A Introduction

Services have become the most dynamic sector of world trade – but in ways that are not always recognized or understood. Just as services have come to dominate many national economies, they are playing a bigger role in the global economy as well. Many factors are driving this – including consumption, liberalization and investment – but the game-changer is technology. Services that were once difficult to trade, because they could only be delivered in person, are becoming far easier to trade, because they can be delivered digitally. The 2019 *World Trade Report* explores this globalization of services – why it is happening, how it is impacting economies, and where new policy approaches are needed.

Contents

1. Globalization of services

The services sector is emerging as a key driver of global trade.

Services have already transformed national economies on a massive scale. Not only are services indispensable to running our increasingly complex and sophisticated industrial economies – from logistics, to finance, to informatics – but the services sector is the fastest growing economic segment in its own right – from business services, to healthcare, to entertainment. Services generate more than two-thirds of economic output, attract over two-thirds of foreign direct investment, and provide almost two-thirds of jobs in developing countries and four-fifths in developed ones.

Services now seem to be transforming international trade in similar ways. Although they still only account for one fifth of cross-border trade, they are the fastest growing sector (WTO, 2017). While the value of goods exports has increased at a modest 1 per cent annually since 2011, the value of commercial services exports has expanded at three times that rate, 3 per cent (see Figure A.1). The services share of world trade has grown from just 9 per cent in 1970 to over 20 per cent today – and this report forecasts that services could account for up to one-third of world trade by 2040.[1] This would represent a 50 per cent increase in the share of services in global trade in just two decades.

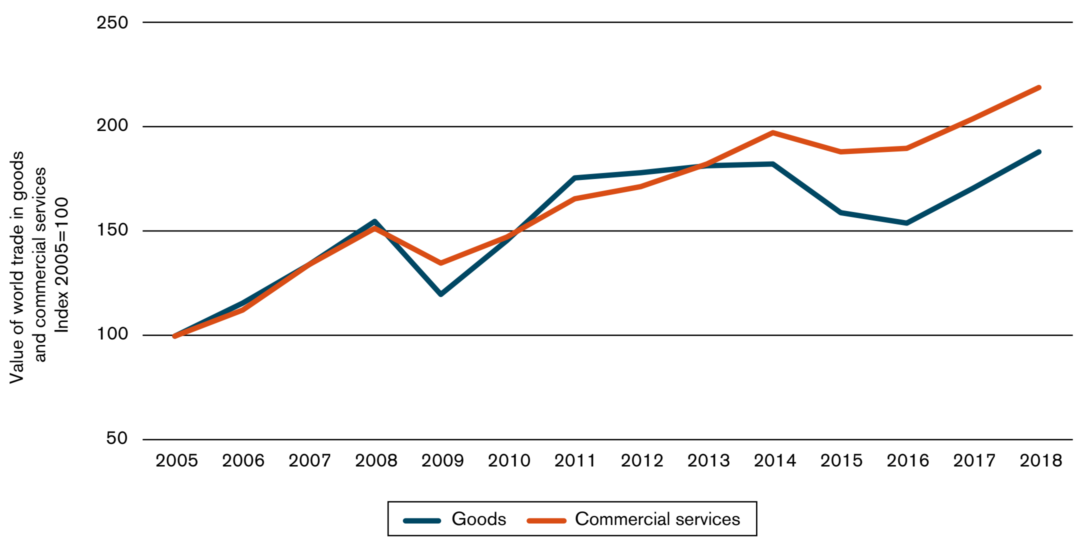
There is a common perception that globalization is slowing down. But if the growing wave of services trade is factored in – and not just the modest increases in merchandise trade – then globalization may be poised to speed up again.

2. Digitalized services: the non-tradable becomes hyper-tradable

The main driver of this shift is technological change. Thanks to digitalization, the internet and low-cost telecommunications, many services sectors that were once non-tradable – because they had to be delivered face-to-face in a fixed location – have become highly tradable – because they can now be delivered remotely over long distances.

Of course, some services, such as taxis, hotels or hair salons, will continue to be delivered locally and require a physical presence (although companies such as Uber and Airbnb demonstrate how even these sectors can be radically transformed by new internet-based business models). But other services, such as retailing, software development, or outsourced business processes, are now being "de-localized"

Figure A.1: Trade in goods has grown more slowly than trade in commercial services
Growth of world trade in goods and commercial services



Source: WTO-UNCTAD-ITC estimates.

Note: World trade is calculated as the average of world exports and world imports.

and "globalized" to an extent and on a scale that may surpass the even most globe-spanning multinational goods manufacturers.

Other services seem on the cusp of radical change. Not too long ago, most medical services were delivered by local doctors and hospitals to local patients. Accessibility was limited, competition was constrained, and quality could vary dramatically across countries, regions, or even neighbourhoods. Now, medical information is accessible to anyone with an internet connection anywhere in the world; medical procedures, such as diagnostics, analyses, and even some types of surgery, are increasingly performed remotely; and medical tourism is becoming more common, as increasing numbers of patients seek more affordable or advanced treatment abroad.

Similar trends can be seen in education, with the proliferation of e-learning platforms such as Moodle and Massive Open Online Courses (MOOCs), or in entertainment, with the spread of streaming services such as Netflix or Spotify. If services trade has yet to realize its full growth potential, it is partly because services industries are still catching up with the new global business possibilities that technology has created.[2]

This seismic shift is in turn exposing many services sectors to the same process of specialization, competition and scale economies that previously drove massive productivity gains in the manufacturing sector. This helps to explain why information, finance and telecommunications services have experienced such fast productivity growth in recent decades – faster even than many manufacturing industries.

In the process, the global economy itself is being transformed. Just as the transport and communications revolution in the latter half of the 20th century drove down the cost of trading tangible goods across borders, giving rise to globalized manufacturing, so too is the digital revolution in the early 21st century rapidly driving down the cost of trading services across border, giving rise to a globalized services market.

Indeed, the globalization of services could unfold even more rapidly than expected, as new technologies not only allow existing services increasingly to be traded across borders, but also help to drive the development and growth of new services sectors, as well as new ways of delivering services, that have yet to be imagined.

3. The evolution of trade: from agriculture to manufacturing to services

The way services are transforming the global economy is a delayed reflection of the way services have already transformed national economies. During the 19th century, agrarian economies gradually evolved into increasingly industrial economies, a transformation so profound that it is termed the "Industrial Revolution". Then, during the 20th century, industrial economies evolved into increasingly services-based economies: an equally profound – and even more rapid – transformation that could be termed the "Services Revolution". In the United States, for example, the services sector, which accounted for just 43 per cent of GDP in 1950, had grown to 61 per cent by 1990, and has reached almost 80 per cent today (BEA, 2019).

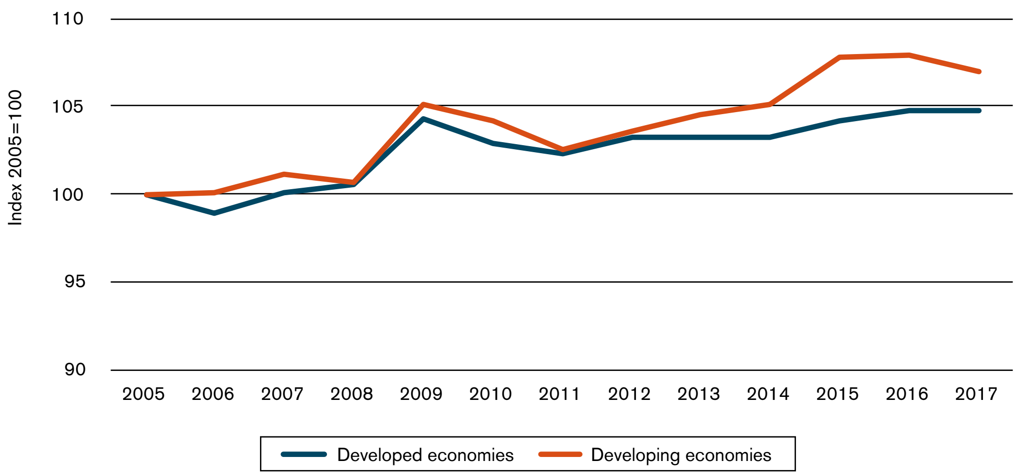
This progression from farms to factories to urban offices was driven largely by productivity-enhancing innovations, skills and technologies. As economies learned to produce more agricultural and industrial output with less labour, human resources were freed up to supply an expanding range of services – from improved healthcare, to better schooling, to more entertainment. Improved services, in turn, fuelled further productivity increases in farming and manufacturing – both through the services that enable production (such as finance, logistics, and retailing) and the services that are embedded in production (such as design or research and development).

Services already accounted for 76 per cent of GDP in advanced economies in 2015 – up from 61 per cent in 1980 – and this share seems likely to rise (UNCTAD, 2017). In Japan, for example, services represent 68 per cent of GDP; in New Zealand, 72 per cent; and in the US, almost 80 per cent (OECD, 2019).

Emerging economies, too, are becoming more services-based – in some cases, at an even faster pace than advanced ones (see Figure A.2). Despite emerging as the "world's factory" in recent decades, China's economy is shifting dramatically into services. Services now account for over 52 per cent of GDP – a higher share than manufacturing – up from 41 per cent in 2005. In India, services now make up almost 50 per cent of GDP, up from just 30 per cent in 1970. In Brazil, the share of services in GDP is even higher, at 63 per cent (World Bank, 2019). Between 1980 and 2015, the average share of services in GDP across all developing countries grew from 42 to 55 per cent (UNCTAD, 2017).

Some developing countries seem to have by-passed the industrialization phase altogether, leapfrogging

Figure A.2: Services account for an increasing share of GDP
Growth of value-added in services (% GDP)



Source: WTO calculations based on World Bank Development Indicators.

Note: In this report, the aggregate "developing economies" includes developing economies, least-developed countries (LDCs), and the Commonwealth of Independent States (CIS). Except for LDCs, this statistical grouping has no implications for any matter relating to the level of development of WTO members.

directly from agriculture to services. In the Bahamas, for example, manufacturing accounts for just 5 per cent of GDP while services – dominated by finance and tourism – account for over 85 per cent. Similar trends can be observed in economies as diverse as Bermuda and Sri Lanka. Services industries can offer many advantages for developing countries that manufacturing industries do not: they are generally less capital-intensive, more mobile, more accessible for female workers, and they can be up and running more quickly (The Economist, 2011).

Just because the services sector is playing a bigger role in national economies, this does not mean that the manufacturing sector is shrinking or declining. Many advanced economies are "post-industrial" only in the sense that a shrinking share of the workforce is engaged in manufacturing. Even in the world's most deindustrialized, services-dominated economies, manufacturing output continues to expand thanks to mechanization and automation, made possible in no small part by advanced services. For example, US manufacturing output tripled between 1970 and 2014 even though its share of employment fell from over 25 per cent to less than 10 per cent (Baily and Bosworth, 2014). The same pattern of rising industrial output and shrinking employment can be found in Germany, Japan and many other advanced economies.

This is because an economy's prosperity does not depend on the relative size of its manufacturing or services sectors but on the productivity of the economy as a whole – which in turn depends on efficiencies and innovations across all sectors, and the extent to which they are mutually reinforcing. Just as an efficient services sector helps to fuel manufacturing growth, so too does an efficient manufacturing sector help to fuel services growth. In essence, all economies, whether agrarian-, resource-, or manufacturing-based, are "service economies", to the extent that producing any good necessarily involves a service. What matters is how productively those services are applied.

This line between manufacturing and services activities, which is already difficult to distinguish clearly, is becoming even more blurred across many industries. Automakers, for example, are now also service providers, routinely offering financing, product customization, and post-sales care. Likewise, on-line retailers are now also manufacturers, producing not only the computer hardware required to access their services, but many of the goods they sell on-line. Meanwhile, new processes, like 3D printing, result in products that are difficult to classify as either goods or services and are instead a hybrid of the two. This creative intertwining of services and manufacturing is one key reason why productivity continues to grow.

4. More complex services trade requires more coherent policies

Although technology is driving the expansion of services trade, both within and among economies, it is not the only factor. More open and enabling national policies, as well as greater international regulatory cooperation, are critical as well. But while the world trading system has been highly successful in opening up goods trade – thereby helping to drive 20th century globalization – it has so far proved less successful at opening up (or keeping open) trade in services, the driver of 21st century globalization. Over six decades of bilateral, regional, and multilateral trade negotiations have thus resulted in a global economy in which trade in goods, broadly speaking, is more open than trade in services.

This imbalance partly reflects the importance of merchandise trade in the past, and the tendency of negotiators to focus many of their efforts on lowering barriers to agricultural and manufactured exports. But it also reflects the reality that the measures affecting the international supply of goods – such as tariffs, quotas, or technical standards – are generally simpler and easier to address than the equivalent measures affecting the international supply of services – such as professional standards, licensing requirements, investment restrictions, or work visas – which are more complex and politically sensitive, and are likely to be linked to other policy concerns besides trade. Arguably, no measures affecting services trade are more controversial today than those related to labour mobility; and yet none have a greater impact given the central role that human resources, talent, and ingenuity play in driving innovation and growth.

This need for new approaches to services trade – as well as for greater policy coherence – was recognized when the WTO's General Agreement on Trade in Services (GATS) was first negotiated during the Uruguay Round between 1986 and 1995. The GATS set out four ways (or "modes") in which a service can be supplied internationally: mode 1 describes "cross-border trade" (e.g. through the internet); mode 2 describes "consumption abroad" (e.g. through tourism); mode 3 describes "commercial presence" of an enterprise (e.g. through foreign direct investment); and mode 4 describes the "movement of natural persons" (e.g. through temporary labour mobility). This novel architecture clearly reflected the insight that opening services trade required a complex nexus of different but related policies and regulations.

The GATS represented a major step towards creating an open and secure global policy framework for services – especially in the context of the ground-breaking negotiations of the 1998 WTO Agreement on Basic Telecommunications Services and the 1999 WTO Financial Services Agreement, which helped to lay the groundwork for the global expansion of finance and telecommunications in recent decades. But these major advances in global services regulation took place over two decades ago, when the internet was in its infancy and Google had yet to be invented. There is a risk that multilateral rules are falling behind the fast-globalizing services market they helped to create, leading to uncertainty about future progress.

5. Why it matters

The globalization of services has the potential to scale up growth, deepen integration, and level the economic playing field in ways that go beyond the changes wrought by the globalization of manufacturing in recent decades.

It holds out the promise of a major expansion not just of trade, but of the essential enablers of trade, development, and economic growth, from transport, logistics and information technology, to finance, healthcare and education. Where services were once secondary to a country's industrial strength, they are now central determinants of productivity, competitiveness, and rising living standards. Services-led growth strategies are becoming as important as manufacturing-led growth strategies – indeed, they need to go hand-in-hand. The ability to access and export efficient, affordable, and innovative services will be a game-changer for development.

The globalization of services also holds out the promise of creating a truly global marketplace for skills, expertise and knowledge, irrespective of geography or distance. If the globalization of manufacturing created a level playing field for products, the globalization of services can create a level playing field for people. For developed countries, services trade will be key to retaining global competitiveness and building on their technological strengths. For developing countries, services trade offers an opportunity to leap-frog into more high-value-added exports and to diversify away from resources or manufacturing.

But with these new opportunities come new challenges. Not only is there a need to devote more energy and attention to services liberalization; there is also a need to develop new negotiating tools and approaches. If past negotiations to open up good trade were driven mainly by tariff bargaining – the exchange of one market access "concession" for another – future negotiations to liberalize services trade will be driven more by regulatory cooperation – the effort to develop common standards, improve information exchanges, or advance shared policy objectives.

Goods-centred trade negotiations will need increasingly to become services-centred trade negotiations as well. And since services cross over into other policy areas beside trade, such as health, education and immigration, advancing services negotiations will also require deeper cooperation and more policy coherence with non-trade actors. This is particularly true in the area of investment, since over two-thirds of global foreign direct investment flows into services sectors.

The globalization of services raises domestic, as well as international, policy challenges. The same technological shifts that make it possible for services suppliers to reach global markets more easily, also leave previously protected services sectors more exposed to new competitive and adjustment pressures. There is a risk that, even as technology opens up and integrates services markets, government policies will restrict or fragment them. Equipping workers with the skills needed for a more services-oriented, knowledge-based global economy, while simultaneously helping existing services sectors to adjust to the coming wave of competition, will be important. Domestic reform will need to go hand-in-hand with global reform.

The core message in the *World Trade Report 2019* is that cross-border trade will increasingly involve services, not just goods, agricultural products or raw materials, and that it will transform the global economy in the process. Globalization is not slowing or stalling. Rather, it is evolving, driven by trade in human skills, knowledge and ingenuity. The report's other core message is that finding innovative ways to advance global trade cooperation will be key to realizing this potential – and to ensuring that trade remains an engine of global growth, development and poverty reduction.

6. Structure of the report

The World Trade Report 2019 discusses how services, and services trade in particular, have evolved since the establishment of the WTO in 1995 and the entry into force of the GATS, and how trade in services is likely to evolve further in the years to come. It also discusses the role of international cooperation on trade in services.

The report is divided into four main parts:

Section B reviews recent trends in services trade. It analyses the relative importance of the various modes of supply and examines the sectoral evolution of trade in services. It also discusses the participation of micro, small and medium-sized enterprises (MSMEs) and of women in services trade. Section B ends with a discussion of the content of services value-added in international trade.

Section C examines the role of trade in services in helping economies to achieve rapid and inclusive growth. It reviews and attempts to quantify how services trade benefits the economy and promotes growth, and it discusses the role trade in services plays in enhancing the competitiveness of domestic firms. Finally, it considers how services trade promotes inclusiveness, for example in terms of skills, gender and the location of economic activity.

Section D reviews recent trends in services trade costs and identifies the factors affecting these costs. It looks at major future trends in technology, demography, income and climate change to explain how these trends can affect the choice of services traded by economies, with whom they trade these services, and how. The section ends with a quantification of the potential impact that these trends have on trade in services, using the WTO Global Trade Model.

Section E discusses the motivations for international cooperation in services policy-making. It outlines the changing landscape of trade in services, the rationale for and the design of governments' interventions in services markets, and the reasons why governments may choose to collaborate on services trade policies. It examines how economies engage in international cooperation on services and describes how cooperation has evolved and is evolving, both within the WTO and in regional trade agreements. It also provides an overview of the regulatory cooperation activities of other international organizations that are most relevant to services trade, and it considers the prospects for further collaboration on services trade policy.

Endnotes

1 These figures are based on balance-of-payments data and account for services traded via only three of the four modes of supplying services (see Section B for further details).

2 It is important to note that WTO members' views differ as to whether or not certain downloadable products are services.