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IMPORTANT FEATURES OF THE SERVICE SECTOR AND TRADE IN SERVICES IN TRANSITION ECONOMIES

Note by the secretariat

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I. Introduction

1. The rapid development of the service sector in developed market economies and the growing scale of international transactions in services have been major features of the world's economic development over the last thirty or more years. In transition economies'[1], growth of the service sector is expected to be an effective means of promoting economic restructuring and raising the competitiveness of new private enterprises. In several transition countries, growing exports of services have been enabled by successful institutional transformations and technological advances. Additional revenues and growth stimulated by these exports have, in turn, influenced favourably the potential for internal reforms, facilitating structural adjustments and modernization. Last, but not least, trade in services has been at the forefront of multilateral trade negotiations within the framework of the World Trade Organization, and many transition economies of the region have been directly involved in these negotiations in the past and will be a part of them in the future.

2. The present note aims at providing background material for discussions at the fifth session of the Committee for Trade, Industry and Enterprise Development. It summarizes current trends in the service sector in developed and transition economies, identifies factors which have contributed to the growth of trade in services, in particular the impact of new technologies, and surveys major trends in services trade with special reference to transition economies.

3. The UN/ECE secretariat would like to thank Mr. Marko Kosonen, an intern with the secretariat, for his substantive contribution to the preparation of this note.

II. Executive summary

4. Growth of the service sector has outpaced overall economic growth in developed market economies for decades and at the end of the 1990s, services accounted for about 65 per cent of GDP in the OECD countries. This growth has been the fastest in the financial, business and personal services, while the relative importance of transport and communications has been decreasing.

5. In the 1990s, growth trends in the service sector in European transition economies varied from country to country and from sector to sector. The development of services has been most rapid in the countries aspiring to fast accession to the European Union. At the end of the past decade, in the majority of central and eastern Eropean countries, the service sector amounted to over half of GDP. In the CIS area, service as a percent of GDP was generally lower, although close to 50 per cent in the largest countries of the grouping (Kazakhstan, Russian Federation, Ukraine).

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1 The European transition economies refer to the formerly centrally planned economies of eastern Europe and the former Soviet Union. Central and eastern Europe refers to the economies of Albania, Bulgaria, Hungary, Poland, Romania and the Czech Republic, Slovakia, and the successor States of the former Socialist Federal Republic of Yugoslavia. Among the newly independent republics of the former Soviet Union, a distinction is made between the Baltic States, Estonia, Latvia and Lithuania, and the remaining republics which cooperate within the institutional framework of the Commonwealth of Independent States (CIS): Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Russian Federation, Republic of Moldova, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.

6. New telecommunications and computer technologies have had a major impact on the service sector, enhancing their tradability. In particular, they have created the possibility of cross-border exchanges in any services that were not transportable before (e.g. education), and have facilitated trade in the already tradable services (e.g. in retail trade). Technological innovations have reduced the need for foreign direct investment (FDI) as an exclusive mode of supply in many sub-sectors (e.g. banking, business services). However, FDI remains one of the important vehicles of delivery, while trade in services through traditional modes of supply, as reflected in the balance of payments, accounts for only about 20 per cent of the world's trade turnover.

7. In the 1990s, world trade in commercial services increased by 6 per cent a year, and OECD economies dominated both their imports and exports. During the same period, the transition economies' share in this trade sector was relatively modest, fluctuating between 3 and 4 per cent. At the same time, the value of trade in services represents a significant percentage of both overall trade and GDP in several central and eastern European countries, in which it is close to (or even exceeds) the respective figures for western European countries. In major economies of the CIS, trade in services is relatively less developed, both as compared with trade in goods and as a ratio of GDP.

8. Trade in services by transition economies is highly concentrated in country terms, five countries (Czech Republic, Hungary, Poland, Russian Federation and Ukraine) accounting for three quarters of exports; and the concentration rates are almost equally high on the import side.

9. In the second half of the 1990s, several transition countries (Czech Republic, Hungary, Poland, Slovenia) became net exporters of services (transport and travel services, in the first place). However, even at the end of the 1990s these countries remained net importers of business to business services, requiring highly skilled labour. Over the same period, in the CIS the situation was diverse. While some of the CIS states (Belarus, Ukraine) enjoyed a surplus in their trade in services, others, including Kazakhstan and the Russian Federation, were important net importers of services.

III. The service sector at the end of the 1990s

1. Defining services

10. In broad a sense, services, which are often called the "tertiary sector" of the economy, represent a diverse group of economic activities which are not directly associated with the "primary" or "secondary" sectors – i.e. agriculture, mining and manufacture of goods.[2] Production of both goods and services typically involves the provision of human value added in the form of labour, knowledge and skills. In both cases, it can be based on high technology and advanced knowledge or, alternatively, can engage large quantities of low-skilled labour.

[2] In statistical terms, the service sector includes the following International Standard Industrial Classification (ISIC, rev.3) categories: wholesale and retail trade and repair (G), hotels and restaurants (H), transport, storage and communication (I), financial intermediation (J), real estate, renting and other business activities (K), public administration and defence (L), education (M), health and social work (N), other community, social and personal services (O), and private households with employed persons (P).

11. Theoretically speaking, the main division line between goods and services lies in the tangibility of the former and intangibility of the latter. The tangible character of manufactured goods allows them to be stored, distributed, valued, transported and consumed without a direct interaction between consumer and the entity that produced them.

12. In contrast, the intangibility of most services implies their non-storability, non-transportability, and non-divisibility of production and consumption, in other words there is a direct interaction between the producer and the consumer in a simultaneous process of production and consumption. Since their quality cannot be known prior to their consumption, the sale of services strongly depends on the experience and credence of the buyer. This enhances the value and role of the reputation built up by the provider of services.

13. The cost structure of the service industry differs from manufacturing. In manufacturing, substantial costs are incurred in production (raw materials, capital equipment and labour). In the case of knowledge-based services some of these costs can be negligible. At the same time, these services often require considerable inputs of qualified labour.

14. Despite the "definitional" differences between goods and services, one should emphasize their growing complementarily and symbiotic relationship in the modern economy, the distinction between the two often becoming arbitrary. Many manufactured goods, for example, include a substantive service component (for example, software). In addition, many of the world's largest firms are increasingly operating in service-related activities: in 1997, this was the case of six out of the ten biggest world companies (by revenue). For example, in 1998, General Electric and IBM obtained over 50 per cent of their revenues from services.[3]

15. An efficient service sector is increasingly viewed as a prerequisite for economic growth, and this is particularly true for the knowledge-based services where high value is placed on intellectual capital, the so-called strategic business services (see Box). The transition to knowledge-based, service-oriented economies is giving a powerful impetus to upgrading the educational level and skills of employees. Shortages of skilled workers encourage Governments to pursue educational reforms, and create incentives for companies and individuals to invest in continuous learning.

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[3] As quoted in: OECD (2000) "The Service Economy", p. 10

Strategic business services

"Strategic business services" (SBS) is a sub-sector of the service sector, which includes computer software and information processing services, research and development and technical services, marketing services, business organization services and human resource services. It largely determines the competitiveness of the modern economy, as the services in question are proving to be key elements and an important source of growth and dynamism of individual companies, especially in developed economies.

Although internationally-comparable statistics for the sub-sector of strategic business services do not exist yet, it is believed to have grown rapidly. In 1995, in 19 OECD countries for which data are available, turnover in SBS is estimated to have exceeded USD 1.1 tn and was expected to make up USD 1.5 tn in 1999. During the last decade, at current prices the turnover of the sector was growing at about 10 per cent a year.

The rise of knowledge-based economies in general, and businesses' increasing reliance on expertise and specialised service inputs, in particular, have created the background for the accelerated development of these services. Advances in computing and telecommunications have made outsourcing economically justified: firms are shifting their non-core value-added functions and activities, for example, data processing and back office services, to external suppliers and different locations. At the same time, modern telecommunications allow external suppliers to deliver their products directly to the firms' information systems. As long as due control can be exercised, and transaction costs incurred from outsourcing agreements remain reasonable, companies can reduce their costs, invest more resources in the areas where they have the comparative advantage and render their operations more competitive. At the same time, subcontractors achieve economies of scale and scope by signing contracts with a number of firms, which allows them to provide the outsourced services at lower prices.

The expansion of strategic business services benefits developed countries both in terms of economic efficiency and employment. While the statistics are not available for all OECD economies, in 1995 employment in the sector of SBS is estimated to have exceeded 11 mn in the OECD area. That represented about 2.4 per cent of the total workforce of the OECD countries and was over twice the number of employees in the OECD vehicle industry (4.8 mn in 1995). An efficient SBS sector has positive spillover effects in both services and manufacturing sectors. Its impact is particularly beneficial for small and medium-sized enterprises because their improved performance through outsourcing and subcontracting enables them to increase turnover and raise their employment levels.

The constructive role of strategic business services has inspired OECD to recommend its member governments to economically support the SBS sector. This support can be effected through the encouragement of the supply of these services (direct support). This would consist of promoting R&D in services, as well as assisting in training and education, and business organisation. Another way would be to support the demand for strategic business services by other sectors (indirect support). As an example, changes in regulations that would encourage firms to use more externally supplied services, could be implemented. Internationally, the liberalization of international trade and foreign investment in strategic business services would contribute to expanding supply and improving the competitiveness of their providers.

Source: *Strategic Business Services*, OECD 1999

2. Impact of new technologies

16. Technological advances have had a major impact on the basic features of services: non-storability, non-transportability, and simultaneous production and consumption (implying personal interaction between the customer and the producer).

17. Some services have acquired characteristics usually associated with goods. For example, performances can be recorded and movies reproduced, to be distributed in thousands of copies or on-line via telecommunications.

18. Technological change has also considerably influenced the capacity of services to enter international trade. Telecommunications and information technologies have made tradable services, which before were considered to be non-tradable (e.g. education and medical services) and facilitated tradability of many other services already present in the international market place (i.e. banking) (see Section V).

19. In research and development, for example, the establishment of virtual working places in a country that are connected to research centres abroad enables specialists in that country to transfer results of their research to foreign employers. In the same manner, educational services have become transportable (transferable over long distances) via the Internet and video-conferencing.

20. Thanks to telecommunications, some retail banking services can be provided now both domestically and abroad without the actual commercial presence of bankers. Improved telecommunications make it possible for a customer to communicate with the bank either by telephone or through the Internet. At the same time, banks can process customer requests at any location worldwide, where ever they find it the most cost-efficient. A number of banks and non-financial companies have already concentrated their back-office data processing in a limited number of processing centres located in various parts of the world. Other service sectors that have benefited from the new technology include, for example, trade logistics, especially retailing, for which the new technology has given access to more efficient business models.

21. The emergence of e-business has had a number of positive effects on goods and service providers: some of the traditional intermediary functions have disappeared, establishing links between businesses has become easier, and the production cycles in enterprises have sped up. The development of telecommunications and information technology (IT) has had a profound effect on small and medium-sized companies by facilitating access to customers and often reducing start-up investment requirements.

22. As a result of technological advances, service providers are increasingly able to benefit from economies of scale in production. In the case of electronically- distributed items, for example, virtually all the costs are incurred in the development of a “master” product, which can subsequently be reproduced and distributed at zero or negligible cost (downloading a free Internet browser from the Internet being an example).

23. Finally, technological change allows the service sector to test completely new business models. In particular, the above-mentioned model of on-line delivery, enabling producers to deliver a product for mass consumption without replicating it, may have profound effects on business operations. Its dissemination is conditioned, though, by the availability of an adequate IT infrastructure and affordable access to it for the users.

24. Experience shows that the synergic development of physical telecommunications infrastructure, computer networks and their software component represent a key to the rapid progress of modern services, e-commerce, in particular. A survey conducted recently by the UN/ECE secretariat has shown that the development of the Internet in European transition economies is closely correlated with the levels of economic development of countries. At the beginning of 2000, the central European and Baltic countries, in particular, Estonia, the Czech Republic and Slovenia, had principal Internet development indicators (number of hosts, secure servers, percentage of Internet users and the range of services available via Internet) close to those in developed market economies. At the same time, in the Caucasian and central Asian CIS States, these indicators were considerably lower than in transition economies on average. While the level of economic development in general, and that of telecommunications infrastructure, in particular, prove to be determining factors in Internet development, the survey also has suggested that proactive government policy (as, for example, in Estonia) can accelerate the development of national segments of the World Wide Web and the scope of related services.[4]

25. A brief overview of major developments in the service sector attests to considerable benefits that transition economies can reap when the growth in service outpaces overall growth. At the same time, the practical use of these benefits largely depends on the general dynamism of individual economies and the success of those institutional reforms required to promote growth in the "tertiary" sector.

IV. Growth of the service sector

1. General trends

26. In a historical perspective, the development of services or the "tertiary sector" is considered to be a demand-driven phenomenon, a function of productivity growth and rising incomes. In the modern knowledge-based economy, however, an adequate level and growth of services becomes not only a result but also a precondition for the development of other economic sectors. Inadequate infrastructure, telecommunications and transportation services, in particular, are well-known obstacles to the development of both manufacturing and services themselves. The accumulation of knowledge is directly influenced by the supply of education services, research and development and legal services, enforcing intellectual property rights.

27. In addition to those factors mentioned above, the empirical research on services in developed countries has found several other relevant explanatory factors for their rapid development in the last third of the twentieth century. For example, increased participation of women in labour-force has expanded the market for domestic and social services. Recently, the growth in services also has been accelerated by outsourcing, that is, firms splitting their

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[4] UN/ECE document TRADE/2000/18, 17 April 2000, p.5 –17, 25.

operations, and opting to purchase activities and functions from specialized firms, rather than producing them in-house. Technological change has paved the way for multi-unit specialized service firms enjoying considerable economies of scale and scope.

28. Growth in services has outpaced overall economic growth for decades and this trend is expected to continue. During 1965 – 1980, in OECD economies, the average annual growth rate of the service sector amounted to 4.5 per cent; and during the next decade (1980 – 1990) it was 3.1 per cent.[5] Owing to high growth in the service sector, its share of GDP has increased considerably. While in 1965 services accounted for 54 per cent of GDP in OECD countries, in 1997 the share of services increased to about 64 per cent.[6]

29. In developed market economies, growth has been fastest in the financial, business and personal services, while the relative importance of transport and communication services has been decreasing.

30. Being largely labour-intensive, the service sector has limited possibilities for substituting labour for capital. This explains why the contribution of services to productivity growth at macro level is relatively limited, compared to the size of the service sector in developed economies. At the same time, a number of services in OECD countries have enjoyed rapid productivity gains (telecommunications, distribution and logistics, financial sector) and thus actively contributed to the enhanced productivity.

31. During 1980-97, in OECD countries the number of jobs created in the service sector exceeded the number of new jobs in these economies overall, that is the increasing number of vacancies in services more than compensated for job losses in manufacturing. In 1995, approximately 65 per cent of total employment in OECD countries was in the service sector (as compared with 55% in 1980). In 1997, this share was over 70 per cent in nine of the OECD countries.[7]

32. In developed market economies, the growth of employment in services, and in their business-oriented, knowledge-based and skill-intensive sub-sectors in particular, is contributing to an overall increase in personal incomes. During 1980 - 1997, the financial sector of OECD countries enjoyed the fastest growth in employment, averaging about 4 per cent a year. Of 20 million new jobs created in the United States during 1993 – 1999, close to 90 per cent were in service-related sectors, and 81 per cent offered wages above median level. As many as 65 per cent of the new vacancies belonged to the highest paid third of jobs.[8]

33. In summary, one can note that services in developed market economies have become the most important economic sector in terms of their contribution both to GDP and employment. During the past decade, the growth of business to business services was particularly dynamic. This service sub-sector employing highly skilled-labour has become a major component of the new knowledge-based economy.

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[5] Liberalizing International Transactions in Services. A Handbook. UNCTAD/DTCI/7, 1994, p. 4

[6] Ibid. and World Bank Development Indicators Database, http://devdata.worldbank.org/data-query/

[7] OECD (2000) “The Service Economy”, p.19 - 20

[8] Ibid.

2. Transition economies

34. While statistics on services in European transition economies have important lacunae and discrepancies, the data available show that during the previous decade, the service sector in these countries did not experience a universal accelerated growth trend. At the same time, in several countries of central and eastern Europe certain sub-sectors of services developed at higher than average speed.[9]

35. For example, during the 1990s, at constant prices in the Czech Republic and Estonia, wholesale and retail trade, transport and communication and financial and business services grew at a rate exceeding the growth of GDP as a whole. On the other side of the spectrum, in Poland, the three above-mentioned sub-sectors grew at an average or lower than average GDP rate.

36. In the other countries seeking to accede to the European Union, the growth rates of services were even more diverse. In Hungary and Slovenia, higher than average growth was characteristic only for transport and communications and, in Latvia and Lithuania, for wholesale and retail trade. The other services sub-sectors grew at an average or at slower than average speed.

37. As a result of these contradictory developments, during the 1990s no prevailing trend in the share of services in GDP (at current prices) could be observed either in east-European or in CIS countries.

38. Among countries of central and eastern Europe, this share (including government services) increased in Poland, Slovenia, the Baltic States and Romania. At the same time, it remained relatively stable in the Czech Republic and Hungary. Overall, at the end of the 1990s, the weight of services in GDP was as high as 67-69 per cent in Estonia and Latvia, around 60-62 per cent in Lithuania, Poland, Slovenia, Slovakia and Hungary, and about 55 per cent in the Czech Republic.

39. In major countries of the CIS, a decline in production continued throughout almost the whole decade, and the service sector tended to follow overall macroeconomic trends.

40. In Ukraine, for example, as from 1993 financial and business services stagnated or declined (although not as steeply as the GDP), while the other services sub-sectors declined at the same rate (wholesale and retail trade) or an even higher rate (transport and communication) than GDP. In Russia, in 1995-1998, the financial and business service sector experienced a small positive growth; wholesale and retail trade stagnated, while transport and communication declined together with the majority of other GDP sectors. Over the same period, the trends were similar in Kyrgyzstan.

41. During the 1990s, in the CIS member-States the share of services in GDP (including government services) grew in Armenia, Georgia, Kazakhstan, Kyrgyzstan, the Republic of Moldova and Ukraine, while in the Russian economy it stagnated. The weight of services also remained unchanged in Azerbaijan and Belarus.

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[9] Estimates in this sub-section are based on data from the UN/ECE statistical database files $final.xls and GDPact.xls.

42. At the end of the previous decade, in the CIS countries, the share of services in GDP was considerably lower than in the most advanced countries of eastern Europe, even when the generally important value of Government services (education, health care, insurance, administration, etc.) was taken into account. It ranged from around 52 - 55 per cent of GDP in the Russian Federation, Kazakhstan and the Republic of Moldova, to 47 – 49 per cent in Belarus and Ukraine, and 35 – 40 per cent in Armenia, Azerbaijan, Georgia, Kyrgyzstan and Uzbekistan.

43. In summary, the statistics show that during the 1990s, as opposed to the trends found in developed market economies, the accelerated growth of the service sector was not characteristic of all countries of eastern Europe and the CIS. At the same time, in some transition economies the service sector and a number of its sub-sectors did manifest a faster than average growth in real terms. By the end of the past decade, the share of services amounted to over half of GDP in the majority of central and eastern European countries, and was particularly high in those countries which aspired to quickly acceding to the European Union. In the CIS area, it was generally lower, although also close to 50 per cent of GDP in the largest countries of this grouping (Kazakhstan, Russia, Ukraine).

V. Tradability of services and modes of supply

44. Tradability of services in international trade can be defined as the possibility of cross-border delivery of the final service or intermediate components in the service chain without the cross-border movement of the service provider or customer. Trade in commercial services still accounts for less than 20 per cent of world trade, which is importantly lower than the share of services in gross output. One reason for the relatively low weight of services in world trade is the non-storability and non-transportability of many services. In the recent past, foreign demand for services in combination with the inability to transport them between countries created a major impetus for a remarkable growth in foreign direct investment in services.[10]

45. As was already mentioned, the rapid development of communications technology and data processing has influenced both the technical and the economic factors of tradability. Many final and intermediate service products, especially financial and business services, have become potentially transportable/transferable over long distances, thus creating a technical basis for trade across national borders. It should be mentioned, however, that even when cross-border trade is technically possible and economically justified, legal and regulatory factors can make it unfeasible.

46. The enhanced possibilities for cross-border trade in services have decreased the imperative of FDI as a mode of supply. However, both for technical (non- storability and non-transportability) and regulatory (insufficient international legal infrastructure) reasons, conventional cross-border trade does not constitute an exclusive mode of linking buyers and sellers of services. FDI remains an economically justified delivery method in quite a number of industries.[11]

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[10] Liberalizing International Transactions in Services. A Handbook. United Nations, 1994, p. 14 – 18.

[11] According to the U.S. Department of Commerce survey of United States companies, FDI has become a preponderant mode of foreign delivery for a number of business services - banking, motor vehicle and equipment leasing, accounting, advertising, legal services, employment agencies, hotels and motels. In communications, construction and engineering, insurance, computer services, franchising, educational and health services, and motion pictures, both trade and investment modes are equally important, while cross border trade dominates only in air and maritime transport services. (Roman Römisch. Trade in Services in the Central and East European Countries. The WIIW Research Reports, No. 274, January 2001, p. 81 – 82)

47. In more general terms, the General Agreement on Trade in Services (GATS) distinguishes between four modes of supply, which are practical in trade in services. These are as follows: cross-border supply; consumption abroad; commercial presence; and presence of natural persons.

48. *Cross-border supply,* when services are delivered from one country to another. Under this mode, similar to trade in merchandise, neither the customer nor the provider of services move across national borders (telecommunications, financial and professional services).

49. *Consumption abroad,* when services are supplied to consumers coming from abroad. Under this mode, the customer physically moves across national borders, while the provider does not (typical cases include tourism, education or the repair of transport means abroad).

50. *Commercial presence,* when services are delivered through service-providing entities of one country established in the territory of another. Under this mode, the institutional service provider moves across national borders while the consumer does not. Being one of the most important delivery modes to date (especially for retail trade and financial services), commercial presence covers various types of foreign direct investment.

51. *Presence of natural persons*; when services are provided by nationals of one country in the territory of another. Under this mode, an individual crosses the border to provide services to consumers abroad. Typical examples include consultancy and other business services requiring highly-skilled specialized employees.[12]

Table 1 –Trade in Services by modes of supply, 1997

Mode of Supply	**Value (USD bn)**	**Share of total (percent)**
Mode 1: Cross-border Supply[1)]	890	41.0
Mode 2: Consumption Abroad[2)]	430	19.8
Mode 3: Commercial Presence[3)] [FDI]	820	37.8
Mode 4: Presence of Natural Persons[4)]	30	1.4
All modes	2170	100.0

1) Statistical proxy used: Business services shown in the balance of payments (excluding tourism and travel)
2) Statistical proxy used: Tourism and travel
3) Statistical proxy used: Foreign affiliates productions (estimates of gross outputs)
Statistical proxy used: Compensation of foreign employees (shown in balance of payments data)

Source: G.Karsenty (2000) "*Just How Big Are the Stakes?: An Assessment of Trade in Services by Mode of Supply*"

12 WTO Secretariat. An Introduction to the GATS, October 1999.

52. According to recent estimates as shown in table 1, conventional cross-border trade made up about 41 per cent of overall foreign sales of services via all four modes in 1997. Delivery through commercial presence, as represented by the value of sales of foreign affiliates in services, was almost equally important (38 per cent). Mode two (consumers moving abroad) accounted for about 20 per cent of the total, while the fourth mode (presence of physical persons as service providers) was insignificant (a fraction of a per cent).

53. If modes 3 and 4 were taken into account by the traditional statistics on trade in services, the total value of foreign sales in 1997 would increase by US$ 820 billion, rendering the overall sales of services abroad to 7 or 8 per cent of world GDP.

VI. Trade in services during the 1990s

1. General

54. In assessing the growth trends in international trade in services, it should be borne in mind that the relevant statistics are based on balance of payment data and cover only the two first modes of service delivery, that is, conventional cross-border trade and consumption abroad. Therefore, the data on cross-border transactions understate the overall volume of sales because of unaccounted services supplied though local affiliates of foreign firms and by individuals.

55. Equally important is the fact that, as opposed to trade in goods, the internationally comparable data on service transactions are available only at current prices. This does not enable a reliable measure of growth rates and comparison either with the growth of merchandise trade or GDP. Both circumstances should be fully taken into consideration when interpreting the statistics on trade in services.

56. During the last decade, the value of world exports in commercial services grew at 6 per cent (at current prices), although the growth rates slowed down considerably in 1998 and 1999 (see table 2 and annex I for statistical definitions).

Table 2 – World Exports of commercial services by major sector

	Value			Annual percentage change			Total percentage		
	1990	1998	1999	1990-99	1998	1999	1990	1998	1998
All commercial services	783	1320	1350	6	1	1	100	100	100
Transportation	223	310	310	4	-1	1	29	23	23
Travel	265	430	440	6	0	2	34	33	33
Other commercial services[1)]	295	580	600	8	2	1	38	44	44

1) Other commercial services include communication, construction, insurance, financial, IT and other business services.
Royalties and fees and personal, cultural and recreational services are also included.

Source: WTO Annual Report 1999 p. 14; WTO International Trade Statistics 2000 p. 94. 172

57. Within the traded services, transportation services had the lowest rates of growth in the 1990s, and their share in the total value of commercial services' world exports dropped from 29 per cent in 1990 to 23 per cent in 1999. Exports of services associated with travel, grew at about the average rate (6 per cent) and their share remained almost unchanged (about one third). Finally, exports of the "other commercial services" which include a heterogeneous spectrum of communication, insurance, financial, information technology and other business services enjoyed growth rates considerably exceeding the average. Their value increased by 8 per cent per annum, and their share in total exports increased from 38 per cent in 1990 to 44 per cent in 1999.

58. During the 1990s, at current prices the growth of commercial service exports' was the highest in the United States and Canada (8.1 per cent on average). In countries of western Europe the rate was considerably slower (4.9 per cent). At the same time, in the latter region the yearly growth of the services exports exceeded that of merchandise exports (4.1 per cent in nominal terms), while this was not the case in Canada and the United States [13].

59. Developed market economies are the major exporters and importers of commercial services (see table 3). At the end of the past decade, the share of western Europe, United States and Japan in the world exports of services made up 71 per cent, and in the world imports 67 per cent.

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13 WTO. International Trade Statistics, 2000, p. 8.

Table 3 – Growth in the value of world trade in commercial services by selected regions, 1999

	Exports						Imports					
	Value			Annual percentage change			Value			Annual percentage Change		
	1990	1998	1999	1990-99	1998	1999	1990	1998	1999	1990-99	1998	1999
World	783	1332	1350	6	1	1	812	1314	1345	6	2	2
North America[1)]	151	272	288	7	3	6	125	203	219	6	6	8
Western Europe	416	645	640	5	7	-1	392	604	609	5	9	1
European Union (15)	370	574	574	5	7	0	350	559	561	5	9	0
Japan	41	62	60	4	-9	-2	84	111	114	3	-9	3

1) Excluding Mexico

Source: WTO International Trade Statistics 2000 p. 172-177 and p. 18

60. At the same time, during the 1990s the aggregated weight of the indicated major market economies in trade in commercial services tended to decrease (in 1990 it constituted over 75 per cent of exports and 71 per cent of imports). This fall in the share of developed countries' weight in world exports of commercial services occurred largely because of the relatively low growth rates of these exports in countries of western Europe and, to a lesser extent, Japan. The share of western Europe dropped from 53 per cent in 1990 to about 47 per cent in 1999, while the weight of the United States tended to grow (from about 17 to 19 per cent).

61. The picture is similar on the import side, where the share of western Europe and Japan decreased from 48 per cent to 45 per cent and from 10 to 8 per cent, respectively. Here again, United States' importers increased their share from 12 to over 13 per cent.

62. Overall, developed market economies (with the exception of Japan) are net exporters of commercial services. The preponderance of exports over imports is particularly high in the case of the United States, where the yearly surplus recently has exceeded US$ 70 billion; in countries of western Europe, exports and imports of commercial services are more balanced.

63. Both for countries of western Europe and for the United States, trade in commercial services remains economically less important than trade in goods. In 1999, in countries of western Europe, the value of commercial services' exports was equivalent to about 7 per cent of GDP, while that of merchandise exports to almost 26 per cent. In the United States, similar percentages amounted to less than 3 and 7.5. This discrepancy shows a considerable potential for future growth in trade in services and emphasizes the importance of international effort to create an adequate regulatory infrastructure for this growth.

2. Transition economies

64. Statistics in trade in services in many European transition economies are only beginning to be collected according to international standards and often have considerable gaps. As a result, the statistics compiled by the World Trade Organization do not contain the data on trade in individual service sectors for these countries.

65. In the second half of the 1990s, the share of eastern and central European countries and of CIS member States in world exports and imports of commercial services was relatively small, fluctuating between 3 and 4 per cent, and not showing any particular upward or downward trend.

66. Within the group of European transition economies, trade in commercial services is highly concentrated in country terms (see annex II, table 1). In 1998, five countries accounted for as much as three-quarters of overall exports of commercial services from transition economies: Russian Federation (23 per cent), Poland (20 per cent), Czech Republic (14 per cent), Hungary (11 per cent) and Ukraine (7 per cent). On the import side, the concentration rate was almost equally high. In 1998, over one third of transition economies' services imports went to Russia, 14 per cent to Poland, 12 and 9 per cent to the Czech Republic and Hungary, respectively, and about 5 per cent to Ukraine.

67. Despite a relatively modest involvement in the world trade in services, exports and imports of services represent a significant proportion of GDP in many central and Eastern European countries. In Bulgaria, the Czech Republic, Hungary, Slovakia and Slovenia, yearly exports and imports of services amount to 8 – 13 per cent of GDP (merchandise exports and imports amounting to 35 – 50 per cent of GDP). In Poland, Romania and the Russian Federation, this ratio is smaller but also significant, making up between 4 and 6 per cent of GDP (as opposed to 20 – 28 per cent for merchandise trade).[14]

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[14] Roman Römisch. Trade in Services in the Central and East European Countries. The WIIW Research Reports, No. 274, January 2001, p. 107 – 122.

68. From the above figures one can see that in several central European countries the value of services exports as a proportion of GDP is close to or possibly even higher than the western European average (see above). Given this high ratio, one could suggest that the revenues earned from the exports of services might constitute a non-negligible source of funds for structural transformation in the respective economies.

69. Comparing the volumes of trade in goods and in services enables further exploitation of the scope of trade in services in transition economies.

70. At the end of last decade, exports of commercial services were equivalent to about 22 per cent of the value of European transition economies' merchandise exports (see annex II, table 2). This ratio was lower than the world average (24 per cent) and considerably lower than the respective figures in countries of Western Europe and the United States: in the last two cases the value of commercial services amounted to respectively 27 and 36 per cent of merchandise exports. A similar ratio for imports – 19 per cent in 1999 - was smaller than the average percentages for the world as a whole (23 per cent) and Western Europe (25 per cent) but larger than that of the United States (17 per cent).

71. One can note, therefore, that as compared with their merchandise trade, European transition countries export a lower amount of commercial services than developed market economies. Their import consumption of services is also proportionally lower, at least as compared with the respective figures for their western European neighbours.

72. The aggregate picture, though, conceals considerable differences within the group of transition economies. In 1999, countries of central and eastern Europe exported commercial services worth about 27 per cent of their merchandise exports, and the corresponding percentage was as high as 47 for the Baltic States. At the same time, the nine CIS member States, for which relevant statistics were available, exported commercial services equivalent by value to only 13.5 per cent of their merchandise exports.

73. In country terms, one can see that the low services/merchandise exports ratio for the CIS was largely determined by low indicators for the Russian Federation, and to a lesser extent, by those for Kazakhstan and Kyrgyzstan. For several other members of the CIS, the above-mentioned ratio was importantly higher than the CIS average.

74. On the import side, at the end of the past decade the picture was the opposite: in 1999, the Baltic States and countries of central and eastern Europe imported services worth about 19 and 17 per cent of their merchandise imports, while the respective percentage for the CIS States was as high as 24 per cent. Within the later grouping, the Russian Federation, Kazakhstan and Azerbaijan turn out to be particularly committed consumers of commercial services supplied from abroad.

75. In summary, as compared with the value of their merchandise exports, the scale of commercial services exports from countries of Central and Eastern Europe and the Baltics is roughly commensurate with that of Western Europe. At the same time, the former import services on a proportionately smaller scale.

76. In contrast, the trade pattern is different for the CIS countries. As compared with merchandise exports, exports of commercial services are less developed in countries of this grouping, in the Russian Federation in particular. At the same time, the CIS economies tend to import more services than their western neighbours.

77. The examination of balances in trade in services confirms the above conclusion. In the second half of the 1990s, European transition economies became net aggregate exporters of commercial services. Considerable surplus in this kind of trade is characteristic primarily of countries seeking to quickly accede to the European Union (Poland, Hungary, Czech Republic, Slovenia). These positive balances enable these economies to partially compensate for the deficits in merchandise trade.

78. Within the CIS region, however, during the same period most countries were net importers of services, and a considerable deficit in this kind of trade was typical of the Russian Federation, in particular. At the same time, among the larger CIS countries for which the data are available, Belarus and Ukraine have been singled out as sustained net exporters of commercial services.

79. In terms of trade in individual service sectors, in the 1990s the central and eastern European countries were net exporters of transport and travel (mostly related to tourism) services, which are often labour intensive on the one hand and depend on natural factors (are "nature-endowment-intensive"), on the other. At the same time, during the previous decade, countries of central and eastern Europe had a deficit in trade in business to business services (financial services, insurance, computer and information, and other business services), which require a good capital basis and are highly skilled labour-intensive.

80. Before the transition started, the former Council for Mutual Economic Assistance (CMEA) countries had had no background and no demand for such services. In the course of the transition, however, the demand for business services has increased both from local companies and foreign direct investors; this demand has been largely satisfied through imports. Since 1990, along with the progress of transition, the competitiveness of local service providers has strengthened both due to restructuring, transfer of know-how through foreign direct investment (as in the Hungarian banking and Polish insurance sectors, for example) and other forms of co-operation. As a result, the deficit in "other business services" in Central and Eastern European countries has tended to decrease.

81. While no data are available for all the CIS countries, in the Russian Federation in 1993-1998, deficits were observed in all the sub-sectors of trade in services, excluding transport and communication.[15] The deficits in service trade associated with travel can be explained by the lack of adequate infrastructure capable of satisfying the demand of tourists from the developed parts of the world – a feature that the Russian tourist industry shares with that of the other CIS member States. At the same time, the deficit in "other business services" suggests an important lag in the development of business infrastructure in Russia as compared with developed market economies (and probably with some of the former CMEA countries), similar to the one found in Central and Eastern European countries at the beginning of transition in early 1990s.

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[15] *Ibid*., p. 22 - 36.

82. To summarize, the statistical data available suggest that at the end of the 1990s the share of transition economies in the world trade in services was relatively small. At the same time, its value was significant both as compared with the value of merchandise trade and the size of GDP in these countries. Services trade is particularly developed in the most advanced economies of central and eastern Europe, where its economic weight is commensurate with that in countries of Western Europe, those belonging to the European Union, in particular. Several transition countries (Czech Republic, Hungary, Poland, Slovenia) have become sustainable net exporters of services with comparative advantage in low-skilled labour, energy and natural endowment-intensive services (transport, tourism, certain types of construction-related services). At the same time, at the end of the past decade these countries were net importers of business to business services, requiring highly skilled labour, although the deficit in this kind of trade was decreasing.

83. In major countries of the CIS, trade in services is considerably less developed both as compared with trade in goods and as a ratio of GDP. While some of the States belonging to this grouping (Belarus, Ukraine) in the second half of the 1990s enjoyed a surplus in their services trade, others, including Kazakhstan and the Russian Federation, were important net importers of services. While the sectoral data for all CIS member-States are not available, statistics on Russia testify that, with the exception of transport and communication, in the second half of the 1990s it had deficits in all kinds of services trade, including strategic business services. The comparative disadvantage in trade in services and, producer-oriented services trade, in particular, implies a low level of business infrastructure development in Russia (and probably also in the other CIS countries) and a considerable potential for continued market reforms.

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Annex I

Definitions, relating to trade in services

1. Exports and imports

Exports (credits) and imports (debits) of commercial services are derived from statistics on international service transactions included in the balance of payments statistics provided by the International Monetary Fund (IMF). They conform to the concepts, definitions and classification of the fourth (1977) or fifth (1993) edition of the IMF *Balance of Payments Manual*. Countries or territories that do not report to the IMF, data are drawn from national statistics (e.g., Hong Kong, China; Macao and Taipei). Estimations for missing data are mainly based on national statistics.

2. Definition of commercial services

In the fifth edition of the *Balance of Payments Manual* (BPM5), the current account is subdivided into *goods*, *service*s (including *government services, n.i.e.*), *income* (investment income and compensation of employees), and *current transfers.* The *commercial services* category in this report is defined as being equal to *services* minus *government services, n.i.e. Commercial services* is further sub-divided into *transport*, *travel*, and *other commercial services*. *Transport* covers all transportation services (sea, air and other - including land, internal waterway, space and pipeline) that are performed by residents of one economy for those of another, and that involve the carriage of passengers, the movement of goods (freight), rentals (charters) of carriers with crew, and related supporting and auxiliary services.

Travel includes goods and services acquired by personal travellers, for health, education or other purposes, and by business travellers. Unlike other services, travel is not a specific type of service, but an assortment of goods and services consumed by travellers. The most common goods and services covered are lodging, food and beverages, entertainment and transportation (within the economy visited), gifts and souvenirs.
Other commercial services corresponds to the following components defined in BPM5:

- *communication services* (telecommunications, postal and courier services);
- *construction services*;
- *insurance services*;
- *financial services*;
- *computer and information services* (including news agency services);
- *royalties and licence fees*, covering payments and receipts for the use of intangible non-financial assets and proprietary rights, such as patents, copyrights, trademarks, industrial processes, and franchises;
- *other business services*, comprising trade related services, operational leasing (rentals), and miscellaneous business, professional and technical services such as legal, accounting, management consulting, public relations services, advertising, market research and public opinion polling, research and development services, architectural, engineering, and other technical services, agricultural, mining and on-site processing; and
- *personal, cultural, and recreational services* including audiovisual services.

3. Coverage and comparability

Although in recent years the coverage and comparability of services trade data have improved, recorded trade figures still lack comparability across countries and are subject to significant distortions.

First, some countries do not collect statistics for certain service categories.
Second, some service transactions are simply not registered. If central bank records are used, situations where no financial intermediaries are employed are not counted. In the case of surveys, the coverage of trading establishments is often incomplete. A particularly serious problem is that services transmitted electronically are frequently unregistered, especially when the transactions take place within multinational corporations.
Third, statistics may be reported on a net rather than on a gross basis, often as a result of compensation arrangements such as in rail transport or in communication services.
Fourth, the alternate sources used for countries which are not members of the IMF do not necessarily comply with the IMF concepts and definitions.
Fifth, misclassification of transactions may lead to an underestimation of commercial services when service transactions are registered as income, transfers or trade in merchandise rather than trade in services or, conversely, to an overestimation of commercial services when transactions pertaining to income, transfers or official transactions are registered in the private service categories.

The implementation of BPM5 will result in an improvement of country comparability over time. However, given that these improvements are being made gradually, they also result in a number of breaks in series. The borderline between goods and services, as well as the borderlines between the components of commercial services differ in BPM4 and BPM5. Examples of such differences are:

- most processing transactions are included under *goods* on a gross basis in BPM5, while in BPM4 only the value of the fees paid for processing are included in services;
- goods procured in ports, such as fuels and provisions, are included in *goods* in BPM5, and in services (*transport*) in BPM4;
- in BPM4, insurance services are normally measured by the net premiums defined as premiums less claims, while in BPM5, *insurance services* reflects the “normal” service charge, i.e. administrative services and part of the earnings; the rest of the net premiums or the actual risk premiums is recorded under current transfers or in the financial account in case of life insurance; in addition, freight insurance is part of transport in BPM4, and part of insurance services in BPM5; and
- the expenditure of seasonal and border workers is included in labour income in BPM4, and in *travel* in BPM5.

Source: WTO International Trade Statistics 2000, p.212-213.

Annex II – Statistical Tables

Table 1: Transition Economies' Trade in Commercial Services (Billion dollars)

	Exports						Imports					
	1994	**1995**	**1996**	**1997**	**1998**	**1999**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**
Transit. Economies Total	34313	46794	54172	53592	54263	47355	34521	45832	46756	47215	47908	42660
Central and eastern Europe												
Albania	79	94	123	52	83	253	128	98	134	93	119	152
Bulgaria	1257	1431	1366	1307	1766	1756	1246	1278	1246	1157	1398	1465
Czech Rep.	5120	6638	8071	7033	7366	6807	4685	4860	6198	5305	5665	5624
Hungary	3046	5122	5920	5684	5881	5608	2875	3542	3446	3404	4082	4188
Poland	6655	10637	9786	8969	10890	9961	3746	7008	6314	5681	6559	7622
Romania	1023	1476	1552	1500	1192	1342	1166	1801	1924	1899	1838	1753
Slovak Rep.	2221	2378	2060	2151	2275	2058	1549	1800	1997	2062	2272	1797
Slovenia	1802	2012	2117	2032	2045	1947	1034	1010	1112	1376	1409	1439
The FYR Macedonia	128	147	151	127	130	...	225	230	251	289	300	266
Totals	**21331**	**29935**	**31146**	**28855**	**31628**	**29732**	**16654**	**21627**	**22622**	**21266**	**23642**	**24306**
Baltic States												
Estonia	508	868	1100	1314	1476	1486	331	420	525	649	814	829
Latvia	651	718	1121	1027	1103	1026	211	225	703	637	717	628
Lithuania	322	482	786	1020	1096	1083	266	457	639	850	816	747
Totals	**1481**	**2068**	**3007**	**3361**	**3675**	**3595**	**808**	**1102**	**1867**	**2136**	**2347**	**2204**
CIS												
Armenia	12	27	75	97	118	132	41	52	129	157	175	171
Azerbaijan	...	166	139	332	320	...	...	297	433	714	692	...
Belarus	251	466	907	919	870	...	197	276	330	354	431	...
Georgia	...	...	...	...	278	...	...	...	...	...	335	...
Kazakhstan	...	535	674	842	904	933	...	776	928	1124	1154	1104
Kyrgyzstan	33	39	31	40	58	...	69	193	247	169	177	...
Moldova, Rep. of	33	144	111	130	117	105	74	204	170	191	191	156
Russian Fed.	8425	10568	13283	14079	12373	9087	15140	19971	18405	18836	16219	12427
Ukraine	2747	2846	4799	4937	3922	3771	1538	1334	1625	2268	2545	2292
Totals		**14791**	**20019**	**21376**	**18960**	**14028**		**23103**	**22267**	**23813**	**21919**	**16150**
Memorandum Item:	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**
World	1035400	1187500	1269800	1321900	1331600	1350000	1030200	1187600	1253700	1291000	1313700	1345300
United States	180562	197161	215703	234834	239957	253358	119588	129264	137581	152952	165827	180415
Western Europe	492800	565100	589100	601600	644700	640100	456900	529100	549900	552700	604300	609300
European Union (15)	441964	506187	529599	535489	573549	574475	424914	491768	509705	510522	558872	561370
Japan	56776	63966	66382	68136	61795	60313	105449	121548	128674	122079	110705	114173

Source: WTO International Trade Statistics 2000, p.172-177

Table 2: Transition Economies' Trade in Commercial Services as Percentage of their Merchandise Trade

	Exports						Imports					
	1994	1995	1996	1997	1998	1999	1994	1995	1996	1997	1998	1999
Transit. Economies Total	26.4	28.2	24.9	23.5	24.5	21.6	27.1	28.0	19.9	18.8	19.2	19.2
Central and eastern Europe												
Albania	56.4	47.0	57.2	37.1	39.5	93.7	23.3	15.1	14.3	14.8	14.2	12.4
Bulgaria	31.4	26.7	27.9	26.5	41.1	43.3	27.2	22.6	24.6	23.5	28.1	26.8
Czech Rep.	31.6	30.7	36.8	30.9	28.0	25.3	26.9	19.2	22.4	19.5	19.7	19.5
Hungary	28.5	39.8	37.7	29.8	25.6	22.4	19.8	22.9	19.0	16.0	15.9	15.0
Poland	38.6	46.5	40.0	34.8	38.6	36.3	16.5	24.1	17.0	13.4	13.9	16.6
Romania	16.6	18.7	19.2	17.8	14.4	15.8	16.4	17.5	16.8	16.8	15.5	16.9
Slovak Rep.	33.2	27.7	23.3	22.2	21.1	20.1	23.4	20.5	18.0	17.7	17.5	16.0
Slovenia	26.4	24.2	25.5	24.3	22.6	22.6	14.2	10.6	11.8	14.7	13.9	14.5
The FYR Macedonia	11.8	12.2	13.2	10.3	9.9	...	15.2	13.4	15.4	16.2	15.7	13.9
Totals	**30.9**	**33.6**	**33.3**	**28.7**	**28.4**	**26.5**	**20.2**	**20.3**	**18.4**	**16.3**	**16.4**	**17.0**
Baltic States												
Estonia	69.1	75.2	52.9	44.7	45.6	50.5	26.4	21.3	16.2	14.6	17.0	20.1
Latvia	134.2	103.3	77.6	61.5	60.9	59.5	28.1	20.3	30.3	23.4	22.5	21.3
Lithuania	37.4	36.8	23.4	26.4	29.5	36.0	25.0	22.9	14.0	15.1	14.1	15.4
Totals	**71.2**	**65.4**	**43.7**	**39.7**	**42.0**	**46.9**	**26.3**	**21.7**	**18.5**	**16.7**	**17.0**	**18.5**
CIS												
Armenia	21.8	27.0	25.9	41.3	53.6	56.2	21.6	15.3	15.1	17.6	19.4	21.4
Azerbaijan	...	48.8	22.1	42.6	52.9	...	...	69.1	45.1	89.8	64.4	...
Belarus	26.0	32.9	16.1	12.6	12.3	...	20.8	16.2	4.8	4.1	5.0	...
Georgia	...	...	...	...	146.3	...	...	...	...	...	37.9	...
Kazakhstan	...	24.4	11.4	13.0	16.6	16.7	...	69.6	21.9	26.1	26.5	30.0
Kyrgyzstan	28.7	28.9	6.1	6.6	11.3	...	65.7	120.6	29.4	23.8	21.1	...
Moldova, Rep. of	22.0	54.3	14.0	14.9	18.4	22.3	41.1	78.5	15.9	16.3	18.6	27.4
Russian Fed.	16.4	16.7	15.0	15.9	16.7	12.2	41.7	46.4	26.7	25.6	27.4	30.2
Ukraine	63.2	47.9	33.3	34.7	31.0	32.6	56.1	25.4	9.2	13.2	17.3	19.3
Totals	**19.6**	**20.1**	**17.1**	**17.9**	**18.7**	**14.1**	**40.5**	**44.0**	**21.8**	**22.0**	**24.0**	**24.1**
Memorandum Item:	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**
World	24.4	23.4	23.8	23.9	24.5	24.0	23.6	22.8	22.7	22.6	23.2	22.9
United States	35.2	33.7	34.5	34.1	35.2	36.4	17.4	16.8	16.7	17.0	17.6	17.0
Westren Europe	27.3	25.5	25.7	26.4	27.3	27.2	25.3	23.9	24.1	24.3	25.1	25.2
European Union (15)	26.5	24.7	25.0	25.4	26.1	26.3	25.5	24.2	24.4	24.5	25.3	25.1
Japan	14.3	14.4	16.2	16.2	15.9	14.4	38.3	36.2	36.9	36.0	39.5	36.7

Source: WTO International Trade Statistics 2000, p.172-177