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FEATURES OF THE CHANGING SERVICE ECONOMY

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The Nature of Services

The production of services is distinguished from that of goods in only one way. Unlike goods, services do not realize themselves in any particular object. Classical economics has unfortunately seized upon this feature of services and included them in the category of unproductive labor because they perish at the very instant of production and do not endure to add to the value of the subject upon which they are bestowed.

In the 1930s, economists studying the stages of economic growth described the production of services as tertiary activities and included in it all output that did not originate from the agricultural or industrial sector. The residual approach and the classical notion of unproductive services combined to imply, perhaps inadvertently, that services were of a lower order of importance than agriculture or industry and somehow dependent on primary and secondary output.

Modern economics has abandoned entirely the notion that goods and services differ in any important economic sense. Nevertheless, old perceptions die hard, and are often reinforced by legislative and administrative arrangements that continue to distinguish between the two entities. Indeed, the way in which we collect and compile our economic statistics reflect these outdated notions.

In the PECC economies the growth of the service sector has been uneven. Table 1 below gives the percentage shares of the service sector in gross domestic product for the years 1983 and 1995. In the last column we take the simple difference between the percentage shares between these two years. The economy that has changed most rapidly into a service economy is Hong Kong, China. She is followed by Chinese Taipei, Philippines, Singapore and Australia. In the U.S.A, Canada, New Zealand, Japan and South Korea the service sectors have not gained significantly in importance relative to the rest of the economy. The service sectors in Thailand and South Korea have not grown at all in this period.

On the whole, the service sector has become more important among the PECC economies. While most economies have welcomed the development of the services, however, there is some concern as to whether this growth has been at the expense of manufacturing. Many Asian-Pacific economies have in the past decades developed rapidly

as a result of their export led manufacturing growth strategies. Will this shift to services among some of them lead to slower growth in the future? The slow growth of exports in the Asian economies has also raised similar concerns. In the context of the liberalization of international trade and foreign investments, the shift to services represents an even greater challenge than trade and investments in goods. It is therefore useful to examine in greater detail the nature of the shift towards services in the PECC economies.

Dubiously Low Productivity of Services

Productivity differs enormously across sectors. In most economies, measured productivity in the service sector appears to grow more slowly than the goods sector. One should note, however, that measures of productivity are fraught with problems of measurement, in part because quality improvements in the service sector are notoriously difficult to capture. Nevertheless, the slow growth of measured productivity in the service sector is often regarded as the cause of many economic problems, such as slowing economic growth, rising inflation, increasing unemployment, and polarization of the rich and the poor.

Though there is little empirical basis for some of these concerns, they have contributed to a somewhat negative view of the increase in services and the demise of manufacturing, wherever such trends have been observed. Hong Kong with which I am most familiar with is one such example.

While it may be the case that a shift in focus from manufacturing to services may eventually lead to a lower measured rate of productivity growth, this conclusion suggests a misleading view of the role of the service sector in overall productivity levels and economic growth.

I shall illustrate this with the example of Hong Kong, which has witnessed the most rapid expansion of the service sector in recent times. In Hong Kong the growth of the service sector is entirely due to the growth of intermediate or producer services. These services support manufacturing, which, although the location of its operation has largely shifted offshore, has continued to thrive. This growth of the intermediate or producer service economy contributes significantly to the dynamism of Hong Kong.

Growth of Intermediate or Producer Services in Hong Kong

Service industries have grown rapidly in Hong Kong as a result of the globalization of economic activity, rapid economic growth and integration of the Asia-Pacific region, and the opening of China. In the decade between 1983 and 1995, the share of service sector employment in Hong Kong grew from 55.0% to 83.5%, while the share of manufacturing employment fell from 41.0% to 14.7%. The share of the service sector in the GDP grew from 64.9% to 79.7% and the share of the manufacturing sector in the GDP fell from 23.0% to 10.2%.

In reality, the manufacturing sector in Hong Kong has not declined at all, but has merely shifted the bulk of its production activities offshore. Manufacturing companies themselves are primarily serviced from Hong Kong, and between 1983 and 1995 they expanded their scope of operation enormously. It is estimated that in China alone Hong

Kong manufacturers employ as many as 3.5 million workers. The demise of Hong Kong manufacturers is an illusion.

The most important feature of service sector growth in Hong Kong is that all of it is in intermediate or producer services. Intermediate or producer services are used as inputs into the production of other goods and services. They are distinguished from consumption services in that the consumer does not directly consume them. To distinguish between final and intermediate or producer services, using existing data however, is not a trivial matter. We have to make use of both product-based and expenditure-based estimates of GDP.

In Hong Kong, the share of consumption services in the GDP remained stable; it was 28.28% in 1983 and 28.76% in 1995 (see Table 2). The share of final consumption services also remained quite stable in Australia, Japan, South Korea, and the USA. In contrast, Canada, Chinese Taipei, Mexico, New Zealand, Philippines and Singapore all rose significantly. The growth was most remarkable in Chinese Taipei, where it rose from 23.48% in 1983 to 32.30% in 1995

During the same period, the share of producer services in Hong Kong's GDP rose spectacularly, from 31.34% to 44.18% (see Table 2). While the growth of services in general and of intermediate or producer services in particular is evident in all the other economies, Hong Kong presents a striking case of rapid service sector growth that is due entirely to the existence of intermediate or producer services. The growing importance of producer services in the economy is also found in Australia, Canada, Japan, Philippines, Singapore, South Korea, Thailand, and the USA. Only Chinese Taipei, Mexico and New Zealand have experienced no growth in the share of producer services in this period.

What are these producer services that have expanded so quickly in the past decade in Hong Kong? The rapidly expanding areas in the service sector are imports and exports, finance, insurance, business, and real estate services (see Table 3). The combined share of these services in the GDP rose from 28.58% in 1983 to 43.38% in 1993.

The growth of producer services in Hong Kong is closely linked to (1) the expansion of goods-producing activities of Hong Kong manufacturing firms across the border into south China, and (2) the growing integration of trade - and investment-related activities within the Pacific region. These links result in two effects.

First, the increase in demand for intermediate or producer services is derived from the growing demand for goods that are either exported, re-exported, or imported through Hong Kong. These autonomous changes propel the service economy forward. There are, of course, further interactions whereby increases in the demand for some services will generate increases in the demand for intermediate or producer goods, and the process feeds on itself.

The second effect stems from the role of intermediate or producer service inputs as a dynamic force driving the production of goods. According to this view, intermediate or producer service industries are the vehicle by which new technology is introduced into the goods production process. This new technology can lead to the lowering of production costs, the development of improved and new products, and new and more efficient methods for the distribution of goods. These are service inputs that respond to a greater demand for goods and in turn contribute to and change the mix of demand for goods.

Services are produced by bankers, accountants, engineers, scientists and others. Their outputs are used to produce goods and other services. In addition, there are the transportation and distribution services without which there could only be self-sufficiency in production and consumption. Finally, it is possible to interpret the production of education and medical services as inputs into the creation and maintenance of society's stock of human capital and health capital. Without this expenditure, the productivity of any population would fall quickly.

Intermediate or Producer Services and Economic Growth

In free market economies, the satisfaction of consumers is continuously increased through better and cheaper products. Entrepreneurial firms draw heavily on highly educated workers. They also develop and apply new technological and scientific knowledge. They sell advice and deliver innovative services to other firms. These firms in the service industries are the main vehicles through which the human and knowledge capital of society is produced and introduced into the production process. Evidence of the greater educational attainment of service sector workers when compared with workers in the goods-producing sector supports this view.

Human capital is enhanced not only through investments in education and on-the-job training, but also through investment in health care, nutrition, and even the kind of moral and ethical standards which make for honesty and reliability of workers and create a willingness to work hard. Knowledge capital is all the scientific and engineering knowledge which permits the design of more efficient machinery and products. It also includes the knowledge which makes for the efficient organization of firms and society in general. Therefore, even if the measured rates of productivity growth of these intermediate or producer services are not high, their existence is the reason that firms in the goods-producing sector can enjoy high rates of productivity growth.

Economists have long recognized that labor productivity is enhanced when the production process is reorganized and becomes more "roundabout," that is, when it includes more stages of production and employs an increasing number of intermediate or producer inputs. Labor and capital becomes more specialized as a result of "roundaboutness."

The growth of the service sector goes hand in hand with the appearance of more specialized firms producing a greater diversity of intermediate or producer services. In Hong Kong, the average number of persons engaged per establishment in the finance, insurance, business, and real estate services sectors declined from 11.6 in 1983 to 8.2 in 1993; a decline of almost 30%. By contrast, the decline in the average establishment size in the overall economy was about 16.6%. The greater decline of the average establishment size found in the finance, insurance, business, and real estate services sector in Hong Kong reflects the process of increasing "roundaboutness" and is a sign of enhanced economic efficiency and dynamism.

Specialization through the market has variously been called the process of "dehiving," "unbundling," "vertical disintegration," and "contracting out." The process is facilitated when the size of the market grows and the transactions costs of doing business through the market is reduced. The increasing complexity of business operations, rising cost of monitoring the performance of employees in large organizations, rapid rates of technological

change in increasingly specialized activities, and falling cost of information and communication in the marketplace have all contributed to this process.

Any close examination of the service sector in Hong Kong reveals that it is a highly heterogeneous industry. The rapid expansion of the service sector reflects a positive dynamic market process at work, whose purpose is primarily to support the growth of goods-producing industries, which have expanded overseas and across the border into south China. Hong Kong's service economy developed, in response to market demands, to service the requirements of firms wishing to operate across borders, in different nations, and under different jurisdictions in what is an increasingly integrated regional and global economy.

With increasing globalization of the world economy, many PECC economies would naturally experience a gradual relocation of economic activities. The relocation of manufacturing sites and of supporting services will naturally take place as the comparative advantages of economies evolve.

Table 1: Percentage Shares of Services in GDP

	1983	1995	Difference in % shares
Hong Kong, China	64.88%	79.68%	14.8%
Chinese Taipei	46.08%	52.28%	6.20%
Philippines	37.51%	<i>42.76%</i>	5.25%
Singapore	58.79%	<i>62.53%</i>	3.74%
Australia	61.84%	65.34%	3.5%
USA	65.53%	66.70%	1.17%
Canada	54.76%	55.85%	1.09%
New Zealand	58.01%	58.90%	0.89%
Japan	55.71%	56.16%	0.45%
South Korea	41.97%	42.28%	0.31%
Thailand	48.82%	<i>47.48%</i>	-0.34%
Mexico	62.17%	61.59%	-0.58%

Note: italicized figures are for years 1993.

Table 2: Percentage Shares of Consumption, Producer and Government Services in GDP

	Consumption Services		Producer Services		Government Services	
	1983	1995	1983	1995	1983	1995
China, Hong Kong	28.28	28.76	31.34	44.18	5.36	6.74
Chinese, Taipei	23.48	32.30	10.08	9.69	12.52	10.30
Philippines	5.55	7.19	27.78	30.38	4.18	5.18
Singapore	11.55	<i>15.05</i>	39.55	<i>41.61</i>	7.68	5.88
Australia	26.52	26.91	31.60	34.89	3.71	3.55
USA	33.83	<i>34.86</i>	18.84	<i>20.81</i>	12.85	<i>11.03</i>
Canada	26.68	28.81	12.36	14.30	15.72	12.74
New Zealand	26.61	30.31	18.52	17.54	12.87	11.05
Japan	30.34	31.59	15.82	17.10	9.55	7.48
South Korea	21.33	22.02	9.76	14.49	10.88	5.76
Thailand	16.07	<i>13.98</i>	28.29	<i>30.67</i>	4.47	2.82
Mexico	33.91	36.59	22.39	19.32	5.88	5.68

Note: italicized figures are for years 1993.

Table 3: Percentage Shares of Value-Added by Sectors in GDP

Year	Hong Kong, China		Singapore		South Korea		Chinese Taipei		Japan		U.S.A.	
	1983	1993	1983	1993	1983	1992	1983	1993	1983	1993	1983	1992
I. Goods Producing Sector	32.46	18.68	40.02	36.61	54.50	53.30	51.32	42.71	43.84	42.37	29.72	29.77
Agriculture & mining	0.76	0.22	1.19	0.28	15.73	7.56	7.10	3.79	3.74	2.41	3.68	4.00
Manufacturing	22.95	11.15	25.22	27.53	28.24	33.77	36.43	31.08	29.05	26.80	18.79	18.58
Construction, electricity & gas	8.75	7.31	13.61	8.80	10.52	11.97	7.79	7.83	11.05	13.16	7.25	7.19
II. Service Producing Sector (production based estimates)	62.26	78.11	59.98	63.39	42.46	45.33	50.45	58.58	58.09	59.26	70.32	70.96
Imports-exports	10.95	17.54										
Wholesale, retail, restaurants & hotels	9.50	9.54	17.45	17.79	12.17	12.25	12.93	15.51	14.91	12.53	16.08	17.55
Transport, storage & communications	8.20	9.52	12.80	14.44	7.56	8.74	6.29	6.33	6.17	6.31	6.04	6.79
Finance, insurance, business services & real estate	17.65	25.84	22.99	26.86	10.77	14.89	13.48	18.98	15.43	16.17	22.49	21.43
Community & personal services	10.38	9.09	-	-	3.75	4.31	5.23	6.96	13.05	16.36	12.52	13.46
Government services	5.58	6.62	6.74	4.30	8.21	5.14	12.52	10.81	8.53	7.90	13.19	11.73
Overall Economy	100	100	100	100	100	100	100	100	100	100	100	100

Note: For Hong Kong, China and Japan nominal shares were used because figures for real value-added were not available.