

# Service Industries: An Engine of Growth

By Richard B. Self

The postwar era has seen dramatic changes in the economies of both the United States and Japan. Among the most remarkable of these has been the emergence of service industries as the pre-eminent contributors to GNP and the employers of well over half the labor force. And current trends suggest services will continue as the principal provider of new jobs.

As service industries in our domestic economies grew more sophisticated and diversified, they naturally looked to exporting as a way to continue their growth. These efforts have often been hampered by national policies—employing both traditional and novel methods—impeding the free international flow of services. Given the trends in our home economies, we can reasonably assume that in the future, services will become a more significant component of all our exports. Consequently, we must focus increasing attention on an environment conducive to such trade. We must work to do away with existing barriers, and keep a watchful eye for emerging impediments.

## Emergence of services in our domestic economies

The service sectors have played an important role in our economies for decades. Financial, communications, and transport services, to name only a few, have always been recognized as critical to our economic well-being.

More than half of the U.S. GNP since 1950 has been generated by services. In 1982 services rose to 68% of our GNP. Despite the notoriety of Japan's success in manufactured items, over half the GNP of Japan is now in services. Why, then, does there appear to be a new emphasis in services as an important growth element in our economies? Does this portend a significant transformation from goods to services production, as some fear? What are the factors that have made services industries the new job generators of the last decade? Should we place services



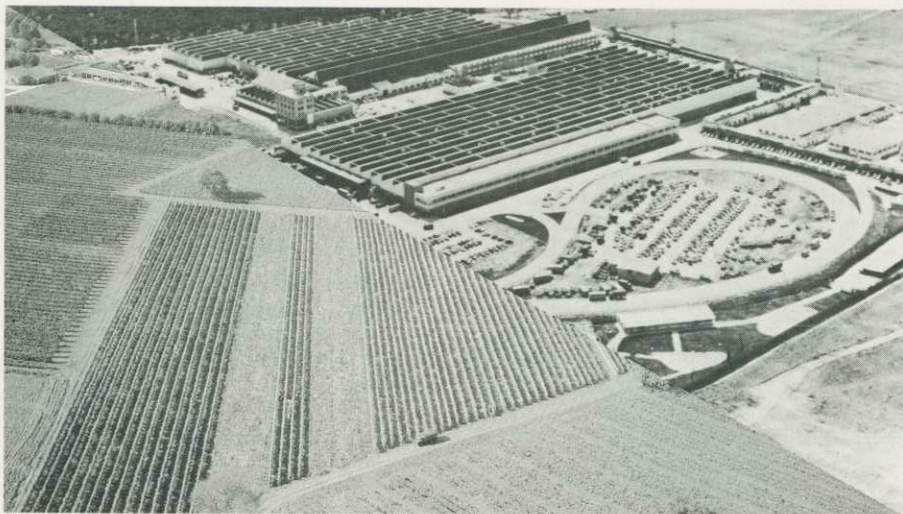
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issues on the agenda for future trade negotiations in order to promote their growth abroad?

These are important questions whose answers could profoundly affect our future economic and trade policies. The United States and Japan have much at stake. Our economies are turning increasingly to activities which depend largely on a heavy information base and rely on technologies whose most important component is frequently a service. Many ana-

lysts see the trend toward services in our respective countries as a healthy one; it reflects an innovative spirit on the part of both Japanese and Americans to move into new industries that will keep us competitive in a rapidly changing global marketplace. Others fear the services trend. In the United States, this group sees a nation of steel and textile mills, shoe plants and auto manufacturing being transformed into hamburger franchises. To this group, the services trend is a sign of national decay.

One of the reasons for such diverse opinions is the variety of the service sectors themselves and the important role some of the new services play in the economy. Few would doubt, for example, the need for having healthy banks, insurance companies, airlines, ships and communications networks to meet the growing needs of industrial output. But many fail to understand how service industries have become increasingly an engine of growth rather than a by-product. Technology is one reason. The American textile (non-apparel) industry was on the verge of losing its competitive edge until the 1970s, when it revolutionized its production process with new capital machinery capable of producing textiles at considerably lower costs. Built into the cost of American textiles is a large service component,



The share of agriculture and manufacturing industries in GNP is declining in both the U.S. and Japan.

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stemming from the information technology associated with the machine. Robotics have had a similar impact on many industries in both Japan and the United States. The technological and data processing elements of the robot are services, and are perhaps the most vital component of the finished product. By one estimate, services used in the production of goods account for 25% of U.S. GNP, and this is certain to grow as manufacturing concerns rely increasingly on technology, information and more sophisticated distribution techniques to stay competitive. And without these technologies, many industrial enterprises would not be in business today. In addition, many industrial concerns are also engaged in producing services.

Another phenomenon is the changing nature of service industries. We have seen this occur most profoundly in the financial services sector. The traditionally separate roles of commercial banks, investment banks, and brokerage services are slowly melding into one-stop financial shopping in our two countries. The financial "supermarket" is beginning to emerge, as traditional American retailers such as Sears, J. C. Penny, and Safeway compete for a share of this market. Many of the large banks have made substantial investments in establishing data processing systems, partly as a means to facilitate the most efficient transfer of funds, as well as to provide this lucrative service by itself. While the debate continues over the speed at which these changes should occur, the full-service revolution seems inevitable in the financial services area, and with it profound changes in competitiveness and the quality of service offered.

The deregulation of some of the more traditional services such as banking, telecommunications, and aviation will have

its own important effects on these sectors. While the deregulatory process is too recent to gauge lasting effects, the resulting growth of new entrants into these sectors, previously excluded by regulation, has inspired a degree of competition unknown or unforeseen in recent times. The effect of all these changes is to provide a greatly expanded availability of services. Deregulation has bred innovation as well as a greater variety of services. And, inevitably, both personal and corporate consumers have found new ways to do business as they utilize the new options available to them.

While these are characteristic trends in many of the services sectors, completely different social factors have led to the increased consumption of some other services. Relatively rapid gains in our standard of living since the 1940s increased the leisure time and disposable income required to consume vastly increased hotel, restaurant, travel and related services. The dramatic growth in the number of retired persons has also contributed to expansion of these services. In medicine and education, the advancement of science on the one hand and the added requirements of academic and technical skills on the other have both led to an expansion of services. Finally, there are the changes in the U.S. household resulting from women having entered the marketplace in much larger numbers. This has fueled growth in a variety of services ranging from day-care to some of the leisure industries.

These structural changes in our society have made it inevitable that services account for an increasing share of GNP, and this is not confined to the U.S. and Japan alone. The average weight of services in European Community GNP is 55%, and for the developing countries this average is 45%. Whether we like it or

not, services are here to stay. But will services contribute to the long-term health of our economies? Those who fear an economy of hamburger franchises are concerned about two things: (1) a society of low-skilled, low-paying jobs and (2) an economy whose capital base is too small to generate an environment for long-term growth.

## Services and employment

The labor question is an important one because most of the new jobs in the last decade were in services. During the 1970s, the United States economy produced approximately 20 million new jobs, 17 million of which were in services. While many services jobs are indeed low-skill, most of the new ones are occupied by individuals with exceptionally high training. The explosion of the services mentioned earlier has been the main force in generating these new opportunities. In the U.S., the fastest growing areas of services employment have been the medical and business fields, while traditional services employment has been stagnant. But the common denominator is that our economies revolve increasingly around the need for a large information base. In blue and white collar jobs, the need for information and the technological improvements for providing information have created employment in areas never before imagined. These are healthy jobs that enhance productivity, provide solid wages, and are environmentally attractive. And there is a demand for information workers that, at this stage, cannot be fully met.

The belief that service industries have a low capital base has proven to be a myth, as revealed in the 1984 *Annual Report of*



the Trade Agreements Program produced by the U.S. Trade Representative. Of the twenty most capital-intensive industries in the United States, nearly half were service industries. Average expenditure per employee on R&D has also grown rapidly in service sectors. Some U.S. economists, in fact, foresee faster productivity growth in services in the years ahead as a result of these trends.

To conclude the goods vs. services question, we should recognize that a healthy economy demands a mix of both, that neither can get along without the other, and that national policies can and should encourage an economic framework for both. Our ability to remain competitive, to adjust to changing economic circumstances, requires a diverse and innovative economy that consists of healthy goods and service industries.

## Trade in services

As service industries have grown, they have naturally expanded their interests abroad. This is attributable to a number of factors, including the increasing presence of goods manufacturers who have established abroad and have sought the same quality of service they are accustomed to at home.

Until the last few years, very little was said about trade in services and the applicability of international trade rules to those sectors. For decades, GATT sought to liberalize trade through the reduction of tariffs, which had virtually no relevance to services. In the 1970s, however, GATT's attention turned increasingly to non-tariff barriers, and it was in that context that attention shifted from trade barriers applied at the border to focus on the environment for foreign products within the border. Slowly trade principles

began to emerge which could be applied as logically to services as to goods.

At the same time many service industries began complaining in the United States about what they regarded to be unfair restrictions imposed by foreign governments on their exports. What are these restrictions and what is unfair about them? The U.S. Trade Representative's office compiled a list of obstacles to services trade that numbers over 250 pages. The practices vary greatly from unreasonable currency controls, unnecessary fiduciary requirements, the inability to establish or obtain the necessary license to sell, and the inability to process data in another country. Many of these obstacles overtly discriminate against foreign firms while others impose regulatory burdens that make it simply impossible to do business.

What is striking about the difficulties of trade in services, as distinguished from goods, is that the "barrier" is frequently the product of a completely different system of managing business activities in a given sector. Services sectors are generally the most heavily regulated of all sectors, and many of the distortions we analyze are the product of well-intentioned, thoughtful government officials whose purpose is to insure order and quality of service. Determining an unfair trade barrier often becomes a process of sorting out competing values and sovereign systems in which secondary consideration is given to the most competitive environment possible. The difficult question is what is "fair" from the standpoint of the foreign exporter and the domestic regulator, and in the absence of international rules, how to resolve difficulties of major commercial consequence.

That is one reason why Japan and the United States have taken the lead in GATT and in OECD to begin the arduous

process of establishing a set of rules and principles that will govern trade in services. It will not be an easy undertaking but it is an essential one. The service sectors are highly diversified and while there are common themes, each sector has aspects that are unique to it. There are widely different philosophies on the role of governments as sole providers of certain services as opposed to a more competitive environment. The degree of government regulation of these sectors varies considerably, with different sovereign reasons for encouraging certain degrees of commercial activity and discouraging others.

The U.S. government is convinced that despite the complexity of these problems, a set of basic objectives can be established for the service sectors that will encourage greater competition and foreign market access without totally compromising regulatory philosophies. We have had a number of useful talks with the Japanese government and representatives of the Japanese service sectors. While our philosophies inevitably differ in a number of areas, the U.S. and Japan are headed basically in the same direction on services, that is, toward a system of liberalized markets encouraging competition to the maximum extent possible.

I was always cautioned that it would be difficult to pursue services issues with the Japanese because of our differing cultures. But Japan and the United States share the same spirit of innovation and modernization of our economies—the desire not to stand in one place for too long a period. The need for new and different services complements the economic philosophy that we share. Whether it is in hamburger stands or full service banks, Japan and the United States want the best, and we should be prepared to negotiate for it.

