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Introduction

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The literature on global value chains (GVCs) has been growing fast over the past decade. It is diffused and has to deal with a rapidly changing world. The authors contributing to this collection of essays consider contemporary challenges and opportunities facing business and government, which in different ways determine the location, configuration and operation of GVCs. The role of services in GVCs is at the centre of the analysis. Through that prism, the chapters consider the extent to which services can act as a catalyst for fuller GVC participation to promote development, growth and jobs.

In what follows, chapter 2 by Low and Hassani focuses on the role of services in the global economy. It begins with a historical discussion of the distinguishing features of services, and considers some of the reasons for past neglect of the contribution of services to the economy, including their perceived incapacity to contribute to productivity growth. Attention is also paid to definitional challenges, measurability and data issues. Certain shortcomings in these domains have resulted in misleading analysis of the importance of services, especially in trade.

In chapter 3, Findlay discusses the challenges of making services work for development. He argues that there are some common principles among goods and services for the development and design of successful reform packages. However, a number of differences between reforms aimed at goods and those targeting services require closer attention. Political economy considerations related to local political interests may influence attitudes to foreign entry in services markets. If impediments to services affect costs, rather than profits, reform could have significant employment effects. If protection is higher in services markets than in goods markets, domestic services providers will be more severely affected. Where services suppliers are subject to universal services obligations – for example in telecommunications or public transport – the ability to finance these obligations may constitute an additional source of resistance to change.

Abrenica (chapter 4) discusses the challenges facing East Asian economies in surpassing the middle-income trap. Only a handful of these economies have attained developed country status, while a good number seem to be caught in a pit of relative economic stagnation. In mainstream literature, a huge part of the East Asian success story in attaining middle income status is attributed to the use of trade to promote domestic growth and overcome development hurdles. While the author does not deny that the realities of the present global ecosystem and the development challenges they present are different from the 1980s, she observes that many still see the East Asian model relevant insofar as it offers an escape path that combines trade with the right mix of domestic policies. The chapter considers how middle-income countries might escape the trap by leveraging their participation in GVCs. However, policy needs to give full play to the development of services as an enabler of trade.

In chapter 5, Stephenson and Pfister seek to clarify the discussion of governance in GVCs, including in the realm of services. They argue that the debate has been obscured by a lack of definitional clarity as to the meaning of the word 'governance'. The authors set out a typology of GVC governance in three different categories. First, industrial policy frameworks look at the governance of GVCs from the firm perspective. Second, national policy frameworks consider governance from an individual country perspective. Finally, in a global trading system framework, the focus is on the World Trade Organization (WTO) and major preferential trade agreements. Stephenson and Pfister maintain that governance considerations at the firm level are the most straightforward to comprehend. For the other levels of analysis, they lay out several recommendations to remedy governance gaps, urging the WTO and the international community to step up efforts in multilateral leadership, ensuring that any gains captured through more efficient GVC governance are beneficial for development and inclusive growth.

Pasadilla (chapter 6) looks at how financial services enable GVCs. She notes that no globally-accepted framework has been developed in this domain. The chapter seeks to demystify various structures and incarnations of supply chain finance by applying two lenses. One is structured trade finance and the other involves specific bank financing instruments that link suppliers and buyers in a supply chain relationship. The author argues that in order to facilitate supply chain financing for small and medium-sized enterprises (which are significant sources of revenue and job creation in developed and developing countries), there is a need to shift more broadly toward asset-based lending practices instead of balance sheet-based ones. This will require the reform of legal and regulatory frameworks in many economies, especially to facilitate financing for movable assets.

Chapter 7 (Tijaja) looks at the role of services in GVCs in the Association of South East Asian Nations (ASEAN). She observes that as trade, investment and GVCs have proliferated in the region, services have accounted for the largest share of direct investment inflows to the region in recent years. A number of ASEAN economies are seeking to overcome the middle-income trap and move up value chains, while others are seeking entry points for participating in GVCs. In all of these cases, services will feature more prominently in national as well as region-based agendas. The author argues that ASEAN's challenge is to further advance the region's understanding of services in order to shape a strategy, not only in the narrow terms of services integration, but also as an integral part of the region's development agenda. Beyond regional integration, future efforts should be informed by trends in e-commerce, additive/digital manufacturing, and data analytics, all of which have considerable services components where continuous innovation is a necessary element.

Nathan, Sarkar and Mehta (chapter 8) examine lessons from a 2004 decision by Airtel, an Indian telecommunications company, to outsource its entire information technology (IT) services requirement to a foreign company – International Business Machines Corporation (IBM) – rather than to one of several Indian IT majors, given the strong positioning of the latter companies in global outsourced IT services. The explanation is provided by taking a close look at the role of Indian IT companies in different segments of the IT services production network, with special attention to declining margins resulting from substantial increases in salaries. The authors argue that Airtel's decision hinged on IBM's stronger end-to-end service provision experience. Since that time, Indian IT companies have focused increasingly on developing end-to-end services and software products to remain globally competitive, while companies in the United States and elsewhere have been integrating low-end tasks (traditionally dominated by Indian IT majors) to provide fully managed services. This convergence between the US and Indian IT majors has significant implications for the role of services in India's economic development trajectory, which will necessitate addressing policies that promote human capital development, innovation and competitiveness.

In chapter 9, Mukherjee and Rawat examine how the outsourcing of business processes, also referred to as BPO, has enabled many businesses to improve the efficiency and effectiveness of their operations. Businesses have leveraged BPO to make their operations more scalable, flexible, resilient and cost effective, while delivering better service and value to their customers. Globally, the BPO industry has also created millions of jobs in low-cost countries, acting as a key enabler of economic transformation and opening up channels into the global services market. The authors argue that governments seeking to leverage the economic development potential of the BPO sector must adopt a planned approach to build capacity and market their value proposition. This requires that they enhance and mature their service delivery capacities and competitiveness, reduce capital and operational costs, and create business linkages with buyers of BPO services from target countries.

Cheung and Sit (chapter 10) consider the relationship between services and manufacturing activities in GVCs and examine the role of various policies in shaping value chain arrangements. Services are generally more highly regulated by governments than goods. Policies can impact costs and supply chain configurations in ways that are sometimes less than fully appreciated by policymakers and by business. They can add unnecessary costs if they are poorly designed or administered. The chapter identifies some of these policy influences, making reference to illustrations from case studies conducted by authors and their colleagues. The authors then explore approaches adopted in Singapore and Thailand, which have different economic structures and policy backdrops, in an attempt to set out government best practices for enhancing value addition of services in manufacturing GVCs.

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Contextualizing Services in the World Economy

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Introduction

Services are increasingly accorded a prominence in economic analysis and policy deliberation that they were long denied. This fresh focus is taking hold in tandem with the growing importance of services as a source of value in the global economy. The neglect of services can be explained largely in terms of western classical precepts, concerns about the sources of growth, traditional statistical conventions and the sparseness of data. Deep economic change is propelling their growing importance. Before analysing what is bringing about this change, it is worth taking a brief look at the growing contribution of services to gross domestic product (GDP) in different economies. Table 2.1 reports services shares in GDP for all income groups, geographical groupings and some individual economies. The table demonstrates two main things. The first is that worldwide, services are the most important source of value in the global economy, and by extension generate the greatest number of jobs and, on average, the most growth. The second is that services are consistently growing their share.

Table 2.1: Share of services in GDP by income group, region and selected countries (%)

Economy	**1980**	**1990**	**2000**	**2013**
World	n/a	n/a	67	70
High-income	n/a	n/a	70	74
Middle-income	39	44	50	55

Contd.

1 The contributors undertook this work while they were at the Fung Global Institute.

Low-income	n/a	41	45	46
East Asia and Pacific	n/a	n/a	n/a	n/a
Europe and Central Asia	n/a	n/a	n/a	n/a
Latin America and the Caribbean	n/a	n/a	n/a	n/a
Middle East and North Africa	n/a	n/a	n/a	n/a
North America	n/a	n/a	n/a	n/a
OECD	n/a	n/a	71	74
Sub-Saharan Africa	n/a	n/a	n/a	n/a
Bangladesh	48	47	53	56
Brazil	45	53	68	70
China	22	32	40	47
Hong Kong	n/a	n/a	88	93
Japan	58	60	67	73
Norway	58	63	7	59
Singapore	62	67	65	75
United Kingdom	n/a	67	72	79
Uzbekistan	n/a	34	43	48
United States	n/a	n/a	76	78

Source: World Bank, World Development Indicators (2015)

What about the preponderance of services in trade? The picture is quite different when contrasted with services in GDP. Historically, it has always been reported that services represent a small share of total exports. According to the WTO using traditional data, services were in the range 18.4 per cent (2011) and 23.4 per cent (2008) between 2008 and 2014 as a share of total merchandise imports (WTO, various years). These numbers are limited to services flows recorded separately, and in gross terms, in balance-of-payments statistics. When measured in a non-traditional way, in value-added terms consistent with the approach for measuring overall GDP, the share of services in merchandise trade was estimated at 45 per cent in 2008. That is an enormous difference and shows how poorly our understanding of the contribution of services to the economy has been because of the difficulties of extracting the appropriate data. We will revert to this issue in due course.

The rest of the chapter is organized as follows. Section 2 examines some of the reasons why services have been considered less important than they deserve over the years. Section 3 will seek to explain some of the statistical challenges encountered in dealing with services. Section 4 will explore aspects of services in national and global settings. It will consider how services are defined, whether it makes sense to attempt a definition of services based on their economic functions, and the issue of services and tradability.

The traditional neglect of services

Classical economic thought

The roots of economic reflection on services can be traced back to the classical thinkers. Adam Smith wrote in *The Wealth of Nations* that: '[T]he labour of a menial servant … adds to the value of nothing … services generally perish in the very instant of their performance, and seldom leave any trace or value behind' (Smith, 1776).

In essence, the issue turned on a distinction between productive and unproductive labour. Unproductive labour did not produce anything that contributed to accumulation in the cycle of production. A product that did not form part of a subsequent production process, nor embody value through accumulation, was unproductive. Services for consumption fitted into that category. Even today, with technological progress, many services are not storable and require instantaneous use, although contemporary reasoning would not relegate them to worthlessness.

In the classical framework, though, value tended to be attached to labour that made material commodities. Labour producing non-storable products was unproductive and such labour did not contribute to growth. This notion of value was not refuted by subsequent classical economists like Ricardo, but underwent modifications a generation or two later in the nineteenth century with influences from socialist thought, most notably from Marx.

Marx distinguished between the use value and the exchange value of a commodity, arguing that capitalist actors were only interested in the surplus value that could be realized upon the sale of a commodity rather than the mere use of it (Marx, 1867). As such, Marx concluded that productive labour is that which produces capital. If selling a good or a service produced capital, then the labour that would go into the production of this good or service would be 'productive' in nature. Marx did not place emphasis on physical accumulation when attributing value; rather, he underscored the importance of re-sale value of goods or services.

Needless to say, the role of services has evolved significantly since then, and the notion of productivity, in its multifaceted incarnations, has continued to be an important element in this evolution.

The Baumol cost disease

In the 1960s, Baumol and Bowen (1966), Baumol (1967) and Fuchs (1968) drew attention to what they viewed as an intrinsic lack of productivity associated with the services sector. These authors observed that labour productivity in the manufacturing sector grew much faster than in services industries, where it might not grow at all. These were labour-intensive services or relied heavily on human interaction, such as teaching and nursing.

Baumol and others argued that because productivity gains are primarily driven by technological innovation, over time services would become more expensive on a per unit basis. They were less amenable to technological advances than the manufacturing or retail sectors, for example. A key feature of the model was that wage levels were driven by those activities that generated productivity gains, thus raising wages inefficiently in some service industries. The market would not drive out the costly and unproductive service industries because they were considered socially essential and often supported by governments. Yet as economies became richer, those same service sectors would expand, aggravating the problem of low productivity growth.

In the wake of the technological integration of the knowledge economy in the late 1980s and early 1990s, along with more careful distinctions among categories of services and a re-thinking of the sources of productivity growth, fears regarding a cost disease trap receded. Baumol (1988, 1993), along with many others, contributed to this re-assessment of services in the economy. Francois and Hoekman (2010) reviewed a significant body of research that had been developing since the mid-1980s, suggesting that 'there is increasing evidence that services liberalization is a major potential source of gains in economic performance, including productivity in manufacturing and the coordination of activities both between and within firms' (Francois and Hoekman, 2010).

Manufacturing and neglect of services

Some recent commentaries and academic work on the implications of trade on jobs have pointed to massive job reductions in manufacturing employment (see, for example, Acemoglu *et al.*, 2016; Scott, 2015; Morley, 2006). The losses have mostly been attributed to trade with emerging economies, as opposed to productivity growth. The main point to be made here about this literature is that little or nothing is said about job opportunities in services, which have been growing as part of the process of adjustment to new competitive forces.

Similarly, in public policy discussions following the 2008 global financial crisis and its knock-on effects in the real economy, policymakers in advanced and emerging economies have tended to focus on increasing investment and net exports in manufacturing. Any consideration of services is frequently absent despite the fact that job expansion has been observable in services sectors, both in the context of manufacturing activities and in the wider economy.

This neglect is partly attributable to the statistical challenges of identifying and measuring services in production (see Section 3 below). Other factors on both the production and consumption side raising the economic footprint of services activities have also received less attention than deserved. A part of the explanation for this may be rooted in an embedded sub-consciousness that sees services as the poor cousin of manufacturing and perhaps other sources of value in the economy at large.

Services and productivity

The notion that services were characterized by low productivity took a narrower sectoral view than would be warranted today and additionally, was more prominent before the digital economy became what it is today. How, then, are services contributing to productivity growth? A major part of the story has to do with the advancement of technological innovation in the services sector; however, another, and arguably more policy-significant, component of the discussion relates to an evolution in the way productivity is perceived and understood. Productivity is a complex and multifaceted notion, and what follows only scratches the surface to illustrate some of the issues upon which clarity is required in order to make precise claims about changes in productivity.

A traditional measure of productivity, defined as output per working hour, is a single factor productivity measure that relates output to labour. The same approach could be used with labour and capital, although measuring the value of capital is harder than estimating hours worked by the labour force. These are relatively straightforward measures, but do not capture all sources of increased efficiency. The notion of total factor productivity (TFP) was developed in an effort to capture other sources of growth, particularly those emanating from services.

TFP is a multifactor measure that accounts for effects in total output not caused by labour and/or capital inputs, including technology, organizational efficiency, networks, institutions, and much more. TFP is not determined through a direct measure; rather, it is residual – what remains once labour and capital contributions to growth are accounted for. This has led many policymakers to assume that TFP represents the aggregate efficiency with which labour and capital inputs are utilized, a concept that at its surface seemed more aligned with the characteristic needs and drivers of the services sector.

As Krugman noted (1994), and as many other scholars, including Felipe (2008), have echoed, TFP by itself does not have a useful or meaningful purpose. In laymen's terms, Felipe draws attention to the 'cake problem,' where he draws an analogy between assessing the importance of a cake's individual ingredients to the size (or taste) of the baked cake, and analysing the individual contributions of labour, capital and TFP to the size of the economy (Felipe, 2008). It seems pointless to conclude that 40 per cent of a cake's size (or taste) is due to flour, 30 per cent due to butter, and so on, until a remaining 10 per cent is due to the cook's own skills. The cake tastes the way it does because of the interaction of the cook's skills, ingredients, cooking conditions, tools and utensils. Focusing productivity-augmenting policy efforts solely on TFP outcomes does not make sense.

What does this mean for policymakers? Improving productivity, especially in the services sector, requires a thorough understanding of an economy's specific dynamics including structural conditions, security, savings rates, educational outcomes (and returns to education), labour force development/training, rule of law, technological development and innovation, sustainability and all of the other factors that lead to prosperous economies.

The challenges of data

Identifying and pricing the product

The value of services has always been difficult to estimate. There are several explanations for this. Apart from the analytical neglect of services in the past,