International trade is no longer exclusively about goods crossing borders. Trade in services, particularly business services, has become a dynamic component of trade and an alternative for export diversification for many developing countries. Besides traditional activities (such as tourism), health, information technology, and communication services are among the most successful service exports. Developing countries seem to follow different policy approaches to trade in services, and diverse trade patterns appear to emerge. What determines the participation of a developing country in trade in services? What is the role of international negotiations?

Services play a broad and strategic role in the economy. New focus in services arises because they have become increasingly tradable, allowing for the emergence of new and improved export activities. Trade in services, particularly business services, has become a dynamic component of trade and an alternative for export diversification in developing countries. Increasing tradability of services allows the cross-border exchange of services, such as professional services, that previously required providers or consumers to move. During 2000–07, before the financial crisis, trade in services grew as fast as trade in goods, at an average rate of 12 percent annually. Trade in business services (such as engineering, legal, health, accounting, and management services) grew even faster over the same period—at 14 percent.

Services play a broad and strategic role in the economy. Low-cost and high-quality services generate economywide benefits. Empirical research confirms that welfare gains from services liberalization are substantial and allow a more efficient allocation of resources while contributing to economic growth. As inputs, services facilitate transactions through space (information technologies, communications, and logistics services) or time (financial services). Open financial, telecommunications, and transportation services, are inputs for the production of goods and other services.

Cross-border is not the only means to provide services. Trade in services requires the movement of factors—capital and labor—as well as the movement of consumers across borders (tourism). Developed countries have an abundance of capital, and developing countries have an abundance of labor; however, international flows of capital enjoy a greater degree of freedom than does labor mobility. Although labor mobility barriers affect developing countries’ comparative advantages in skill-intensive services, those countries have managed to become service exporters.

Despite enormous challenges, developing countries are exporting services. Besides traditional activities (such as tourism), health, information technology, and communication services are among the most successful service exports. Diverse patterns seem to emerge: Latin American countries have become exporters of services through invest-
ments abroad, and South Asian countries are stronger cross-border service exporters. Further analysis is needed to identify the policies and factors that determine the participation of a developing country in trade in services. Finally, international negotiations do play an important role, and developing countries must learn how to take advantage of them.

Services Exports from Developing Countries
A large number of developing countries have successfully exported services, both within their own regions and to high-income countries (figure 1). India’s success is well known: exports of software and business process services contributed to about 33 percent of India’s exports in 2007–08. Brazil, Costa Rica, and Uruguay export professional and information technology–related services; Chile exports distribution and transportation services; and Mexico exports communication and distribution services.

African countries are also participating. In the Middle East and North Africa and the Sub-Saharan regions, countries such as Kenya, Morocco, South Africa, and Tunisia provide professional services to Europe; and the Arab Republic of Egypt has developed a world-class call-center sector. The growing phenomenon of health tourism appeals to many developing countries. Exports of health services are successfully provided by countries in Asia (India, the Philippines, and Thailand), as well as by countries in Latin America and the Caribbean, the Middle East, and North Africa.

Capital-intensive and managerially complex services are also part of the story. Providers of construction services from developing countries are among the top 225 international contractors. Firms in developing countries engage in trade across a variety of environmental services segments. Some developing countries are even engaging in financial and telecommunications services.

Divergent Patterns among Developing Regions
There are differences in trade patterns among developing regions. In South Asia, services exports are mainly concentrated on cross-border services; and within this mode, in information technologies, communication services, and services that enable them, (cross-border provision of business and professional services, among others). In East Asia, services exports are closely linked to the region’s manufacturing exports. In the future, this may offer these countries opportunities to diversify to new activities not linked to trade in goods. In Latin America, exports tend to be more concentrated on services supply through direct investment in other countries in the region. For instance, 61 percent of Chile’s in-

Figure 1. Developing Countries’ Exports of Services Are Growing Fast, 1999–2008

Source: World Trade Organization.
Note: Corresponds to other commercial services: communications, construction, insurance, financial, computer and information, royalties and license fees; professional and other business services; personal, recreational, and cultural services.
vestment abroad is in services and energy industries located mainly in neighboring countries. Although Brazil’s investment abroad is much more diversified in terms of both sectors and markets, services play an important role. In financial, construction, and engineering services, Brazil has been a successful exporter via investment abroad; and the country consistently has resorted to all four modes for information technology services. Likewise, Mexico’s investment abroad is diversified in terms of sectors and countries. But services also play an important role in telecommunications, distribution, call-center activities, and offshoring. Although there is no clear trade pattern in Africa, services have been emerging as an important trade topic.

Patterns of market destinations are also different. Moreover, developed countries are the main destination markets for service exports from South Asia. In Latin America, by contrast, the destinations of exports (measured by investment flows) are countries in the same region. Countries in the Middle East and North Africa region tend to export services to Europe, whereas South African services providers are investing increasingly in their own region.

Domestic Policies and Trade Performance

What determines the participation of a developing country in trade in services? Anecdotal evidence seems to suggest that developing countries with different openness to trade and foreign investment policies (Brazil, Chile, Arab Republic of Egypt, India, Malaysia, and Mexico); different tax incentives such as special economic zones (Costa Rica and Uruguay), different business environments, and different geographic locations, have been successful exporters of commercial services.

Complementary policies should support liberalization. Although empirical evidence suggests that greater liberalization is associated with greater economic growth (Mattoo 2006), correlation between export performance and liberalization in services seems weaker. Liberalization (measured either by the Economic Freedom Index of the Heritage Foundation or the World Bank’s Doing Business Indicators) is a poor predictor of service export performance (figure 2). Of course, this does not mean that liberalization should not be pursued; instead, it suggests that liberalization alone does not provide enough momentum to propel the performance of services exports. Liberalization does not create spontaneously entrepreneurial drive, skills endowment, and the managerial capabilities required to export services. Complementary policies are required to ensure that investment in infrastructure and education will take place; and that possible market failures such as lack of information, lack of transparency, and inadequate regulations will be tackled.

Figure 2. Relatively Weak Correlation between Openness and the Export of Services Performance

Source: Trade in services data from the World Trade Organization; openness and economic freedom measurements from the Heritage Foundation Economic Freedom Index. Note: Trade in services ranking: countries have been sorted on the basis of export values. According to the Economic Freedom Index, most open countries have higher scores. Developing countries: \( y = -1.525x + 176.33, R^2 = 0.1117 \); developed countries: \( y = -0.609x + 69.669, R^2 = 0.0469 \).
(hence the importance of the Aid for Trade initiative for service exports).

Identifying the reasons for the successes of developing countries and the reasons for underperformance is still a challenge because of the lack of data. People and skills availability explain success in services exports (figure 3). Leaving aside the case of transportation and tourism sectors, countries with better human capital endowment tend to be ranked among the most important exporters of business services. Other variables, such as business environment and financial attractiveness, seem to correlate less strongly with services performance. Part of the explanation is that the most successful offshoring companies focus less on saving money and more on improving operational performance. They base their strategies “on building a global delivery model rather than offshoring per se. In other words, when planning for the future, top companies make decisions based on their entire enterprise, rather than simply choosing the next offshore destination” (A. T. Kearney 2007, p. 12). Nyahoho (2010) assesses the importance of factor intensity as a determinant of trade in services. Human capital is clearly related to exports of computer and information services. Other exports (such as construction services and public works, royalties and license fees, and computer and information services) are positively linked to research and development intensity. Finally, for services in passenger transportation; freight; travel; communications; and personal, cultural, and recreational services, the theory of comparative advantage determined by relative factor intensity seems to have little explanatory power (but proves useful as long as other relevant aspects are considered, such as industrial specificities, modes of internationalization, and legislation).

As determinants of trade in services, Shin-gal (2010), using a gravity model, analyzes market size (economic), trade in goods, the presence of an English-speaking workforce, quality infrastructure, an open policy regime (that is, one with few restrictions on the various modes of services delivery), low-cost human capital, and common laws/legal systems. His main findings are that human capital, teledensity, and restrictiveness variables are the most important policy areas available to governments to promote bilateral services trade.

**International Negotiations**

What is the purpose of engaging in ambitious trade negotiations? It is important to understand the role that trade agreements play in the contexts of trade liberalization in general and of services in particular. First, they collaborate in the liberalization process when vested interests oppose liberalization and block initiatives to open access or prevent the establishment of an appropriate regulatory framework. Second, trade agreements create a more stable framework because they are international contracts that cannot be unilateral...
ally changed. Therefore, they also can create a time path for introducing reforms in a gradual manner and provide rules that cannot be modified arbitrarily. Finally, trade agreements provide political support for trade in services liberalization because they ensure reciprocal market liberalization.

Many developing countries have been reluctant to pursue multilateral negotiations, but there is no clear explanation for that reluctance. The political economy of services negotiations is more complex than traditional trade negotiations because it deals with domestic reforms and issues that are close to social policies. At the same time, many countries have actively engaged in regional and bilateral trade negotiations in services. Moreover, many developing countries have been willing to negotiate bilaterally with developed countries some highly demanding rules and disciplines. In addition, trade in services agreements among developing countries are also flourishing, whereas services negotiations in the World Trade Organization Doha Round have attracted less interest and have lagged behind other negotiation groups. Countries still are unable to assess possible outcomes in this topic.

Why does Doha matter for services negotiations? From the developing-countries’ perspective, the World Trade Organization framework provides enough flexibility both to deal with sensitive aspects of services and to address export-offensive interests. Globally, an ambitious outcome in services negotiations will provide the most significant welfare gains of this round. Because of the complex nature of this topic, its overall strategic importance, and the complementary policies required to fully reap its benefits, services liberalization should not be used as a bargaining chip to trade against market access for goods. Trade in services liberalization should be negotiated on its own merit, taking into account the overall potential benefits that are available.

Bibliography


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