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# ***Determinants of Competitiveness and Factors affecting Productivity in Services***

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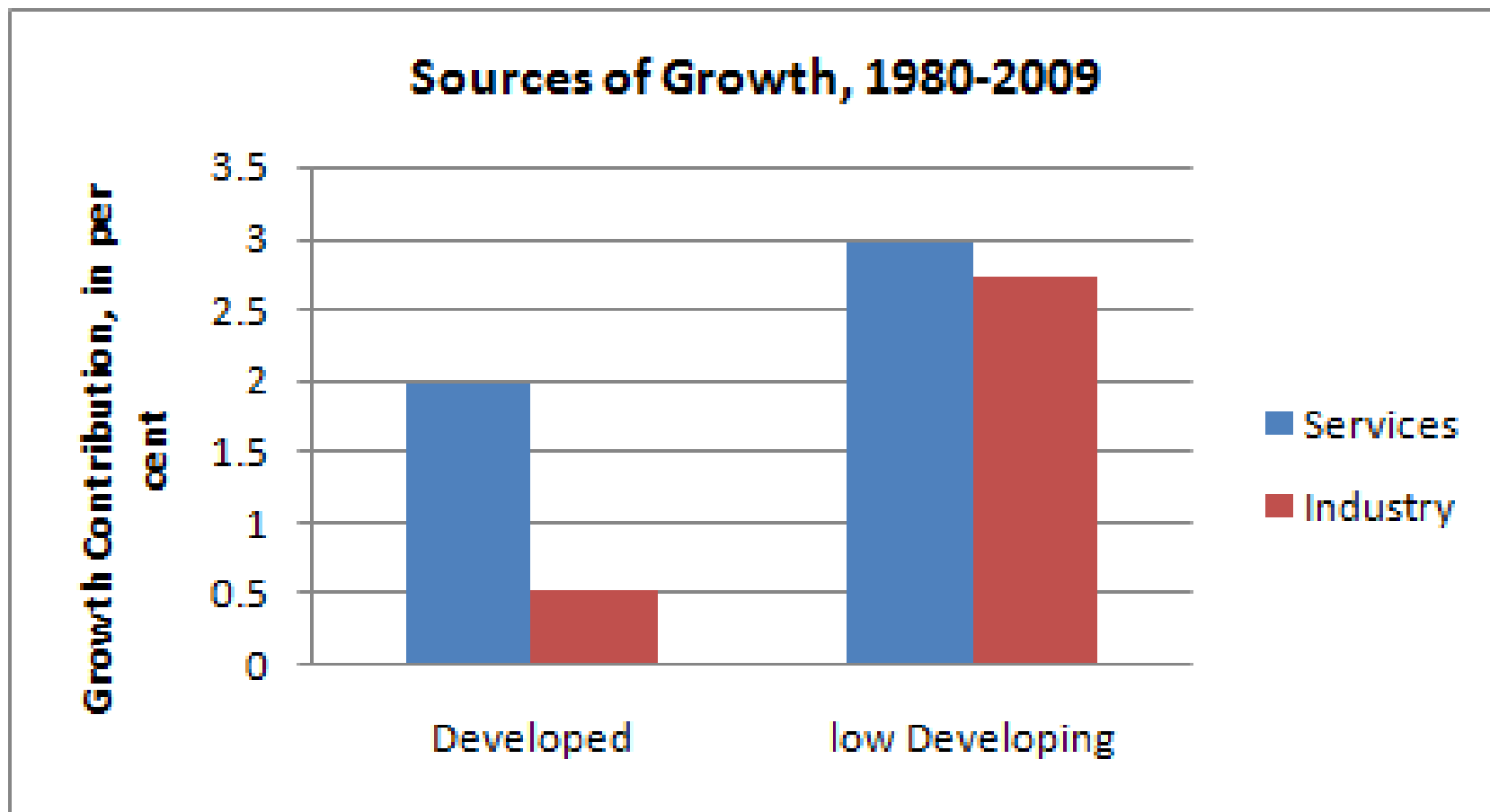


**Services Trade – New Approaches for the 21<sup>st</sup> Century**  
**PECC-ADB Conference; Chinese University of Hong Kong**  
**Thurs 2 June 2011**

# Outline of Talk

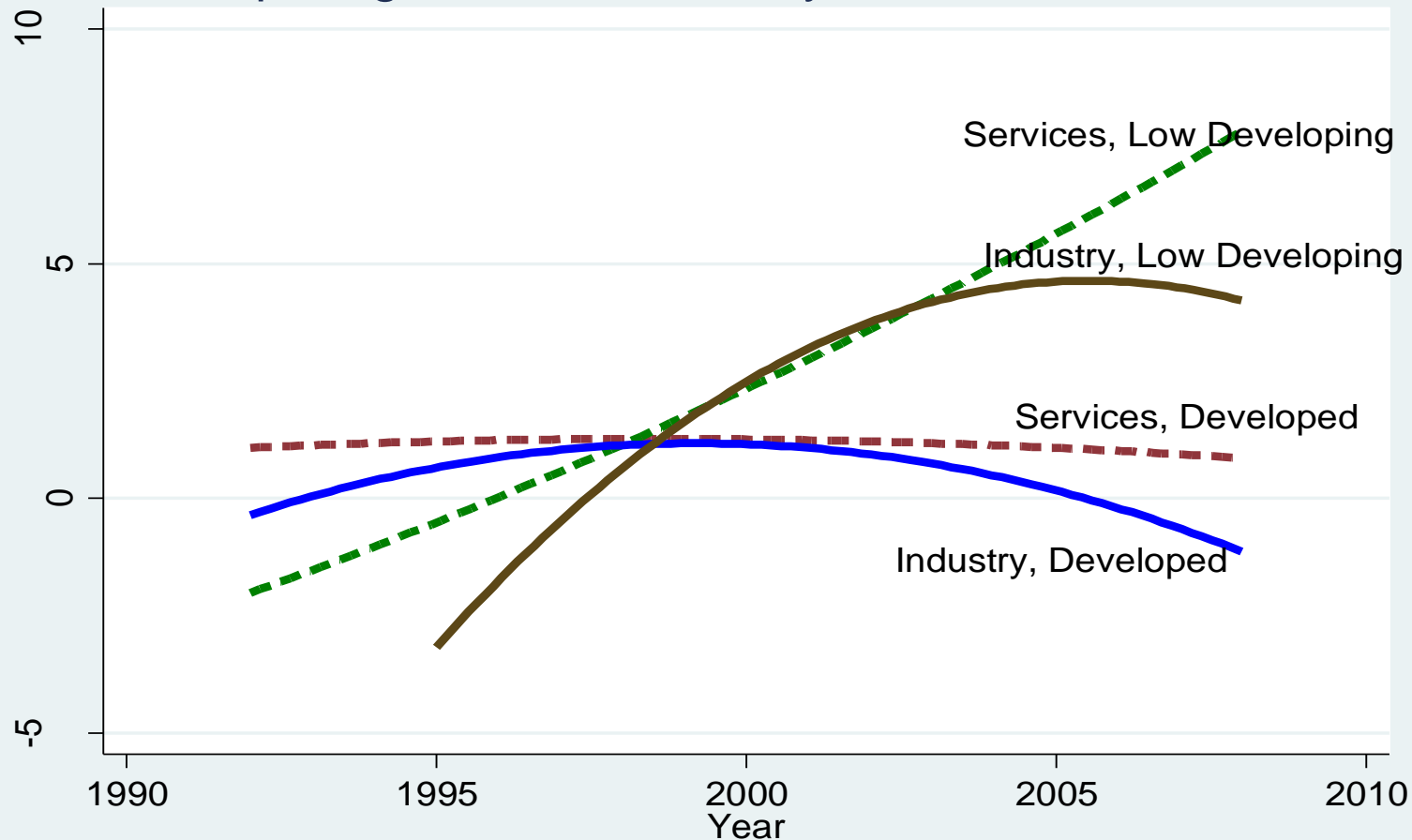
- Evidence of the importance of services
  - not just export of services that is important
- Factors underlying growth in services productivity
- Potential to “leapfrog”
- Policy toolkit
  - Institutions and regulation
  - International business engagement (trade and investment)
  - Innovation
  - education
- Sectors of importance
  - Financial and legal services
  - Information and communications technology

# Sources of growth in rich and poor countries



Ejaz Ghani Arti Grover Homi Kharas 2011, *Service with a smile: A new growth engine for poor countries*, 4 May 2011 [VoxEU.org](http://VoxEU.org)

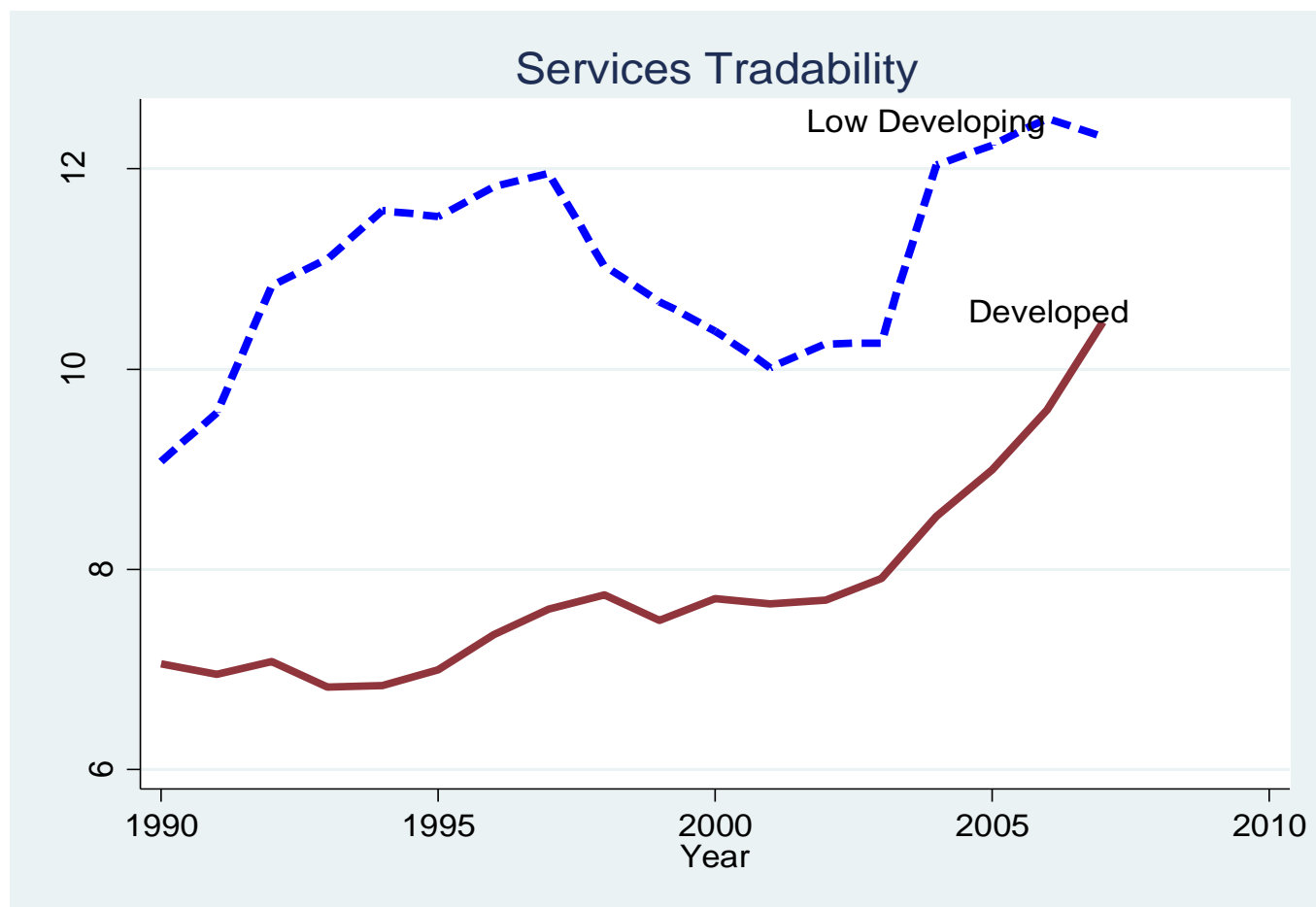
## Comparing Labor Productivity Growth across sectors



Ejaz Ghani Arti Grover Homi Kharas 2011, *Service with a smile: A new growth engine for poor countries*, 4 May 2011 [VoxEU.org](http://VoxEU.org) Source Authors' calculation based on World Development Indicators.

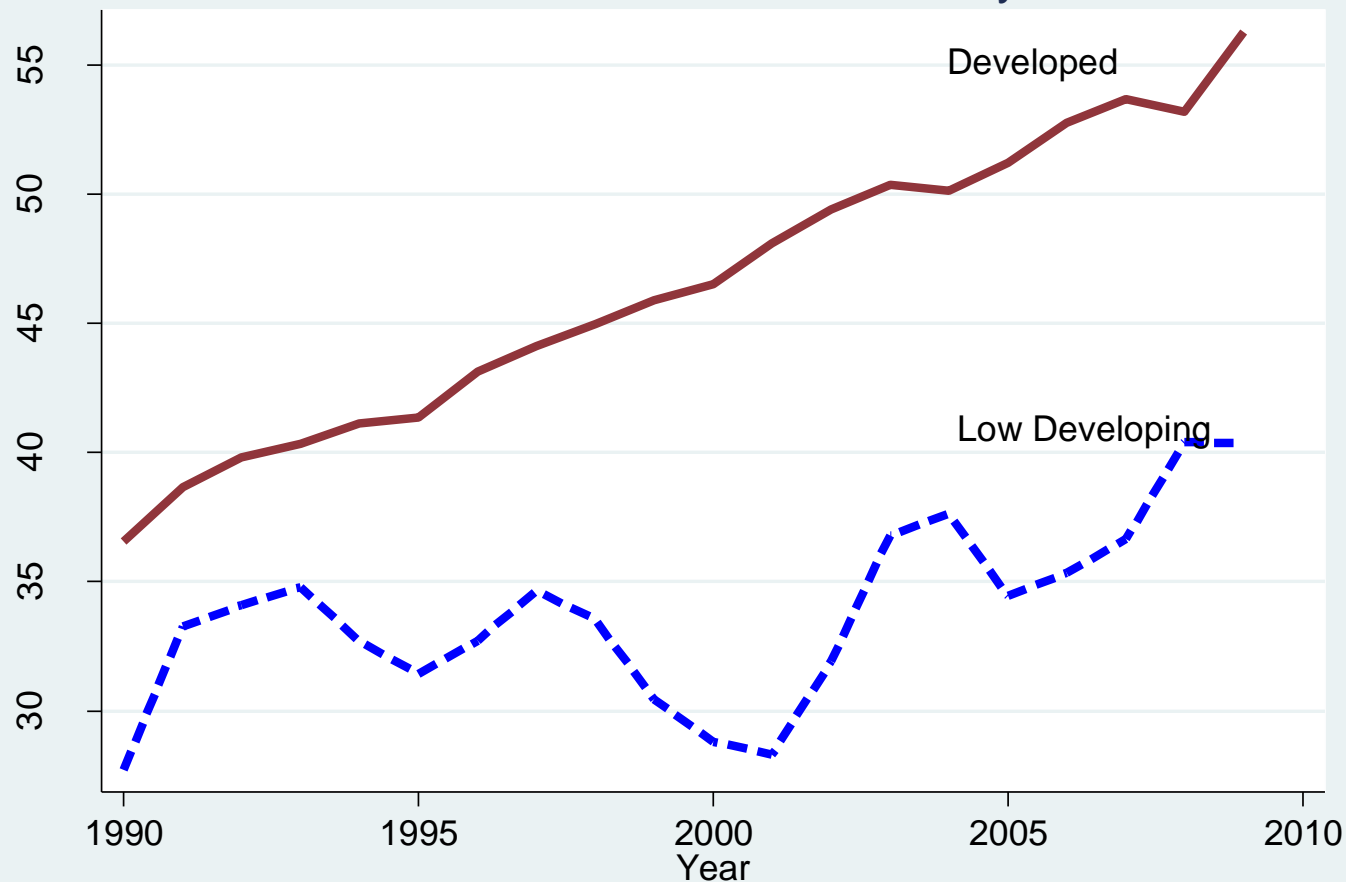
Note: Labour productivity is calculated as the sector value added per employee. Line shown is the best-fit quadratic function.

# Tradability of services is higher for poor countries



Ejaz Ghani Arti Grover Homi Kharas 2011, *Service with a smile: A new growth engine for poor countries*, 4 May 2011 [VoxEU.org](http://VoxEU.org)

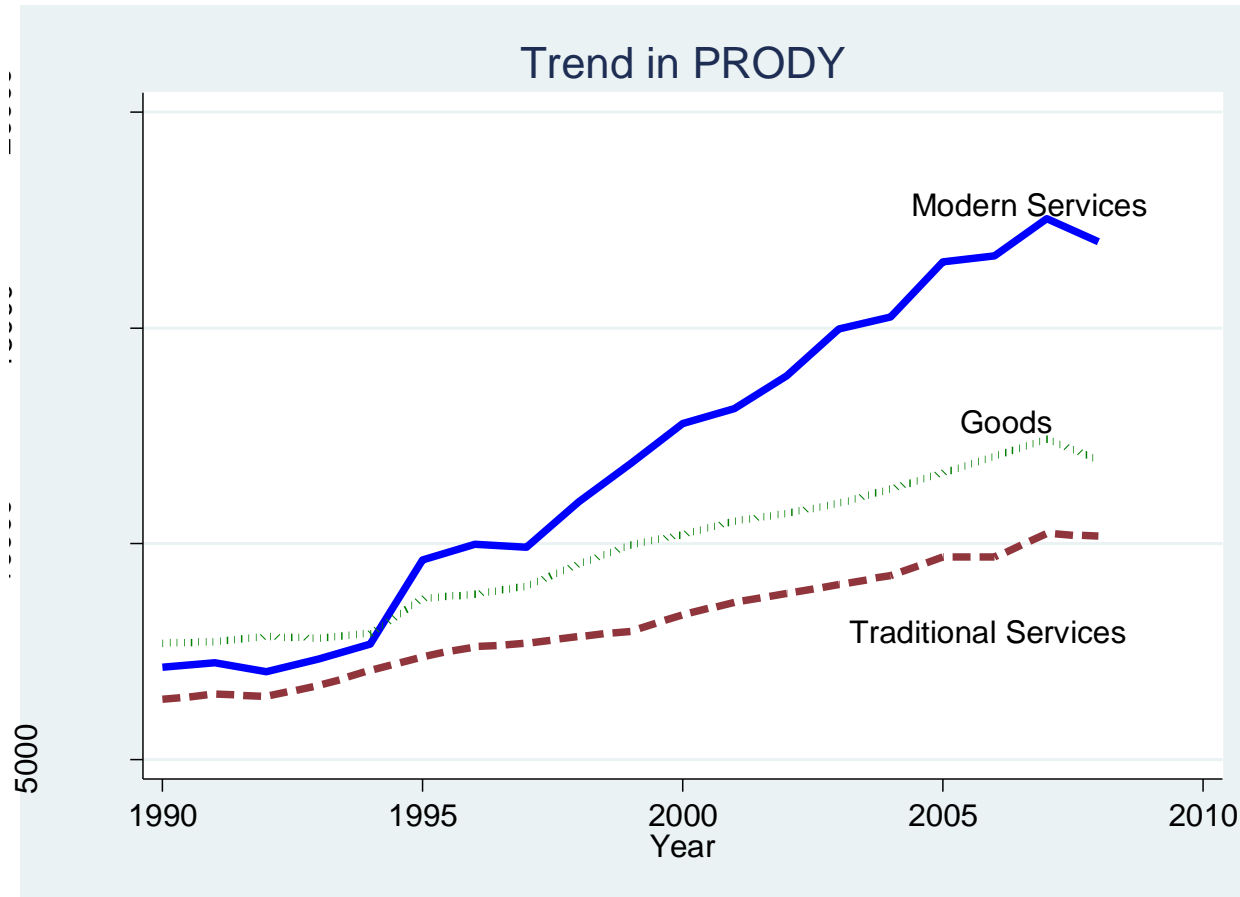
## Modern Services Tradability



Modern services  
defined as ICT  
intensive services

Ejaz Ghani Arti Grover Homi Kharas 2011, *Service with a smile: A new growth engine for poor countries*, 4 May 2011 [VoxEU.org](http://VoxEU.org)

# Modern services increasingly more sophisticated than goods and traditional services



Ejaz Ghani Arti Grover Homi Kharas 2011, *Service with a smile: A new growth engine for poor countries*, 4 May 2011 [VoxEU.org](http://VoxEU.org)

# Factors underlying growth in services productivity

- ICT
- Specialisation, outsourcing, privatisation, disintermediation, supply chain, interoperability, performance based standards, deregulation
  - Post-Chandlerian firm
  - Move of services into the market economy
  - Growth of financial services
- Innovation
  - Increased application of economy of scale and customisation processes
  - Self service/ better understanding the client interface
  - Application of research, including social science, humanities and arts as well as science and technology
- Knowledge-intensity
  - Increased value of knowledge
  - Increased share of workforce in professional and managerial occupations



# How do services firms engage internationally?

- Cross-border supply of services; eg digital services capable of being delivered via the internet
- Cross-border movement of services provider or services client
- Commercial presence/Investment in the target market
- Most services firms, in all services sectors, increasingly use a flexible combination of all these ways of engaging
- Growth of cross-border digital intra- and inter- firm trade has enabled development of services supply chains, and national centers of expertise

# Can poor countries catch up or even “leapfrog” in services

- Once it was believed that you could not leapfrog in manufacturing
  - Only when the factors underlying manufacturing competitiveness became well understood did it become possible
- It is more complex in services
  - Although services exports are growing, most services are domestic and therefore the biggest economic gains lie in raising the productivity of the domestic services sector
  - Services sector is ‘too big’ to subsidise
  - A modern legal, financial and ICT systems are needed as the foundation of a modern services economy
  - Is dependent on professional and other high level skills, although these by themselves are not sufficient.

## References

**Services - the new Manufacturing**, ASR blog, Andrew McCredie, 28 April 2011

**Can poor countries leapfrog manufacturing and grow rich on services?** May 19th 2011, The Economist

# Policy toolkit

- Institutions and regulation
- International business engagement (trade and investment)
- Innovation
- Education

# Institutions and regulation

- Specialisation, outsourcing, privatisation, disintermediation, supply chain, interoperability, performance based standards, deregulation
  - Post-Chandlerian firm
  - Move of services into the market economy
  - Growth of financial services
- A major source of services productivity has been through increased engagement by business in the delivery of services, including 'essential services' formerly delivered by government
- Information asymmetries are feature of many services markets, but we are understanding better how to regulate these markets so they work efficiently
- Competition policy and interoperability

# International business engagement

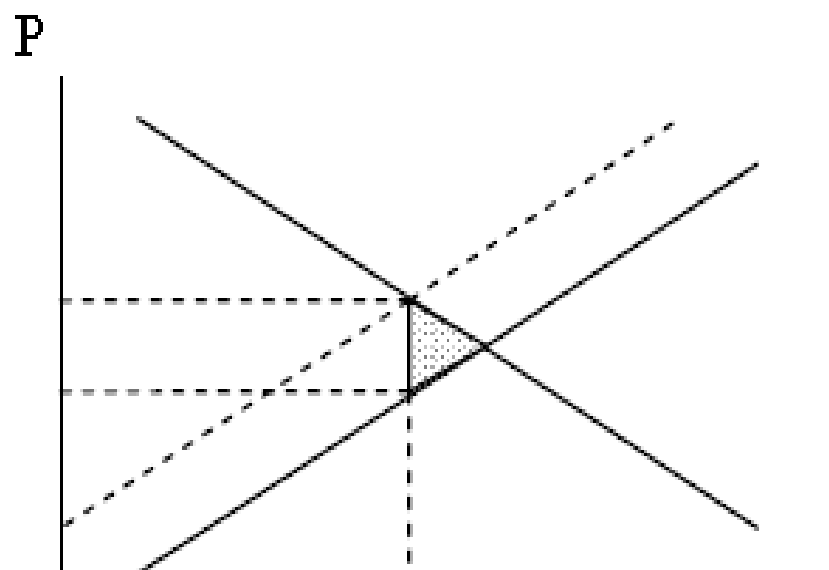
- There are strong spillovers from foreign investment into the domestic service economy
  - Economic literature on investment is focused on manufacturing and export related investment
- There are concerns in developed and developing countries that services trade liberalisation leads to job losses
  - The evidence is that the dominant effect is a rise in productivity
  - This economic impact is much like technological change
- Most services jobs are domestic – and cannot be ‘taken by foreigners’
  - Domestic productivity however can be substantially raised through international engagement, through adoption of new business models, technologies and absorbing new skills.
- Australian legal services, liberalised in 1986 and Malaysian retail liberalised in 1990s.

# Services Trade Barriers are mainly cost-escalating

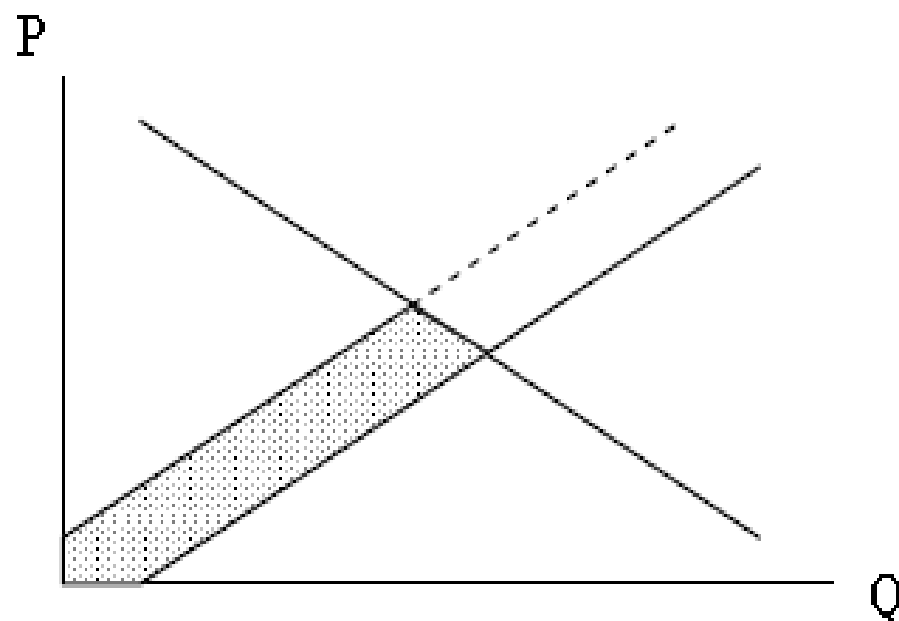
From *New Economic Challenge: responding to the rise of services in the Australian economy* ASR 2010

Figure 21 **Differential economic impact of reducing trade barriers**

Panel A: Rent-creating non-tariff barriers



Panel B: Cost-escalating non-tariff barriers

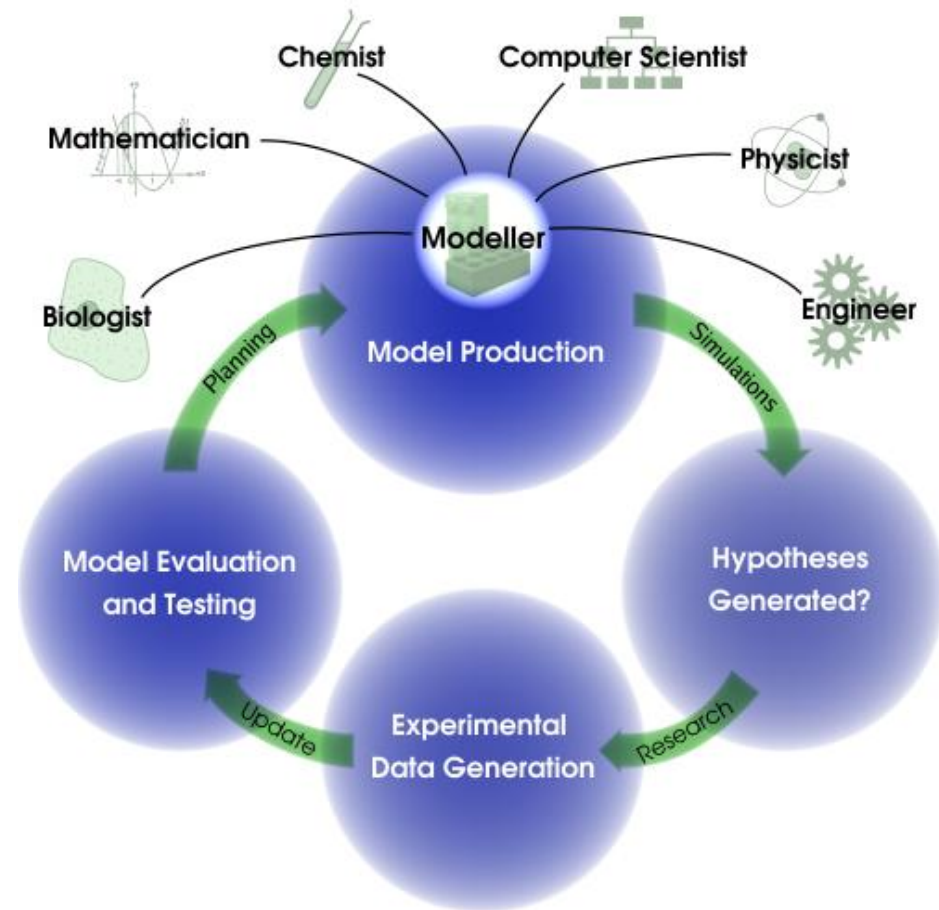


# Service Innovation

- Has been under-estimated and under-valued, in many instances can respond to similar approach as applied in traditional sectors
  - Increased application of economy of scale and customisation processes
  - Self service/ better understanding the client interface
  - Application of research, including social science, humanities and arts as well as science and technology
- Application of markets and marketing techniques to traditional services
  - Immunisation of children in rural Rajasthan, abysmal immunisation rates reversed by a small bag of lentils given as a sort of “reward”. This was opposed by public health officials, who thought “bribing” people was a bad way to go. *Poor Economics*, Abhijit Banerjee and Esther Duflo 2011
- Development of Service Science

# Services Innovation underpinned by Science

- Service Science - an emerging discipline that integrates:
  - Computer science
  - Engineering and design
  - New business strategies
  - Operational research
  - Social science and law
- Significant potential to enhance services innovation by adopting a multi-disciplinary approach





# SRII Focus on Services

## Service Verticals

- Health care
- Financial
- Energy
- Education
- Government
- Telecom
- Transportation
- Retail
- Etc....

See [www.thesrii.org](http://www.thesrii.org)

## Service Horizontals

- Technology  
(Architecture/Platform,  
Hardware, Software,  
Infrastructure)
- Service Business--  
Process/Tools/Models..
- Service Operation  
management
- Service  
Management/Leadership
- Service Marketing
- Human Factor Engineering/  
Skill sets

# Conclusions

- The services sector has long been neglected as a source of productivity and economic growth
- In both developed and developing countries the services sector is now the dominant source of economic growth
- At a conceptual level services productivity growth and the factors underlying it have been slow to develop, but are now reasonably well understood.
- A toolkit of policies to rapidly improve developing countries' services productivity has been described.