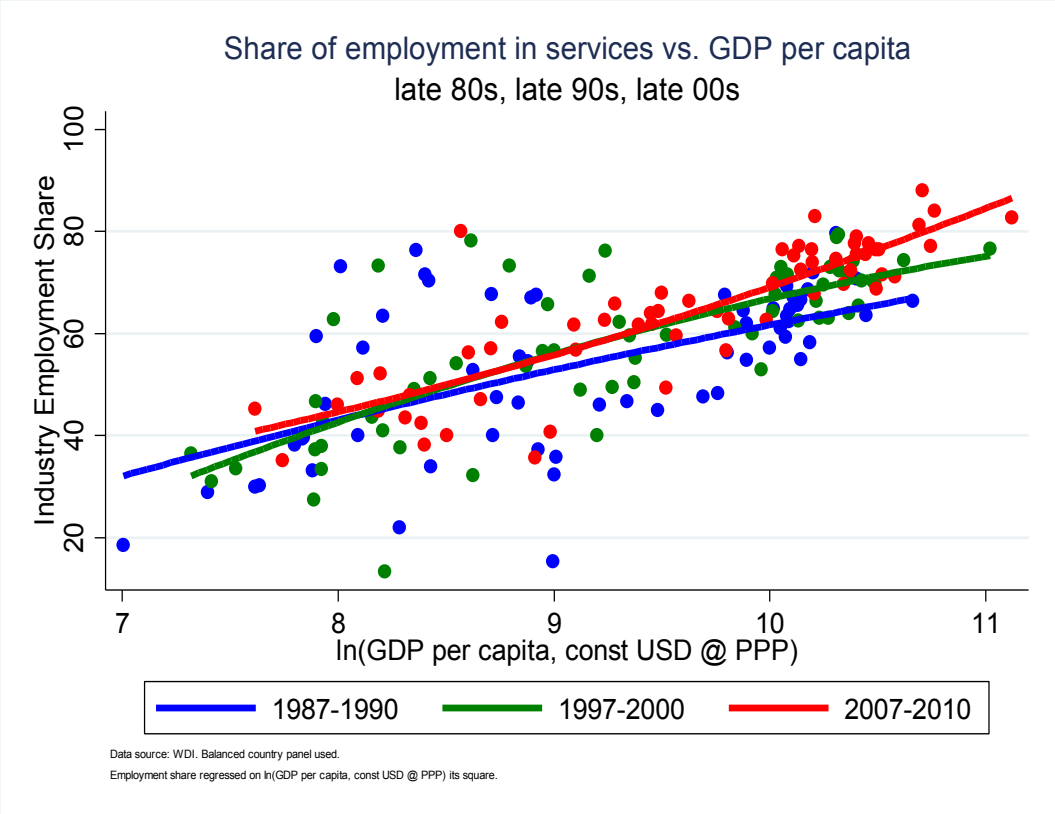
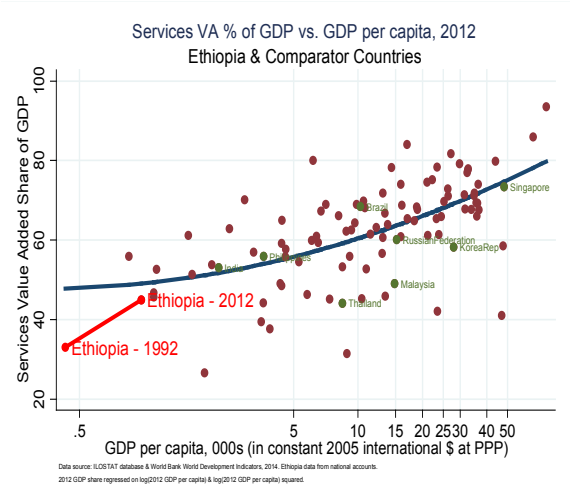
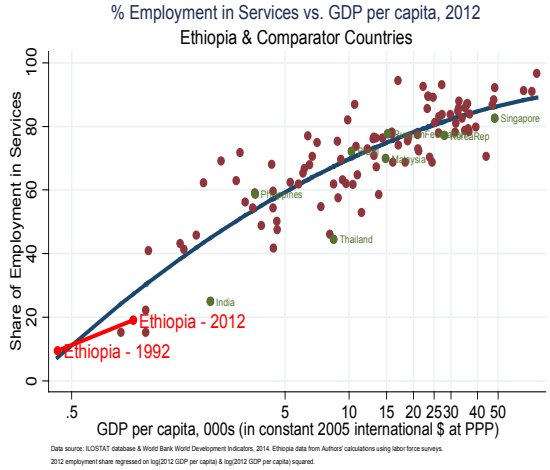
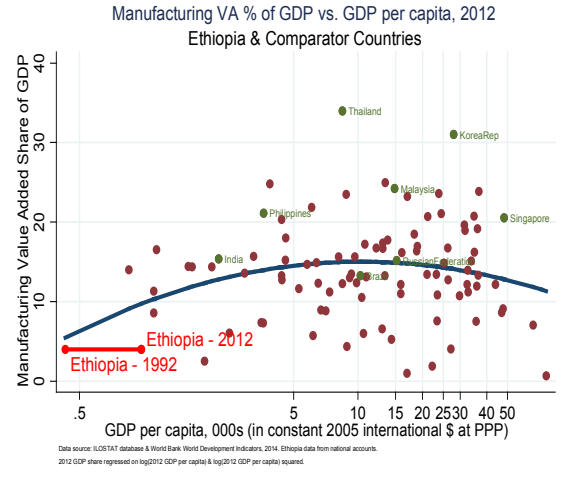
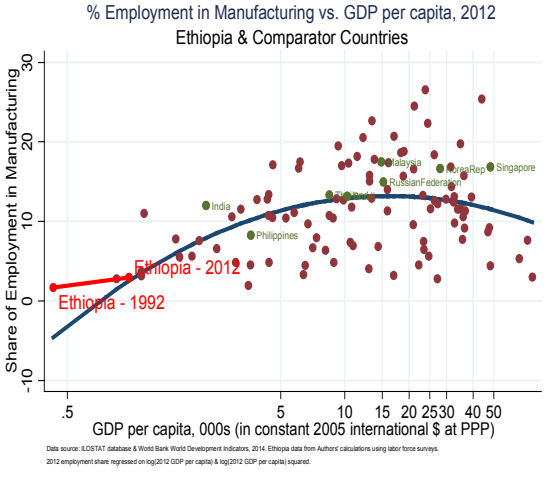


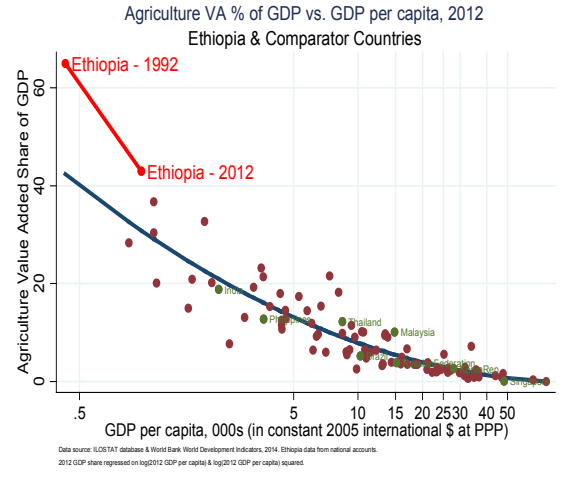
Figure 9: Services are creating more jobs than manufacturing

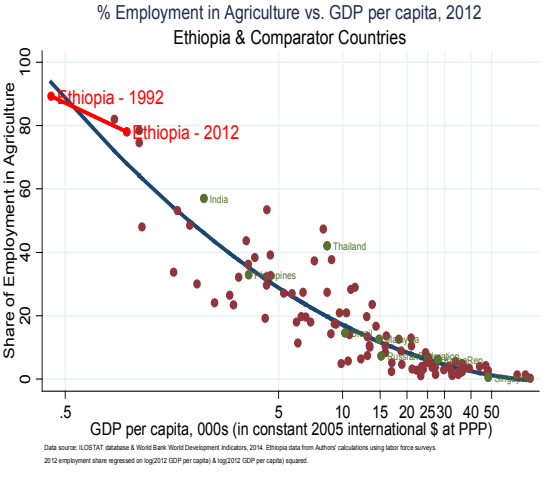












Is the service sector also shedding jobs? Not really. Figure 8 shows the relationship between the share of a country's total employment in the service sector against its stage of development for some 100 countries. This relationship is also shown for three different points in time, 1988 (blue), 2000 (green), and 2010 (red). Notice that the service job curves have shifted upwards and outwards over time. This means that services are creating more jobs and also at earlier stage of development. Services are now more dynamic and are absorbing a greater proportion of labor.

In developed and developing countries alike, labor is being shed from both agriculture and manufacturing (see figure 9). Jobs in agriculture are shrinking as expected. That jobs are shrinking in the manufacturing is a new trend. Although the share of agricultural sector in employment has fallen from over 90 percent in 1992 to less than 80 percent in 2012 in a latecomer to development like Ethiopia, it continues to be the dominant source of employment in the country. There is room to shift more labor out of agriculture if the non-agricultural and modern sector can grow faster and absorb more labor.

Because labor productivity growth in developed countries is higher in services than in industry, it implies that the global technology frontier for services is still shifting up, while that for industry has stagnated. At the same time, labor productivity growth in services in low income developing countries has also accelerated, and its growth has outstripped productivity growth in industry.

However, low income countries cannot afford to be a one-trick pony. Thousands of students graduating from universities and colleges have aspirations of not returning to their parents' farms and villages, but instead moving into urban areas, to look for jobs in the modern sector.

Much of Africa has the youngest population in the world, with more than 50% of the population below the age of 25. The median age in Africa is seven years younger than that of South Asia, the next youngest region. Every year for the next decade, some 11 million young people will enter the job market. This demographic dividend offers a tremendous opportunity for Africa to build the skilled workforce that will serve as the engine for the economic transformation. Building a skilled workforce can spur increased economic growth, but not without more entrepreneurs.

5. Entrepreneurship

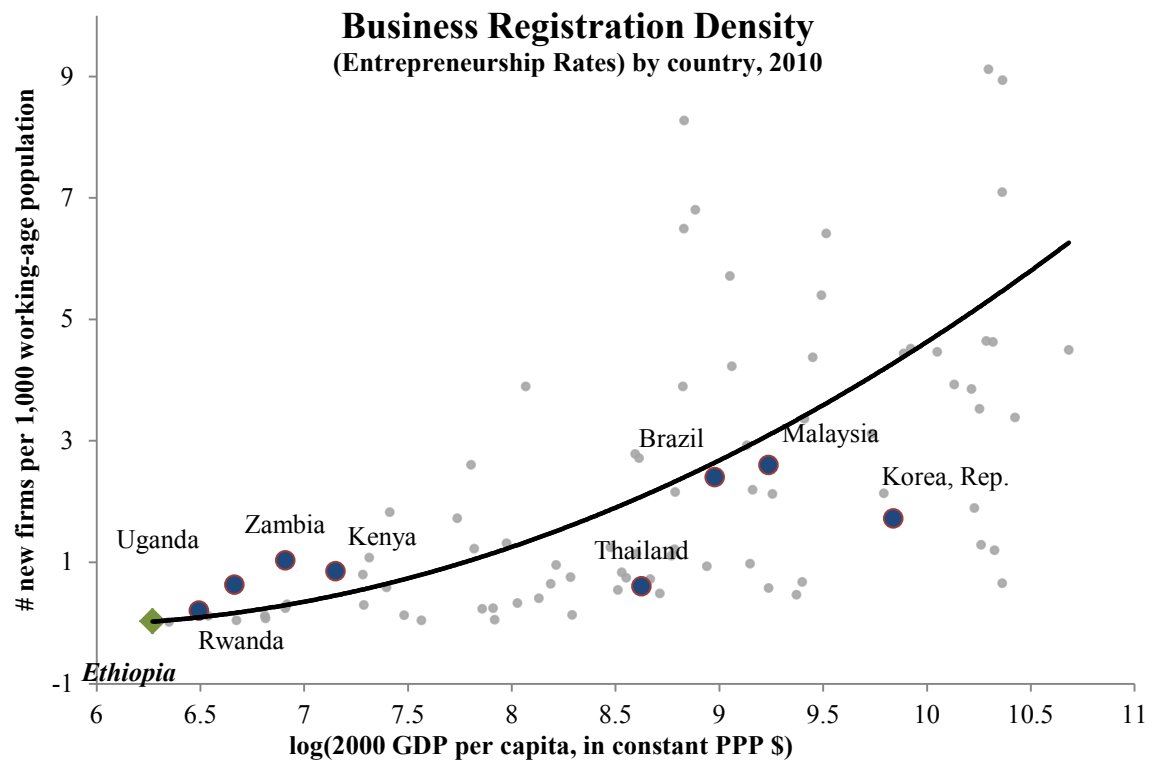
The role of entrepreneurship in structural transformation, growth and jobs has a long intellectual tradition (Cantillion 1730, Knight 1921, Schumpeter 1942). As Schumpeter said "…the inventor produces ideas, the entrepreneur 'gets things done…..". Although a great deal of productivity growth is spurred by existing firms, new entrepreneurs play a vital role.

As economies undergo structural transformation, existing firms see their productivity decline and their jobs shrink. It is the new firms that tend to be more productive than existing firms and create jobs. Thus, entrepreneurship facilitates a faster pace of structural transformation by shifting resources away from traditional and into modern sectors more efficiently, and by keeping incumbent firms from growing complacent. In a study of 23 OECD countries, Audretsch et al. found that a sustained entrepreneurship rate is essential for economic growth. Similar

evidence has been found for India and other developing economies (**Who creates jobs? New evidence from India**).

Figure 10 provides a plot on new business entry density, defined as the number of newly registered corporations per 1,000 working-age people (those ages 15 to 64) for some 100 countries. Ethiopia, Rwanda, and other latecomers to development are at the bottom of this curve. They are substantially behind peer countries in rates of new business entry density, creating 0.03 new registered businesses per 1,000 working age people, compared to a rate of 2.28 in Brazil and 2.17 in Malaysia. In other words, those countries create new businesses at a rate that is orders of magnitude more than in Africa. A key challenge for latecomers to development in Africa will be to promote new business creation and entrepreneurship.

Figure 10: Africa needs more entrepreneurs to create more jobs

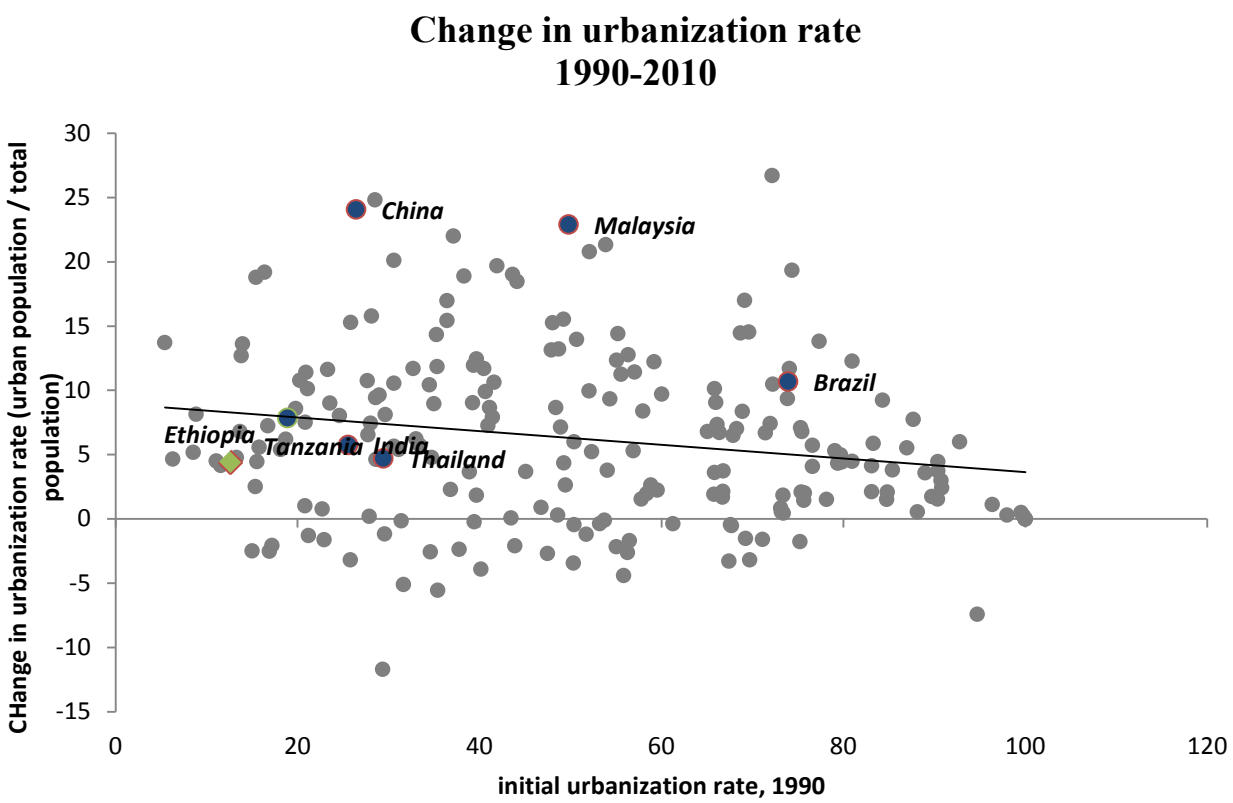


Source: World Bank Group Entrepreneurship Snapshots 2010. World Development Indicators, 2010.
Note: Countries designated as offshore tax-shelters excluded.

While much attention has traditionally been paid to large firms, and their potential to contribute to employment and productivity growth, the focus is shifting away from size and towards the age of firms, particularly to the contributions of young enterprises, and the life cycle of firms. Technology is also changing the landscape for entrepreneurs. The entry of new firms is driving job creation in the US, much of Europe and many developing countries. A strong link has been found between the initial levels of young and small firms and subsequent job growth (Ghani et al, 2011). The policy message is clear: if job creation is a priority, policy makers should focus on promoting entrepreneurship locally. How does one promote entrepreneurship?

Education and physical infrastructure matter greatly for creation of new firms. These patterns are true for manufacturing and services. These relationships are much stronger in developing than in developed economies. So investment in people is an easy call for policymakers. Likewise, local areas must improve their infrastructure – electricity, roads, telecoms, and water/sanitation facilities. Their elasticity is in fact stronger in economic magnitude in developing than in developed economies. Agglomeration economies too operate as strongly for entrants in developing countries as they do in advanced economies. Most strikingly, the importance of the Chinitz effect is concentrated among small entrants.

Figure 11—Global Convergence in Urbanization



Source: World Development Indicators.

Millions of people are expected to move from rural regions into cities in the next two decades. The developing world is experiencing rapid urbanization, with the number of city dwellers set to reach four billion in 2030 – double its 2000 level. In many respects, urbanization is rational. After all, cities are the hubs of prosperity, where more than 80% of global economic activity is concentrated. And their density facilitates the delivery of public services, including education, health care, and basic services. Indeed, as shown in figure 11, low income countries in Africa seem to be urbanizing at a faster pace and there is global convergence in urbanization.

But there are also differences across sectors. Large scale manufacturing establishments, for example, may have broader resources that reduce dependency on local infrastructure and household finance. Likewise, the informal sectors depend less on educated workers than the formal sector, but rely a lot more on city infrastructures. The traded nature of good and services allows more rural settings for firms, and entrepreneurs often seek cheaper environments than the wages and rents associated with high-density areas. While entrepreneurs avoid the high costs of urban areas, they also avoid the most remote areas of in favor of settings that are relatively near large population centers likely to access customers directly or to connect to shipping routes.

Manufacturing and services sectors behave differently with urbanization (Desmet and Rossi-Hansberg 2009). In both the USA and Europe, manufacturing is becoming more equally spread across space, whereas the service sector is becoming increasingly concentrated in medium-sized locations. China too exhibits spatial growth patterns in the service industry more similar to those in the US. In those intermediate places agglomeration economies dominate congestion forces, making them attractive locations for service industries to grow and expand. If the US and Europe provide any guidance, service engines of growth should be its medium-density cities.

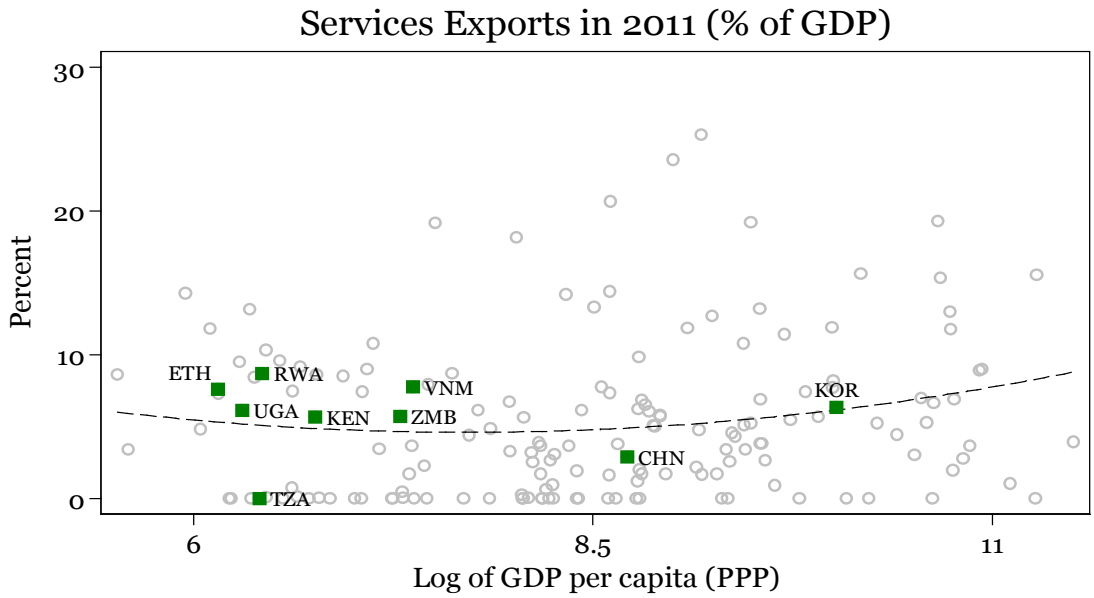
There are many policy levers that can be used by policy makers to promote entrepreneurial growth and make cities more competitive (**What Makes Cities More Competitive?** "World Bank - Economic Premise, The World Bank, issue 132). Getting the business regulatory environment right is only one part of a private sector policy agenda. In most countries, governments also intervene more directly to try and boost the growth prospects of the private sector through a variety of more activist policies. These policies may be motivated by potential externalities, coordination failures, market failures, or by political demands. Examples of these policies include attempts to link firms with suppliers or buyers in value chains (both domestically and internationally); industrial policies designed to boost particular sectors; extension services to teach new technologies and spur technological adoption; the development of new financial products such as micro-equity and broader insurance products designed to help SMEs overcome the risk inherent in innovative ventures; training programs to improve the skills of workers and managers; policies to promote firms exports as a way to foster job creation; and other efforts to spur entrepreneurship. Such policies are of increased focus as a result of the youth bulge in many developing countries, which has made employment creation the number one policy demand in many countries.

6. Globalization

A country's growth/job performance also depends on its trade performance. It provides an important feedback loop for improving productivity, reinforcing competitiveness by increasing competition in the home market, better access to technology and new knowledge, and greater room for specialization and economies of scale. But globalization itself is changing both in terms of outcomes and policy.

The paradox of low income countries is that they appear to be somewhat 'closed' in terms of trade policy, but more 'open' in terms of trade outcomes. Ethiopia, Rwanda and Kenya trade more than a typical country does at its stage of development (see figure 12). Its share of service export has grown robustly. The share of service exports in GDP for them is higher compared to China or oil producing countries in Africa. Implementing a less restrictive and more efficient trading regime is a no brainer.

Figure 12: Service Trade Outcome



Source: World Bank Services Trade Database (June 2013)

Developing countries now account for more than half of the world's economic activity and more than half of global exports. Manufacturing industry's share in global trade has declined, while the share of services has increased. Services are the fastest growing component of trade, but they remain the poor relation of globalization; even agriculture, which accounts for 7% of international trade, receives closer consideration. And yet, services are at the very heart of value chains, because the provision of industrial or commercial services, such as information technology (IT) and factoring, marketing,

logistics, assembly and distribution, after-sales service and so forth, is often sub-contracted globally and nationally.

Global trade policy is also changing in terms of the obstacles trade faces. Tariffs and non-tariff contingency measures – including antidumping duties and safeguards – traditionally formed the principal barrier to trade. They were the focus of international trade negotiations, but in recent years, so-called non-tariff measures – such as technical standards, health and safety requirements, and services regulations – have loomed ever larger (Lamy, 2013). With the expansion of global production sharing, product and process standards are becoming increasingly relevant in linking various stages of global value chains.

7. Poverty Reduction

Can a service led growth reduce poverty? Data suggests that poverty decline with service growth can be as fast as in manufacturing, and much faster than in agriculture, mining and quarrying. So a fast pace of poverty reduction is associated with growth in services. Indeed, the last decade has witnessed strong economic growth led by servicers and steady poverty reduction. However, poverty remains high in most low income countries, and ending extreme poverty requires maintaining consistently high growth and a strong ability to convert this growth into poverty reduction.

8. Conclusion

So what kind of a growth strategy is appropriate for the late comers to development? Should they wait for their turn after the East Asian Tigers have become less competitive? Or should they follow the unconventional development path, and take advantage of services?

There is no easy answer to what is an appropriate growth model for low income countries. It will be shaped by many factors, and it will be country specific. Most countries will have one chance to get it right. And there is no "one size fits all" growth recipe.

The growth landscape in Africa is still evolving. This landscape will be shaped by many policy levers. The conventional policy prescription to reduce bureaucratic red tape, and facilitate foreign investment applies to the Lions in Africa just like they applied to the East Asian Tigers.

But the latecomers to development need much more. The Lions of Africa should also draw upon other levers including demographic dividend, smarter urbanization, more investments in education and infrastructure, and inclusive and more modern institutions. Indeed they are already doing it. A broader set of initiatives will help to reduce coordination failures, government failures and market failures. Ideally, the focus ought to be not on policy best practices but on policy best matches with institutional capabilities. Of course, no policy is failure proof.

Low income countries will benefit from a demographic dividend which is associated with increased supply of labor, more savings and investments, technological progress, and growth,

although these benefits are not automatic. The East Asian Tigers had a much higher ratio of working age to non-working age people at the time of their industrialization take-off. The demographic dividend has already matured in East Asia. It is still to materialize in Africa.

Smart urbanization is also associated with structural transformation that shifts people and resources from traditional to modern sectors, be they in manufacturing or services. Cities generate the majority of new jobs, a process that could drive several fold increase in per capita incomes. Low income countries have experienced the highest urbanization growth rate in the world, but they also face many challenges.

Any growth model in low income countries need to address three major constraints: (a) infrastructure, (b) entrepreneurship and (c) education and technical skills. The infrastructure in low income countries has seriously lagged behind that of other developing regions, and the gap has widened over time. Moreover, because of their small scale and limited competition, infrastructure services in low income countries in Africa are typically several times more expensive than those in other parts of the developing world such as East Asia. This is a big cost disadvantage and is one of the obstacles to sustain high growth in low income countries. Infrastructure deficit issue has been further compounded by stabilization efforts to reduce fiscal deficits. As it is much harder to reduce current expenditures than it is to reduce expenditure on infrastructure, the bulk of adjustment has been consequently borne by the latter. The region needs to spend around 15 percent of its GDP on infrastructure (Bevan, WIDER Working Paper Aid, Fiscal Policy, Climate Change, and Growth).

Both human and physical infrastructure matter greatly. This is true for manufacturing and services. These relationships are much stronger in developing countries than that found in developed economies. An entrepreneurial foundation that provides for local growth and regeneration is essential for long-term success and prosperity.

The skill content of both manufacturing and services sectors has increased over time (Eichengreen and Gupta, 2011). It is not as if manufacturing employs only unskilled labor while modern services employ only highly-skilled labor. Unless more investments are made in education, skill shortages are likely to become an increasingly important constraint to growth and jobs.

Given that most jobs are created by new, young and usually small enterprises, creating a positive overall business environment is critical to unleashing their potential, improving their productivity and facilitating their transition from informal-to-formal status. Informal sector, historically neglected in most low income countries, deserves much more attention from policy makers. Even as modern wage jobs multiply, the informal sector will remain Africa's biggest "employer" in the near future. Millions of informal and small enterprises do not have bank accounts or a credit history. Improving registration, licensing, and trade logistics seems to be of particular importance. Entrepreneurship and technical skills development and technology upgrading are critical for rapid expansion of all firms, regardless of their size and sector.

The promise of the service revolution is that latecomers to development need not wait to get started with rapid development. There is a new boat that the latecomers can take. Unlike the

goods sector, where developing countries already have a large market share, making it difficult for new entrants to become large-scale exporters, services appear to be steadily expanding, with catch-up opportunities continuing to rise, and entry for all.

The globalization of service provides alternative opportunities for low income countries to find niches, beyond manufacturing, where they can specialize, scale up and achieve explosive growth, just like the East Asian Tigers did. A service led growth can be sustained because the current globalization of services is only the tip of the iceberg, and service is the largest sector in the world, accounting for more than 70 percent of global output. The Lions of Africa can sustain can sustain service-led growth because there is enormous space for catching up and convergence. Nevertheless, it is tricky to identify the best growth escalators for the latecomers to development, as there is still so much more that we still do not know and understand.

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