Introduction

African trade is heavily concentrated in agricultural and natural resource-based commodities and the agricultural sector continues to be a major source of employment, activity and regional/rural economies – especially when indirect ancillary linkages are taken into account. Although trade volumes have risen since the 1990s, and exports of some industrial and processed products have been increasing, intra-regional trade remains well below potential, and the challenge of diversification continues to prevail. There are encouraging prospects for accelerating trade growth as a result of policy reforms, ranging from trade facilitation efforts to the high-level political ambition to achieve regional integration objectives – e.g., through a continental free trade agreement. Much depends on the willingness and ability of African leaders to deliver on their stated objectives. A premise of this paper is that a precondition for leveraging trade opportunities is a substantial reduction of trade and transactions costs for African firms, and that this must go beyond the current focus on actions to facilitate trade and include more of a focus on improving the performance of a wide variety of services, including transport, logistics and related services.

ACET (2014) emphasizes that agriculture must play a central role in boosting growth and structural transformation, and identifies a number of specific areas that offer substantial opportunity, including: (i) processing and adding value to traditional export crops; (ii) scaling up exports of fruits and horticulture by upgrading supply chains, investing in processing plants and developing agribusiness services; and (iii) substituting agricultural imports from the rest of the world by building regional value chains – e.g., producing poultry meat and associated inputs such as soybean cake in different sub-regions of Africa. The same is true for manufacturing activities, which have been expanding in a number of countries/regions, and have been the subject of significant attention in the literature [cites]. Making progress along these lines and enhancing the share of value added created in Africa will require improving the availability and access to a range of ancillary services, and more generally increasing the productivity of firms supplying services.
McMillan and Rodrik (2011) have noted that in Africa the process of structural transformation in which workers move out of agriculture/rural locations into other economic sectors/urban centres has not been accompanied by the shift observed in East Asia (and more generally current OECD member countries in the course of their economic history) in which this process can be characterized by a shift from low to higher productivity activities, with manufacturing absorbing a large proportion of the workers who move out of agriculture and an overall rise in economy-wide productivity performance. The pattern that is observed instead in many African countries is one of a shift of people from rural areas into the urban informal sector or into low productivity services activities (retail, personal services etc.), with little in the way of an expansion of the manufacturing sector.

Why this is the case is an active subject of research and debate. Whatever one’s views about the inherent value of a rising share of manufacturing in total employment, a key factor is to understand why there is limited investment in economic activities that generate higher productivity per worker than in agricultural production or associated rural activities. Many services are relatively skill intensive and are associated with higher productivity, but some relatively low-skilled services activities also offer opportunities for real wages that are higher than in agriculture – e.g., related to the tourism industry. One reason for the observed pattern of (lack of) transformation in Africa may be that the overall “services environment” is such as to preclude investment in higher-value activities – whether these are in agriculture/processing, manufacturing or services-related. This is generally captured in the literature through analysis of the role of the investment climate and business environment as a determinant of investment incentives, but it can also be viewed through the lens of whether firms (potential investors) have access to the services they need in order to be able to produce competitive products.

Services are increasingly tradable as a result of technological advances, investments in ‘backbone’ infrastructure and connectivity, and policy reforms that increase the contestability of services markets, including liberalization of FDI and gradual progress in regional integration within Africa. These developments permit increases in direct exports of services by allowing the sale/provision services over ICT networks, and suppliers/customers to physically move to satisfy the proximity constraint that still prevails in allowing services transactions to occur. While developments in areas such as development of software and apps, business process outsourcing and the like attract much attention, more important perhaps is the role that services trade can play in impacting on industry-level competitiveness and the ability of entrepreneurs to participate in value chains and to add value to products.
Reducing trade costs in Africa is in (large) part a challenge of increasing productivity in a variety of services activities, most obviously in the areas of transport and logistics, less obviously in areas such as communications and financial services. The level of trade costs associated with moving goods and services (including services providers) from one country to another is in large part a function of the costs of the services that are needed to enable cross-border movement. But trade costs are also a function of the quality and costs of a large variety of intermediate services that are inputs into production of trade goods and services. The lower is the productivity of firms providing intermediate services, the more disadvantaged the sectors that source from them.

Trade in services, broadly defined to span both cross-border exchange through telecommunications channels and the temporary movement of service suppliers or consumers, and foreign direct investment (FDI) (establishment in a host country foreign affiliates that produce/sell services) is a therefore one potential channel for productivity growth. Trade in services allows specialization according to comparative advantage. In that regard there is no difference between goods and services. What is different is that trade in services requires movement of providers, whether legal entities or natural persons, both of which imply that a (much) broader range of policy instruments and underlying public policy concerns arise than in the case of trade in goods. Another difference, at least in degree, is that many services are critical inputs for a large number of different industries, and thus that imports of services may be a particularly important channel for productivity growth.

This paper reviews some of the literature on trade in services, with an emphasis on recent analyses of services trade policies and their effects. The plan of the paper is as follows. Section 1 briefly discusses the role of services in development and growth, the potential role of trade in services, and recent evidence on the magnitude of services trade costs. Section 2 turns to services trade policies, summarizes some of the extant literature on the impact of services trade and investment policies and discusses recent findings for a sample of African economies of the relationship between services trade barriers and productivity of downstream firms. This indicates that market opening can bring significant gains in productivity, but that the magnitude of such productivity effects is determined in part by the quality of economic governance. Section 3 discusses what could be done through regional integration to reduce services trade barriers, the state of play in this regard in Africa and what research on services trade policy suggests should be on the agenda looking forward. Section 4 concludes.
1. Services and Structural Transformation

The share of services in total output and employment for the world as a whole has been increasing over time as countries become richer. This is nothing new (Kravis, Heston and Summers, 1983; Herrendorf, Rogerson and Valentinyi, 2013), but for any level of economic development the role of services in the economy is today more important than in the past as a result of technological changes in information and communication and other industries. Efficient services are critical for economic development. Many services are inputs into the production of other services and goods. As a result, their cost and quality impact on the growth performance of the economy. An important economic characteristic of many services is their “intermediation” role: intermediate or producer services support the process of ever-finer specialization associated with economic development. Producer services are not only differentiated intermediate inputs into production. They perform an important function in coordinating production processes, both within, and increasingly, across countries.

Recent initiatives such as the OECD-WTO Trade in Value Added (TiVA) database have educated many in the trade policy community about some basic features of economic structures and international exchange that have long been understood by specialists and that are part and parcel of the national accounts and input-output tables: services account for a significant share of the value added of all sectors in the economy. Consequently, by definition, services play a much larger role in international exchange than is measured by a nations’ balance of payments. At least 50 percent of global trade on a value-added basis comprises services: the sum of the value of services output that is traded directly and is captured in BOP statistics (some 20 to 25 percent of total exports), plus the value of services that are embedded in trade goods (another 25 to 35 percent). Case study evidence suggests that at the level of the enterprise the services-content of output (the share of services in total costs or total value added) is high in both developing and developed countries (Low, 2013). However, the services intensity of production is higher on average in high-income countries, reflecting a steady

Francois and Reinert (1996) note that: (i) the share of value added originating in services is positively linked to the level of per capita income; (ii) income levels are positively associated with employment shares for intermediate services and with the share of services activities within total manufacturing employment; (iii) income levels are strongly linked to demand by firms for intermediate or producer services, particularly in manufacturing; and (iv) changes in the allocation of service activities between manufacturing and service firms (outsourcing) explains only a small share of service sector growth – fundamental changes in the structure/organization of production dominate. See also Park and Chan (1989) and Schettkat and Yocarini (2006) for a discussion of ‘stylized facts’ regarding the changing role and structure of services as countries become richer; Broadberry and Ghosal (2005) for a historical analysis of the role of services expansion in US economic growth in the 19th and early 20th century; and Young (2014) and Herrendorf et al. (2013) for recent analyses that revisit both the stylized facts and contest some of the shibboleths in the literature that the scope for productivity improvement in services is inherently much more limited than for other sectors.
increase over time in the use (reliance) on purchases by firms in all sectors of outsourced business and professional services. Berlingieri (2014) shows that structural transformation is not simply an inter-sectoral dynamic, but that within services shifts are important as well, driven by increasing demand for intermediate services. This helps to understand finding such as those by Young (2014) that average productivity growth in services is similar to that in other sectors, contrary to the received wisdom and long-standing presumption dating back to Karl Marx that most services are unproductive, best illustrated in Baumol’s celebrated view of the inherent “cost disease” that arises in services sectors. An implication is that contrary to what is often assumed in the macro literature, the rise of the share of services in GDP as countries grow richer is not sole a function of final demand patterns and income elasticities.

Services do not figure prominently in research on economic growth and development. Basic growth theory defines (increases in) aggregate income (output) as a function of (increases in) the quantity and productivity of capital and labour inputs, with long run (steady state) growth being driven by technological progress. No special role is accorded to services activities, with the exception of finance. Financial services can affect growth by facilitating capital accumulation and fostering innovation. In a survey of the relevant literature, Levine (1997) identifies five major functions that financial systems perform in reducing transactions costs and improving the allocation of real resources: facilitating the trading of risk, allocating capital to productive uses, monitoring managers, mobilizing savings through the use of innovative financial instruments and easing the exchange of goods and services.

Even if not explicitly incorporated into theoretical growth models, many services activities will have a powerful influence on growth. Low cost and high quality telecommunications will generate economy-wide benefits, as the communications network is a transport mechanism for information services and other products that can be digitized. Telecommunications are crucial to the dissemination and diffusion of knowledge—including through the Internet. ICT services are a “transport” mechanism for information services and other products that can be digitized. Similarly, transport services affect the cost of shipping goods and movement of workers within and between countries. Business services such as accounting, engineering, consulting and legal services reduce transaction costs associated with the operation of financial markets and the enforcement of contracts, and are a channel through which business process innovations are transmitted across firms in an industry or across industries. Retail and wholesale distribution services are a vital link between producers and consumers, with the margins that apply in the provision of such services influencing the competitiveness of firms on both the local and international markets. Health and
education services are key inputs into – and determinants of – the stock and growth of human capital. Further discussion of these different linkages can be found in Schettkat and Yocarini (2006), Eichengreen and Gupta (2009) and Berlingieri, 2014).

Francois (1990) notes that the growth of intermediation services is an important determinant of overall economic growth and development because they allow specialization to occur. As firm size increases and labour specializes, more activity needs to be devoted to coordinating and organizing the core businesses of companies. This additional activity is partly outsourced to external service providers. The “producer services” that are demanded and supplied as part of this process (such as information and communications services, accounting and logistics) are not just differentiated inputs into production. They play an important and distinct role in coordinating the production processes needed to generate ever more differentiated goods and to realize scale economies. The associated organizational innovations and expansion of “logistics” (network) services yield productivity gains that in turn should affect economy-wide growth performance.

Although a number of studies and reports have had a specific focus on the role of services trade and related policies for development (see for instance Mattoo and Payton, 2007; Cali et al., 2008, World Bank, 2010 and Saez et al., 2015), much of what is known about the way trade occurs, the policies that affect services exchange, the location of production (investment) and the characteristics of firms producing and consuming services is based on studies of developed economies – e.g., Breinlich and Criscuolo (2011); Wagner (2012). This literature has generated findings that will most likely apply to developing country contexts as well, however, i.e., that firm heterogeneity plays an important role in shaping patterns of services trade, much as is the case for trade in goods, and that foreign direct investment (FDI) is an important channel for firm entry and for technology transfer and diffusion (see, e.g., Jensen, Rutherford and Tarr, 2010).

A difference between trade in goods and services in terms of their growth impact and implications for employment is that imports of services often entail FDI. This is because the services either must be locally produced for technological reasons or because there are incentives to be close to the customer. As long as greater foreign factor participation is associated with increased competition, there will be a larger scale of activity, and hence greater scope for generating growth-enhancing effects. If foreign participation merely substitutes for domestic factors and the sector does not expand, i.e. the degree of competition remains unchanged, then there cannot be a positive growth impact on account of the scale effect. However, because services tend to be produced locally, greater competition will generally have less of an effect in forcing a reallocation of employment across sectors than in the case of liberalization of trade in goods (Konan and Maskus, 2006).
Conversely, a larger scale achieved merely by eliminating domestic barriers to entry and attracting domestic resources from other sectors would suffice to generate larger endogenous growth as resources are allocated to more productive resources. Even without scale effects and even if services sectors do not possess endogenous growth attributes, inward FDI following services sector liberalization can have positive effects on growth by bringing in new technology. There is substantial empirical evidence that FDI has positive effects of the productivity of economies by inducing greater competition and providing access to higher quality, greater variety and cheaper services (Francois and Hoekman, 2010).

2. Services trade policies and productivity

Research on the effects of services trade policies has been impeded by data limitations. Information on policies often is patchy at best, with time series data on key policy variables generally not being available on a cross-country, comparable basis, and such information frequently not existing at the country level either. This situation has changed recently with the publication of a new dataset by the World Bank that characterizes the restrictiveness of policies towards services trade and investment (Borchert et al. 2012). The World Bank database covers five services sectors and three modes of supply: cross-border trade, commercial presence (FDI) and temporary movement of service suppliers. Not all of these are relevant for all sectors, and in some case policies affecting a mode of supply apply to many or all sectors. The services trade restrictiveness indicators (STRI) are a numerical summary of applied services policies believed to affect trade flows. The more restrictive a country is towards trade and investment in services, the higher the STRI.

Figure 1 summarizes the data, which are available for only one year at present. The reported STRIs present an overall indicator, in the sense of a summary number that covers all sectors and modes. The average STRI for sub-Saharan countries included in the database is 32. The general picture that emerges is that African countries are relatively liberal when it comes to Mode 1 (cross-border supply of services), but have higher levels of trade restrictiveness in place for Mode 3 (sales through establishment by foreign affiliates, i.e., FDI) (not plotted). However, policy measures vary considerably by sector and country.
Services trade policies matter for many dimensions of economic performance. For example, services trade policy has also been shown to matter for product differentiation and diversification. Building a gravity framework for more than 100 countries Nordås (2011) finds that price-reducing liberalization in business services is associated with more product differentiation, particularly in the motor-vehicle industry. Based on these findings she argues that services market opening should be considered as an element of strategies for industrial upgrading in developing countries.

Miroudot and Shepherd (2015) find that a 10% increase in the level of services trade restrictiveness indicators (STRI) is associated with an increase in trade costs of 2.7%, using trade costs data compiled by Arvis et al. (2015). For intermediate trade, a similar change in the STRI is associated with a 3.1% increase. Results are strongest for postal services and telecommunications. Interestingly, the coefficient for intermediate trade is larger than that for final trade, which provides some evidence that services trade restrictions matter more for intermediate trade than for final trade (Figure 2). An implication is that trade costs are in part determined by trade and investment restrictions in services that increase the cost of transport, distribution, storage, logistics and other services that are inputs into production and exchange. Achieving lower trade-related operating costs is therefore in part a services agenda. Borchert et al. (2015) note that many landlocked African countries restrict trade in services that are particularly important for overall trade performance – e.g., on average air-transport policies are significantly more restrictive than in other countries, reducing connectivity with the rest of the world. The consequence is more concentrated market structures and less access to transport services. Even moderate liberalization of air transportation services by landlocked Sub-Saharan countries could generate a 20 percent increase in the number of flights.
Figures 3 and 4 plot World Bank Enterprise Survey data and report the correlation between the share of firm sales that is exported and the quality of logistics services in each country, as measured by the World Bank Logistics Performance Indicators (LPI), distinguishing between large firms and SMEs. Average export performance is stronger for large firms than SMEs, with exports accounting for an average of 29% of sales of the former, but only 16% for the latter. This result is not at all surprising given the extensive evidence that large companies generally export much more than small ones. What is relevant here however is the relationship between the LPI and export performance. For both sets of firms there is a positive relationship, which is again not surprising given that logistics are not just a direct monetary cost factor but are as if not more important in reducing the time costs and uncertainty associated with international transactions. The simple regression analysis suggests that logistics performance is more important for SMEs than for large firms: the LPI accounts for more than 12% of the observed variation in the percentage of sales directly exported for SMEs, but only 2% for large firms. Hoekman and Shepherd (2015a) show that this conclusion continues to hold using fully specified econometric models that control for standard determinants of export performance.
Of particular interest from the perspective of this paper is the effect of services trade policies: measures that limit the ability (raise the cost) for foreign firms to provide services in a market. Empirical research on this question is of relatively recent vintage due to the absence of data on prevailing policies. In an early paper, Mattoo et al. (2006) use a cross-section regression framework to show that countries with open financial and telecommunication sectors display a GDP growth rate about 1.5 percentage point higher than other countries. Eschenbach and Hoekman (2006) find that liberalization and adoption of good practices in the regulation of financial, telecommunications, energy and transport services were statistically significant explanatory variables for the economic performance of a sample of 20 transition economies during the 1990-2004 period. Focusing on trade
outcomes, Gabriele (2006) demonstrates the existence of a positive and robust correlation between cross-border services exports and long run GDP growth for a sample of developing countries.

A positive association between policy reforms in services and inward FDI in services, and between total factor productivity (TFP) growth performance of downstream firms and FDI is perhaps the most robust finding to emerge from the limited empirical research on the impacts of services reforms (Francois and Hoekman, 2010). FDI is a particularly important channel for international provision of services and associated transfer of knowledge and know-how, as well as a mechanism through which higher quality, lower cost services improve total factor productivity of firms that use services relatively more intensively.

Using data from over 1,000 firms in 10 sub-Saharan African economies, Arnold, Mattoo and Narciso (2008) also find a statistically significant positive relationship between firm-level TFP and the productivity of two services industries (communications and financial services). Other empirical studies have focused on specific countries so as to allow analysis of changes in policies over time and obtain find similar results, e.g., Arnold et al (2011 and 2015) for the Czech Republic and India, respectively, Bas (2014) for India, Duggan et al (2013) for Indonesia, and Fernandez and Paunov (2011) for Chile. Similarly, Barone and Cingano (2011) and Bourlès et al (2013) use industry level data for OECD countries and find that that pro-competitive policies in the services (upstream) sectors have a positive effect on the productivity of downstream manufacturing. Miroudot et al. (2012) use a gravity model setting to estimate cross-border (mode 1 and mode 2) trade costs in 12 services sectors for 61 countries and finds that lowering trade costs by 10% is associated with 0.5% gain in services TFP. Van der Marel (2012) shows that services trade and investment policies (notably FDI regulations) form a determinant for TFP growth in services.

Hoekman and Shepherd (2015b) build on these types of analyses using more recent data for a much larger sample of firms and developing countries. Using World Bank enterprise survey data for 58,000 firms in over 100 developing countries, they find that service sector productivity matters for the productivity of downstream firms producing goods, with services productivity mattering more for those firms that use services relatively intensively in their overall input mix, as is to be expected. The strength of the productivity linkages varies substantially across African countries in their sample, reflecting differing intensities of use of services inputs in the production process. They also find that the relationship depends on services trade: lower barriers to services trade and investment increase the productivity performance of domestic manufacturing industries. They find that at the average rate of services input intensity, a 10 percent improvement in services productivity is associated with an increase in manufacturing productivity of 0.3 percent, as well as higher exports of manufactures.
While the effects are statistically significant, they are relatively small in magnitude compared with the findings in the above mentioned country case studies, suggesting that country-specific and institutional variables may play an important intermediating role. As in the country specific analyses briefly mentioned above, less open FDI regimes appear as the core causal channel for this link.

Hoekman and Shepherd (2015b) also use a gravity regression framework analyse the relationship between levels of services trade policies and merchandise export performance, using services trade restrictiveness indices (STRI) that have been compiled by Borchert, Gootiiz and Mattoo (2012). They find that STRIs are a statistically significant determinant of manufactured exports performance, a finding that is robust to the inclusion of the overall level of trade restrictiveness that is applied against manufactured exports directly. A 10% increase in the restrictiveness of services trade policies is associated with a 5% decrease in bilateral trade in manufactured goods. While this is a partial equilibrium result, as there is not account taken for general equilibrium effects, this is substantially greater than the estimates based on firm-level data. The main channel through which services trade restrictions negatively affect manufactured exports is through FDI. At the sectoral level, restrictions on transport and retail distribution services have the largest negative impact on exports of manufactures. The strongest impact is found in the retail sector. To understand this result, it is important to note that the retail STRI is de facto correlated with restrictions on trade in distribution services. Distribution and logistics are key to the production and movement of goods, both within and across countries. Given that international production networks and supply chain trade depend on efficient distribution and logistics services (World Bank, 2014), it is unsurprising that the impact of trade restrictions affecting retail services should have an impact larger than that of any other sector considered in the analysis. Trade restrictions that reduce transport sector productivity have the next most negative impact on exports of manufactured goods.

Results for specific countries help to provide a sense of how variation in STRIs impacts on trade performance. Focusing on the East African Community member states, which tend to be somewhat less restrictive towards trade in services than the average nation in sub-Saharan Africa, but where three out of five EAC member countries have an average services trade restriction score that is 30 or higher, Hoekman-Shepherd argue that if the EAC countries as a group were to reduce their average level of services trade restrictions to the level of Ghana (the African country with the lowest services trade barriers, with an STRI of 18), merchandise exports of EAC countries could increase substantially: by 13% for Rwanda, and some 20% for Kenya, Tanzania and Uganda.

There is a big difference in the Hoekman-Shepherd estimates of potential impacts of better services performance on merchandise exports using the WBES data and the estimated impact of services
trade reforms on merchandise trade based on gravity regressions using overall country-level trade data. The estimates of services trade policy reforms using trade data indicate there is great potential for export growth if African firms were able to improve their access to services inputs following a reduction the STRI, especially ‘backbone services’ such as transportation, retail distribution and telecommunications. Beverelli, Fiorini and Hoekman (2015) help to understand what may be driving the differences in estimated impacts of STRIs. They follow the approach proposed by Rajan and Zingales (1998) that has become widely used in the economic literature and assume that the effect of services trade policy on downstream industries is a positive function of the intensity with which services are used as intermediate inputs. Using the World Bank STRIs, they estimate the following model:

$$ y_{ij} = \alpha + \beta CSTRI_{ij} + \mu (CSTRI_{ij} \times IC_i) + \gamma x_{ij} + \delta_i + \delta_j + \epsilon_{ij} $$

where $y_{ij}$ is the natural logarithm of productivity in downstream sector $j$ in country $i$, $IC_i$ is a measure of economic governance (quality of the investment climate) in country $i$, $x_{ij}$ is a control variable (the average level of tariff protection for non-services inputs used by downstream manufacturing sector $j$) and $CSTRI_{ij}$ is a measure of the effective restrictiveness of services trade policy confronted by downstream sector $j$ in country $i$. The latter is constructed by calculating $\sum_s STRI_{is} \times w_{ij}^s$ where $STRI_{is}$ is the level of services trade restrictiveness for country $i$ and service sector $s$ going from 0 as complete openness to 100 as full restrictiveness and $w_{ij}^s$ are a set of weights that reflect the use of service $s$ by manufacturing sector $j$ in country $i$. The input-output for the United States is used to calculate these weights. The same approach is used to weight the effect of import tariffs on intermediate goods used in downstream manufacturing sectors.

Using industry-level data for a sample of 57 countries they estimate the effect of services trade openness on productivity in downstream manufacturing. As in the rest of the literature they find a positive and statistically significant impact between lower STRIs and labor productivity. However, on interacting their measure of input-use- weighted STRIs with different governance variables they find that the effects of services trade restrictions are mediated by the quality of domestic economic governance. Thus, a similar services trade policy reform in two countries is predicted to have very different impacts on productivity of downstream sectors if the quality of institutions, as proxied by

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2 Input output weights are given by shares of intermediate consumption. Beverelli et al. (2015) show that the estimation results are robust to the use of technical coefficients or weights derived from the Leontief inverse matrix, and that the coefficient estimates do not change substantially if the input-output of China is used. For discussion and assessments of the appropriateness of using US weights as an indicator of the technological linkages between industries see for instance Rajan and Zingales (1998) and Barone and Cingano (2011).
indicators such as control of corruption and rule of law, differs a lot. The positive effect of trade openness conditional on quality of economic governance is not capturing differences in level of economic development. The results are insensitive to controlling for the level of per capita income.

An explanation for the effect of institutional quality may be related to the characteristics of services. Many services are not storable, so that foreign suppliers need to establish a local presence in the market in order to provide services. Policies that restrict establishment will then impede trade. But removing such policies may not be enough. The need to establish means that foreign firms will also consider the business environment they must operate in. The implication is that the quality of economic governance and related institutions will have an impact on the effect of services trade reforms. Good economic governance, measured by variables such as control of corruption, the quality of regulation and strong rule of law, significantly increases the potential gains for an economy of services trade liberalization. This result has important implications for the design of services trade policy reform. In developing countries with very weak institutions the gains from services trade liberalization may be small, suggesting a need to focus attention on improving economic governance.\(^3\)

This relationship between institutional quality and STRIs is illustrated in Table 1 for the African countries in the sample analysed by Beverelli et al. (2016). Their estimated coefficient on \(CSTRI_{ij}\) (\(\beta\)) and the estimated marginal effects for the interaction effect (\(\mu\)) provide a qualitative assessment of the impact of higher services trade policy restrictions on downstream industries, assuming at least some level of demand for services is observed. The marginal effect of reducing barriers to services trade on downstream productivity accounting for cross-country heterogeneity in economic governance \(-\frac{\partial y}{\partial CSTRI} = \beta + \mu \times IC_i\) increases with the quality of governance (\(\mu < 0\)) and it is positive and statistically significant at the 0.05 percent level for 65% of their sample observations (33 out of 57 countries). This result is robust to a variety of alternative approaches and instruments to account for measurement and endogeneity issues.\(^4\)

To quantitatively assess how much the effect of services trade policy is influenced by economic governance quality in a country, the coefficient estimates can be used to calculate the productivity

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\(^3\) The need to complement liberalization with reforms targeting broader economic governance is consistent with the conclusion by Kasekende (2007) in his analysis of financial sector reforms in Uganda and the arguments in Hoekman, Mattoo and Sapir (2007) on the design of services trade agreements and services trade liberalization.

\(^4\) Robustness checks in Beverelli et al. (2015) include instrumentation and random assignment of the policy component \((STRI_{ij})\) of the composite restrictiveness indicator; estimation with alternative input-output weights and alternative productivity measures, and variations in country and industry coverage.
changes associated with complete removal of the restrictions to services. As a completely unrestricted trade policy regime corresponds to an STRI with a value of 0. Therefore, the policy change associated with a country removing all existing barriers to trade through commercial presence in services sector is given by \((0 - STRI_is)\). The variation in the independent variable \(CSTRI\) reflecting full liberalization of trade across the four service sectors (transport, communications, finance and business services) is then given by:

\[
\Delta CSTRI_{ij} = \sum_s (0 - STRI_{is}) \times w_{ij}s
\]

The associated change in productivity (expressed in levels) implied by the estimated coefficients \((\beta\) and \(\mu\)) can then be computed as follows:

\[
\%\Delta Y_{ij} = 100 \times (\beta + \mu \times IC_i) \times \Delta CSTRI_{ij}
\]

The productivity effect of the services trade policy of a country is a function of services input intensities at the downstream sector level and two country-level variables. The first is the policy change required to reach complete openness \((STRI=0)\); the second is the quality of economic governance. Results are reported in Table 1 for the African countries in their sample.

In Table 1, “Impact” refers to the estimated percentage change in sectoral labour productivity of removing all barriers to FDI in financial, transport, communication and business services, as measured by the World Bank’s STRI for mode 3. This impact is reported for the largest and for the second largest manufacturing sector in each country. The column “current institutions” is simply the estimated impact, while the figures in the columns labelled “High Institutions (Africa)” measures the effect on labour productivity under a counterfactual scenario where the governance variable (rule of law, regulatory quality, control of corruption respectively in panel A, B and C) is set at level of the African country with the best performance on each respective variable in our sample. “High Institutions DNK” is a much more ambitious counterfactual in which the institutional variables are set at levels observed in Denmark – generally one of the highest performing countries in terms of economic governance indicators. The last 2 columns report the ranking of countries in terms of STRI levels (the more restrictive or the weaker the governance performance, the higher the number).
Table 1: Impact of removing Mode 3 services barriers on downstream labour productivity (% change)

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<td>Botswana</td>
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<td>28.18</td>
<td>34.04</td>
<td>57.36</td>
<td>food/bev</td>
<td>31.37</td>
<td>37.89</td>
<td>63.85</td>
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<td>Burundi</td>
<td>food/bev</td>
<td>-6.18</td>
<td>27.57</td>
<td>46.46</td>
<td>metals</td>
<td>-2.22</td>
<td>9.92</td>
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<td>Ethiopia</td>
<td>food/bev</td>
<td>7.68</td>
<td>97.24</td>
<td>163.86</td>
<td>minerals</td>
<td>12.6</td>
<td>159.51</td>
<td>268.80</td>
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<tr>
<td>Malawi</td>
<td>food/bev</td>
<td>8.82</td>
<td>26.41</td>
<td>44.50</td>
<td>chemicals</td>
<td>8.48</td>
<td>25.39</td>
<td>42.78</td>
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<td>18.33</td>
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<td>food/bev</td>
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<td>92.24</td>
<td>coke/oil</td>
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<td>16.77</td>
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<td>9.44</td>
<td>41.21</td>
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<td>minerals</td>
<td>12</td>
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Panel A: Rule of Law (Highest Africa: Mauritius)

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<td>(A)</td>
<td>Current Inst.</td>
<td>(Africa)</td>
<td>(A)</td>
<td>(A)</td>
<td>STRI</td>
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<td>food/bev</td>
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<td>42.97</td>
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Panel B: Regulatory Quality (Highest Africa: South Africa)

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<td>(A)</td>
<td>(A)</td>
<td>Current Inst.</td>
<td>(Africa)</td>
<td>(A)</td>
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<td>STRI</td>
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<td>34.32</td>
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<td>food/bev</td>
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<td>Mauritius</td>
<td>textiles/app</td>
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<td>food/bev</td>
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<td>34.72</td>
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<td>17.97</td>
<td>52.83</td>
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</table>

Panel C: Control of Corruption (Highest Africa: Botswana)

<table>
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</thead>
<tbody>
<tr>
<td>Sector</td>
<td>Current Inst.</td>
<td>(Africa)</td>
<td>(A)</td>
<td>(A)</td>
<td>Current Inst.</td>
<td>(Africa)</td>
<td>(A)</td>
<td>(A)</td>
<td>STRI</td>
</tr>
<tr>
<td>Notes: Source of governance variables: World Bank Governance Indicators. Services trade policies from the World Bank Services Trade Restrictiveness Database. Labour productivity (output per worker) from UNIDO industrial statistics database. Sectors based on ISIC 2-digit classification (Food/Bev: 15+16; Textiles/Apparel: 17+18+19; Furniture/n.e.c.: 36+37; Metals: 27; Mineral Products: 26; Chemicals: 24; Coke/Oil: 23). “Current institutions” estimates are statistically different from zero only for Botswana, Mauritius and South Africa. Source: Based on Beverelli, Fiorini Hoekman (2015).</td>
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Food processing tends to be the largest or second largest manufacturing activity in all of the countries in the sample. Botswana and Mauritius have the best governance of this set of countries. If Botswana were to remove all mode 3 barriers, this would generate a productivity increase in the food and beverages sectors of some 24 to 34 percent, depending on the governance indicator that is used. Similar magnitude effects are estimated for Mauritius and South Africa. However, for the other countries the impacts would be substantially smaller, despite the level of mode 3 restrictions being higher. If, however, the 4 countries with weaker governance were to improve their institutional environment to that prevailing in the best performing Sub-Saharan African country, the positive productivity impact of services liberalization would increase by a factor of four to ten. Moving towards the Danish benchmark would increase impacts even more. While the magnitudes are only indicative they are nonetheless informative: they illustrate the importance of economic governance as a determinant of the gains from trade liberalization.

Of course, more than an open trade regime and improving economic governance will be needed to support competitive local services sectors and to generate positive productivity effects and lower trade costs. Services are relatively intensive in human capital, so it is important to have sufficiently high quality educational services at primary, secondary, and as it becomes appropriate, tertiary level (Saez et al. 2015) so as to ensure workers have the skills demanded by service suppliers in areas such as ICT, finance, and business and professional services.

Another area of policy that deserves attention is to identify and address monopoly power of providers of services inputs and/or monopsony power on the part of buyers located in services sectors (trading companies; retailers). This can lower domestic farm/factory gate prices and/or may result in retail prices that are higher than they would be if the relevant markets were characterized by greater competition. Questions that arise here are whether and how much market power firms have, and given any market power, what is done with it. Market power at any stage of a value chain can be expected to affect the distribution of the rents that accrue to the agents that are involved in the chain. These considerations point to the importance of competition policy and contestable markets, and more generally a pro-competitive business environment.

In practice the design of policy reforms and identification of priority areas for action must be informed by detailed analysis and consultations with stakeholders, including the business community (Hoekman and Mattoo, 2013). Particularly important is to recognize the need to go beyond the general findings relating to the importance of governance and to ‘unpack’ how different dimensions of the business environment and economic governance institutions, including sectoral
policies and regulation, impact on different services industries (see the contributions in Mattoo and Payton, 2007 for an example of such analysis for Zambia). The focus of policy needs to span the various dimensions of policy that impact on the structure of services markets. While trade policy, both as it pertains to goods and services trade, should not be neglected, even in countries with weak governance, given that an openness can be expected to be a force for better governance as more foreign firms enter the market, the point is that trade reforms need to be complemented by efforts to improve governance.

3. Regional cooperation and integration of services markets

Regional integration is a stated priority of many African countries. Until recently integration efforts were focused solely on goods trade. More recently there has been increasing attention given to services, although in many cases this is still quite limited in practice. Thus, in the context of the EPAs with the EU, services are left for the future. However, intra-Africa RECs do include a focus on services, with some having made significant progress in some dimensions – e.g. the EAC with respect to the intra-EAC movement of citizens. But there is still very much to be done to ease the temporary cross-border movement of people. Karingi and Davis (2016) note that the average African citizen needs to obtain a visa in advance of travel for 55 percent of the countries he or she may want to travel to. Inconsistencies and lack of clarity of the wording of the EAC treaty with respect to services trade and the temporary movement of services suppliers led leaders [in 201x] to authorize a rewrite of the relevant provisions ([cite]).

Services trade liberalization may be facilitated if pursued in a cooperative setting. This may be because of the type of political economy dynamics that prevail for trade in goods – quid pro quo reciprocity that helps to overcome resistance by domestic services interest groups – or it may simply be a necessary condition for obtaining access to partner country markets. Important in this regard is to recognize that services liberalization will often be supportive of the agriculture and manufacturing sectors and trade in their products. Regional integration needs to go beyond trade in goods and policies affecting trade in goods and include issues like transport facilitation and reducing barriers to regional trade and movement of service suppliers. There is also a major services dimension associated with addressing existing infrastructure gaps and weaknesses. Joint infrastructure investments may be a key element in making regional transport corridors work for example. Progress is being made on some of these issues – e.g., in the case of regional power pools (Karingi and Davis, 2016). But what is missing is a concerted focus on services.
Enhancing regional connectivity through trade facilitation and cooperation between Customs and tax agencies to establish joint border posts and single windows needs to be complemented by cooperation to create efficient road corridors and effective transit regimes that allow trucks and people to move across borders and along transport routes, and cooperation in the setting and enforcement of health and safety standards and certification/licensing of service providers.

These considerations point to the need to think through (re-think) the design and approach towards the negotiation and implementation of international trade agreements to support welfare-enhancing opening of services markets. The empirical literature on the design (content) and effects of services trade agreements suggests most have not been very effective at opening services markets (Dee and Findlay, 2007; Roy et al. 2007; Fink and Jansen, 2009; Adlung and Morrison, 2010; Miroudot et al. 2010). Unilateral reform instead appears as the prime channel through which steps toward liberalization have been made. Djiofack-Zebaze and Keck (2009) for example show that the effect of GATS commitments for the economic performance of the African telecommunication sector is rather weak as opposed to a strong positive effect of unilateral reforms. This points to the need to focus on national services trade policies. But that will not be enough, especially given the many countries in Africa and the many economies that are land-locked. As discussed in greater depth in Hoekman, Mattoo and Sapir (2007) and Hoekman and Mattoo (2013) it is important this goes beyond market access and includes efforts to improve and strengthen regulatory regimes. This brings us back to the results of Beverelli et al. (2015) on the key role that economic governance quality plays in determining the magnitude of the net gains from services liberalization.

[[TO BE REVISED AND EXPANDED]]

4. Concluding Remarks

Services play a critical role in economic growth and development. Trade in services is a key channel through which countries can exploit their comparative advantage. Sectors such as tourism or business process outsourcing are important activities that can generate substantial employment and foreign exchange earnings. More generally, however, it is important to recognize that that services activities affect economic development through a variety of indirect channels. Opening trade and investment in services to foreign competition is a source of new knowledge and new products that can have a major impact on the productivity, and thus competitiveness, of many firms in the economy. Services account for a substantial share of the total costs of production of many firms in many sectors. Reducing the costs and increasing the quality of available services is therefore a mechanism through which to increase economy-wide performance. But the recent economic
research literature also makes clear that services liberalization is not a panacea. The quality of prevailing economic governance, implementing institutions and regulatory regimes will determine how much a country stands to benefit from opening services markets to foreign competition. This is turn strengthens the case for a concerted and consistent focus on improving economic governance as a necessary condition for sustained growth. The more that trade agreements are designed to promote that goal the more valuable they will be from a development perspective. The question is how to do so, a subject that has not attracted the attention is deserves.

References


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Konan, D.E., Maskus, K.E., 2006. Quantifying the impact of services liberalization in a developing country. J. Dev. Econ. 81, 142–162.


