

# Servicification: Its Meaning and Policy Implications

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Services account for about 80 percent of employment and 75 percent of GDP in OECD countries. In Korea, the ratio of the service industry in total employment is 70.2 percent, and its ratio in total GDP is 59.2 percent as of 2016.<sup>1</sup> In major emerging economies, the ratios are between 40 and 70 percent on both accounts. Furthermore, these ratios are steadily increasing over time.

In relation to this phenomenon, servicification means that services are becoming more important in manufacturing activities. In other words, the servicification of manufacturing can be defined as the fact that manufacturing increasingly *buys, produces and sells* services.<sup>2</sup> More and more services are embedded in manufacturing goods. Likewise, manufacturing firms produce increasingly more services nowadays. For example, the share of services in total sales of the tech company IBM is about 60 percent, exceeding that of manufacturing.

<sup>1</sup> World Bank Development Indicator. 2018.

<sup>2</sup> National Board of Trade. 2010. *Servicification of Swedish Manufacturing*. Stockholm. Sweden: National Board of Trade.

From the existing literature, we can identify the following reasons why firms servicify.<sup>3</sup> Firstly, the use of knowledge-intensive services may contribute to the adoption of new technologies, hence manufacturing firms increasingly use services to become more productive. Secondly, services such as transport and communication are increasingly necessary for manufacturing, thus manufacturing firms more and more need services to participate in value chains. Thirdly, using services can be a strategy for manufacturers to increase the value of products to consumers in that maintenance and repair services can be used to add value to products and build customer relationships. Lastly, services such as legal services are used to overcome market access barriers by helping manufacturers comply with regulations.

Accordingly, competitiveness in manufacturing, as well as the service industry itself to a larger degree, depends on being able to buy cost-efficient and high quality services. Servicification, therefore, implies that competitive services could be a key to improving performance in manufacturing. This again implies that free movement of services and natural persons is central to the competitiveness of manufacturing.

In other words, evidence indicates that service imports, foreign establishment of service providers and openness to trade in services are positively linked to enhanced performance in manufacturing, while burdensome domestic regulation and barriers to trade in services are negatively related to productivity and exports in manufacturing.<sup>4</sup> Liberalization of trade in services can therefore be important in reaping the benefits of the servicification of manufacturing.<sup>5</sup>

In this regard, we can compare sectoral differences in the restrictiveness of trade in services using the OECD's Services Trade Restrictiveness Index (STRI). A snapshot of the OECD's STRI in 2017 shows that air transport, legal services and accounting and auditing services tend to be more restrictive on average than other sectors, while distribution services seem to be the most liberalized on average. Reforms in the former sectors would bring significant benefits not only to exporters, but also to firms serving the local market, since these sectors provide important inputs to, and facilitate trade in other sectors.<sup>6</sup> In addition, considering the

<sup>3</sup> National Board of Trade. 2016. *The Servicification of EU Manufacturing: Building Competitiveness in the Internal Market*. Stockholm, Sweden: National Board of Trade. P. 10.

<sup>4</sup> Nordas, Hildegunn K., and Rouzet, Dorothee. 2017. "The Impact of Services Trade Restrictiveness on Trade Flows", *The World Economy*, Vol. 40, Issue. 6, pp. 1155-1183.

<sup>5</sup> National Board of Trade. 2016. *The Servicification of EU Manufacturing: Building Competitiveness in the Internal Market*. Stockholm, Sweden: National Board of Trade. P. 33.

<sup>6</sup> OECD. 2018. Trade Policy Note: OECD Services Trade Restrictiveness Index, March 2018, p. 2.

degree to which services are being used as inputs to produce manufacturing goods as well, the liberalization of service sectors such as telecommunication, business services, financial services, construction services, transport services, and distribution services can raise competitiveness in both manufacturing and services where these infrastructure services are used as inputs.

In particular, the disciplines on domestic regulation to enhance market access for short-term services providers (movement of natural persons, or Mode 4) of trade in services are important in the professional services. Recently, at a meeting of the WTO Working Party on Domestic Regulation, India presented a comprehensive proposal stating that recognition of educational qualifications and licenses acquired in the territory of another member is a "major impediment" to the short-term movement of services providers under Mode 4 – especially in the case of regulated professions.<sup>7</sup> India argued that while it acknowledges that measures relating to qualification requirements, licensing requirements and even technical standards are applied to achieve legitimate public policy objectives, such measures "can also limit access" for the movement of short-term services providers. In this regard, even though it may be premature to have a discipline on the basis of equivalency of education, experience and/or examination requirements, it is imperative that WTO members agree on a rule about the adequate procedures to meet these requirements which are not more burdensome than necessary.

Just a few decades ago, services were regarded as non-tradables. However, in the Uruguay Round, services emerged into the world trade arena and became one of the important pillars of the WTO. Even though the ratio of trade in services accounts for only approximately 20 percent of the total trade, this is mainly because the lack of proper data, especially the lack of data on total sales of overseas establishment, leads us to underestimate the total trade in services. Notwithstanding the underestimation in services trade statistics, the importance of services has been increasing to a larger extent; in other words, servicification has been gaining momentum. Thus, it becomes crucial to liberalize services not just to enhance the competitiveness of the services sector itself, but also to raise productivity of manufacturing which uses services as inputs. In this regard, the world trade community needs to be more attentive to reducing unnecessarily burdensome regulatory procedures in respect of the movement of natural persons, which is one of the most sensitive areas in services trade negotiations. **KIIP**

<sup>7</sup> Washington Trade Daily, December 6, 2018.