EXECUTIVE SUMMARY

The importance of services trade and “servicification” of economic activity has grown in countries overtime. However, regulatory and administrative barriers to the movement of service suppliers have meant that “Mode 4” accounted for only 2.1% of total services trade in 2005 and 2.9% in 2017. While trade costs for services have been computed in the literature, barriers specific to Mode 4 services trade have not yet been quantified. We contribute by constructing an index to quantify regulatory barriers to the movement of service suppliers, using qualitative information embedded in OECD data on services trade restrictions, and examining its relationship with services trade by mode of supply. Results show that the constructed Mode 4 restrictiveness index is negatively correlated with services imports in three of the four modes of services delivery that require proximity between buyers and sellers. Notably, services delivered by these Modes 2, 3 and 4 are already adversely affected by COVID-19 and accounted for over 70% of global services trade in 2017 according to WTO data. These findings thus further underline the need for countries to refrain from imposing prohibitive restrictions on service suppliers during this pandemic.

BACKGROUND

Trade in services is important for countries globally. Services are also important for economic growth and development given their role as inputs into production in all sectors of economic activity. While services trade and FDI are found to foster productivity growth (Arnold et al. 2011, 2016; Beverelli et al. 2017), trade costs for services are higher than those for goods and the rate of decline observed for services trade costs has been much less than that for goods (Miroudot et al. 2013).

These costs are especially salient for services delivered by the “temporary movement of natural persons” or “Mode 4” trade in WTO GATS parlance, which inter alia explains the low share of Mode 4 trade in total services trade. There are four different ways in which services are...
traded internationally: Mode 1 ("cross-border services trade") that includes the entire range of services transacted via the internet e.g. online medical transcription services; Mode 2 ("consumption abroad") where the buyer travels overseas to consume a service e.g. tourism; Mode 3 ("commercial presence" by a foreign affiliate in the domestic economy and the affiliate’s transactions e.g. international retail banking services); and Mode 4 ("movement of natural persons" where the seller travels abroad to deliver a service e.g. IT professionals working onsite abroad and intra-corporate transferees).

According to WTO’s Trade in Services by Modes of Supply (TiSMoS) dataset, in 2017, 59.3% of global trade in services was delivered by Mode 3, 27.6% by Mode 1, 10.2% by Mode 2 and only 2.9% by Mode 4. In fact, irrespective of the level of economic development, the share of Mode 4 in services trade hovers around 3% though it was even lower at 2.1% in 2005 and 2.5% in 2010.

Trade costs for services, for intermediate vs final services, and for disaggregated services sectors, have been computed (Miroudot et al. 2013; Miroudot and Shepherd, 2016) and also estimated using structural gravity (WTO, 2019). Measures of regulatory impediments to services trade – the services trade restrictiveness indices (STRI) – have also been used to examine the effects of regulatory incidence and heterogeneity on services trade, investment, integration into global value chains and membership and depth of preferential trade agreements (Kox and Nordås, 2007, 2009; Nordås, 2016; Miroudot and Cadestin, 2017; Nordas and Rouzet, 2017; Rouzet and Spinelli, 2016; Rouzet et al. 2017; Andrenelli et al. 2018; Shingal et al. 2018; Egger and Shingal, 2020). However, barriers specific to Mode 4 services trade have not yet been quantified.

Against this background, we contribute by constructing an index (see Figure 1) to quantify regulatory barriers to the movement of service suppliers, using qualitative information from the OECD’s STRI data, and examining its relationship with services trade by mode of supply. Note that the OECD’s STRI database only provides qualitative responses to measures that affect Mode 4 trade. We thus add value by quantifying these responses and constructing an index that can be used in empirical analysis.

HYPOTHESES

We expect Mode 4 restrictiveness to be negatively correlated with Mode 4 services imports. At the same time, given complementarities between different ways in which services trade is transacted, we expect the index to also be negatively correlated with services imports delivered via Modes 2 and 3.

RESULTS

Figure 1 presents the average Mode 4 restrictiveness in 2017 based on weighted averages. The average score ranges from 0.19 for Latvia (at the bottom end of the distribution) to 0.74 for Russia (at the top end). The average score for non-OECD countries (0.39) is found to be lower than that for the OECD (0.45) as Latvia, Colombia, and South Africa are amongst the least restrictive countries in the sample while nine of the top ten most restrictive Mode 4 countries (barring Russia at the top) belong to the OECD.

In general, barriers to services trade do not take the form of border measures such as tariffs, but are rather embedded in regulatory frameworks. However, barriers to Mode 4 trade also include border measures such as visas, work permits and quotas and are therefore more distinct. At the same time, labour market tests for work permits for service providers, and nationality/citizenship/permanent residency requirements for license to practice are examples of “behind-the-border” regulatory barriers constraining Mode 4 trade.

Figure 1: Weighted average Mode 4 restrictiveness index (2017)
The Mode 4 restrictiveness index is found to be negatively associated with imports of services delivered by Modes 2-4; the estimated coefficient for Mode 1 services imports is found to be statistically indifferent from zero. Given that the index captures regulatory barriers to the movement of service providers, one would expect the estimated elasticity to be the largest for Mode 4 imports. Encouragingly, this is what we find: a 10% increase in Mode 4 restrictiveness is associated with a 7.6 and 5.0% decline in services imports delivered by Modes 2 and 3, respectively, ceteris paribus and on average.

These findings also confirm complementarities between different ways in which services trade is transacted. They also illustrate how barriers in one mode of service delivery can affect another. Such complementarities are obvious, for instance, when establishing commercial presence abroad (Mode 3 trade) leads to intra-corporate transfers (Mode 4) from the home country to the host country. In such a scenario, any restrictions on the movement of ICTs is also likely to have an adverse effect on foreign affiliate transactions. Similarly, a
short-duration professional visit abroad (Mode 4 trade) can also generate an appetite for exploring a new country as a tourist (Mode 2 trade), possibly with family. Thus, any curbs on the movements of CSSs and ISSs could also result in a decline in tourism.

Disaggregated analysis suggests that the overall results may be driven by computer; maintenance & repair; professional & management consulting; and technical, trade-related and other business services.

CONTRIBUTION

The world is going through an unprecedented health and economic crisis emanating from COVID-19. Services trade will be more severely affected and will also take longer to recover in this crisis than it did during the 2008 global financial crisis because over 70% of global services trade is transacted via the three modes of supply (Modes 2, 3 and 4) that require some form of physical proximity between buyers and sellers and the latter is the first casualty of social distancing and related practices in the wake of COVID-19 (Shingal, 2020).

The need for social distancing and continued fear of the pandemic until a vaccine is available has resulted in countries imposing restrictions on international travel. Meanwhile, our findings underline the need for countries to refrain from imposing prohibitive restrictions on service suppliers. Such restrictions are found to be negatively correlated with precisely those modes of supply that are already more adversely affected by COVID-19, suggesting that imposing them would be doubly detrimental. Moreover, given the importance of services for economic activity in general, de-restricting this sector would also be a crucial determinant of economic recovery in the aftermath of this pandemic.

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ABOUT AUTHOR

Anirudh Shingal is Senior Fellow at the Indian Council for Research on International Economic Relations (ICRIER), New Delhi. He is also affiliated to the European University Institute, Florence and World Trade Institute, University of Bern. Email: ashingal@icrier.res.in

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