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Towards an Understanding of World and South African Trade in Services

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ABSTRACT

The Services sector has become one of the most important sectors in the South African economy as it has grown double the rate of manufacturing over the last three decades. There is a noticeable absence of serious economic analysis on the importance of the South African Services sector both to employment and export revenue. This paper provides a landmark attempt to look at what is often a very complicated industry to study.

EXECUTIVE SUMMARY

There has been growing interest in services trade internationally as its share of world output and trade increases. In the Uruguay Round of trade talks services was placed on the agenda and the General Agreement on Trade in Services (GATS) was established. The purpose of this TIPS working paper is to contribute to the understanding of world and South African services trade through a quantitative analysis of its characteristics and trends.

Chapter one takes a brief look at the characteristics of different services and finds that it is not useful to analyse such diverse sectors as a homogenous group. While consumer services are labour intensive with low skill requirements and low labour productivity, both producer and community services tend to have high skill requirements, high labour productivity and high capital intensity. Producer services also have strong linkages with the manufacturing sector and contribute significantly to its competitiveness.

The second chapter analyses the structure and trends in world trade in services. It notes that services trade has recently become quite a significant component of world trade (21%) despite the dominance of direct investment over trade as the preferred means of penetrating a foreign market in services. Much of this growth is built on the growing share of services in total world demand and very little is attributable to an increasing tradability of this sector. In fact, the inherent low tradability of services will always limit its role in world trade. A product breakdown reveals that services trade is dominated by business services (43.5%), transport (22.8%) and the travel industry (29.2%). The first two offer a comparative advantage to the industrial nations because of respectively the high skill and capital intensity of their production. The latter offers production advantages to developing countries yet remains dominated by industrial countries. This is because factors such as geographic proximity, high levels of international business travellers and consumer preferences have served to override traditional comparative advantage. However, the travel industry is not alone in having other influences disturb the factor endowment predictions of trade flows. Most producer services are influenced to some extent by policy interventions, geographic proximity or the level of integration within the international trading system.

The third chapter concentrates on South Africa's trade flows in service products. When analysing South Africa's trade volumes

and patterns, it is important to acknowledge the role of factors other than comparative advantage. South Africa's service export and import volumes have been negatively affected historically by low goods exports, poor regional growth and sanctions, which limited the level of integration of the country in the world trading system. The product mix of South Africa's service trade has been influenced by both the comparative advantages and disadvantages of the country, and its geographic location. The developing nature of the economy means that South Africa performs relatively better in the travel industry, which is low skill and non-capital intensive, compared to the transport industry, which is very capital intensive. South Africa's location in the poorest region in the world and some distance from major markets has, amongst other things, limited the extent of trade in business services. As a result, these make up an unusually small component of total services trade in South Africa. The importance of regional location in services trade is reflected in the fact that African countries dominate South Africa's services trade. This is in contrast to goods trade where Africa represents only a small proportion of total trade.

The policy conclusions from the paper are:

a trade strategy for services must recognise the importance of FDI and form policy around it,

although there is considerable scope for improving South African exports, these will be limited by the wealth of the region,

the low tradability of services and South Africa's regional dominance should prevent service imports from being more than a marginal aspect of total imports, and

growing liberalisation of services trade will probably influence ownership patterns (i.e. result in greater levels of foreign ownership) but should not impact on the overall level of domestic output and employment significantly.

INTRODUCTION

Historically, trade in services is probably the most neglected topic in international economics. The reason for this has been its low share of total world trade, the sparse and poor quality data, and the general difficulty in analysing the services sector as a whole. The latter is reflected in the fact that the service sector's role in economic development is still poorly understood and has also suffered from a lack of economic analysis.

Interest in services trade started in the early 1980's when discussions around the Uruguay Round of trade talks began. It was the industrial nations, specifically the USA, which placed services on the agenda for trade talks. They realised that their economies were increasingly being dominated by the service sector and it was an area in which they had definite comparative advantage. Therefore, to balance the market penetration achieved by developing countries in manufactured goods, they felt that they should have market access in the highly protected service sector. Despite considerable reservations by developing countries, services trade was placed on the Uruguay agenda for trade talks and the General Agreement on Trade in Services (GATS) was established. It is this that has sparked some limited academic work on services trade. However, the continuing lack of data and difficulty in analysis has meant that services trade still remains under-researched.

The purpose of this working paper is to contribute to the understanding of world and South African services trade. The first section takes a brief look at the characteristics
of services - a necessary precursor to any analysis of trade. The next section concentrates on the structure and trends in world services trade. It includes an analysis
of the size and growth of services, the product breakdown of traded services and an exploration of the patterns of trade amongst different regions. The third section is devoted to South African trade in services. The size, growth, product structure, performance and regional patterns of services trade are calculated and analysed.

1 CHARACTERISING SERVICES

The services sector makes up approximately 63% of world output.[1] and covers anything from taxi-drivers to insurance giants,

[1] 1) This is calculated using the World Bank World Development Report 1996. Industrial countries average well above this with the U.S.

spanning four standard industrial classification (SIC) categories. It is not useful to characterise and analyse such a large and diverse sector as a homogeneous group, and attempts to do so has led to a number of economic untruths being permeated about services in general.[2] For example, conventional wisdom stresses the low productivity and low capital intensity of services. In order to perform some useful macroeconomic analysis of the services sector, it is necessary to sub-divide the services sector into closely related groups displaying similar economic characteristics.

One logical split is to group services into consumer, producer and community/social services. These groups can be defined as follows:

> ***Consumer services*** - these are the final demand services which would include entertainment & leisure services (e.g. restaurants & hotels), wholesale & retail traders, and personal services (e.g. hairdressers & domestic services). This includes SIC category 6 and components of category 9;
>
> ***Producer services*** - these are intermediate input services which would include distribution, financial, communication and business services (e.g. marketing, design, legal & accounting services). It covers SIC categories 7 and 8;
>
> ***Community/Social services*** - these are public-orientated services which are usually, yet not necessarily, provided by government. These would include public administration, defence activities, educational services, health services, sanitation, etc. It comprise of most of SIC category 9.

In order to paint a picture of the economic characteristics of each of these service sectors, some key indicators for each sector need to be constructed. These are contained in *table 1* below.

Table 1 : A Comparison of Defining Economic Characteristics for Different Economic Sectors in South Africa (1995)

SIC Category	Avg. Monthly Wage (Rands)	Labour Productivity (Rands)	Capital Productivity (Rands)	K-L Ratio (Rands of Capital per Rand of Labour)	Income Elasticity
Primary Sector	**1,130**	**35,800**	**300**	**8.9:1**	**0.70**
Agriculture	0,376	22,010	328	14.9:1	0.24
Mining	2,185	55,220	284	7.4:1	0.99
Secondary Sector	**2,800**	**70,000**	**430**	**4.8:1**	**1.08**
Manufacturing	2,970	71,290	538	3.7:1	1.05
Utilities	5,661	249,260	158	23.2:1	1.60
Construction	1,677	33,580	1,875	0.9:1	0.83
Services Sector	**3,160**	**60,900**	**270**	**5.9:1**	**1.12**
Consumer Services	2,000	42,000	730	2.4:1	0.86
Producer Services	5,050	128,000	210	9.9:1	1.18
Community/Social Services	3,500	45,700	200	5.3:1	1.37
Total Economy	**2,730**	**55,730**	**296**	**5.7:1**	-

Note : Labour productivity is measured by the GDP contribution per employee while capital contribution is measured by the GDP contribution per unit of capital, where 1 unit of capital = R1,000

Sources : CSS Labour Statistics, SALDRU Living Standards Survey; the DBSA and SARB Quarterly Bulletin

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recording services output at 71% of the economy.

[2] 2) The March 1996 US Department of Commerce report *'Service Industries and Economic Performance'* concludes that an "Examination of productivity growth rates in individual service industries reveals a diversity so broad as to suggest: (i) that, as an accounting category, "the service sector" may be an impediment to understanding; ..." - pp.14

Consumer Services

From the indicators in table 1, consumer services appear to have *relatively low skill requirements*[3] are *highly labour intensive*, have *low labour productivity* and are *income inelastic*. These characteristics are very similar to the agricultural and construction sectors which are also able to absorb large amounts of low-skilled labour. This is hardly surprising considering that a large part of this sector is made up of retailing and personal services (such as domestic workers) where the skill content of the work is relatively low and the capital requirements needed to launch a business are minimal. This makes it one of the few options open to the unemployed when the manufacturing sector is unable to absorb the growing urban population. At the other end of the spectrum, however, lies the travel and entertainment services which may create slightly better paid and higher skilled work, and are very definitely income elastic. In fact, many developing nations are promoting international tourism as a development tool because it can create sustainable employment and income growth while keeping the benefits of high labour intensity and low skill and capital requirements.

Producer Services

Producer services can be characterised as having *high skill requirements, high labour productivity, high capital intensity* and being *income elastic*. In fact, they outscore the manufacturing sector by some margin on all of these measures. Producer services also make up the fastest growing sectors in most economies. This growth is driven in part by the changing nature of manufacturing and in part by an independent growth path. Changes in the range of products manufactured and the nature of competition within the manufacturing sector have led to more technology-intensive production. This has resulted in a greater service component in the manufacturing process. Also, the increasing complexities of these services, and attempts by firms to focus on their core competencies, has led to an increased externalisation (or out-sourcing) of these services. Independent growth has stemmed from the rapid growth in new products, especially in the information and communication technologies (ICTs), but also within more established services such as the financial and insurance fields. Rising incomes world-wide has also helped spur this growth.

The producer services sector has tended to be neglected by LDCs because it was felt that producer services were the result of development (the post-industrial society syndrome) rather than a means to development. However, because of the strong interdependency between the producer services sector and the manufacturing sector, any strategy aimed at improving manufacturing performance must take the development of the producer services sector seriously. Inefficiencies and a lack of sophistication in the producer services sector will negatively impact on the competitive performance of manufacturing.

Community/Social Services

Community/Social services appear to have *relatively high skill requirements, low labour and capital productivity, high income elasticity* and be *relatively capital intensive*. Growth and development in this sector is a reflection of public preferences expressed through the voting system to the budget levels and priorities of the government of the day. The most outstanding feature of the community/social services sector is the low productivity of both capital and labour. One possible explanation is that productivity measures do not truly reflect actual productivity in the sector. Because there is no market, and hence no market price by which to measure the output of most of these services accurately, estimates are based on input costs. These will tend to bias downwards the estimate of output and therefore also productivity. Another more popular explanation may be that it is a true reflection of the inefficiency within the government sector which performs the majority of these services.

2 STRUCTURE AND TRENDS IN WORLD SERVICES TRADE

This section begins by defining what is included under trade in services. This is important not just from a data analysis perspective, but also for marking the boundaries of multilateral trade negotiations aimed at liberalising this aspect of world trade. Following this is a discussion on the size and growth of this area of trade and a detailed analysis of the product breakdown of trade and regional trade patterns.

2.1 Defining International Trade in Services

When examining trade in services, there is a need to move away from the conventional idea of trade being only the transportation of a physical product from one country to another. The very nature of services means that there usually needs to be some interaction between the producer and the consumer of the service for a transaction to take place. For this reason, services trade is

[3] 3) Wage levels are used as a proxy for skill levels.

seen to include the *movement of the producer to the consumer* (e.g. business consultant), *movement of the consumer to the producer* (e.g. tourism), *movement of both the producer and consumer* (e.g. passenger transport) in addition to *no movement of either producer or consumer* (e.g. financial services). The latter is becoming more important as modern ICTs have made long distance interaction and the movement of capital and information far easier. A service firm will often not be restricted to any one particular transaction method, but will choose the most appropriate method depending on the intensity of interaction required and the relative transaction costs between different methods (e.g. physical transportation vs. telecommunication costs). Despite the variety of options, it has been suggested that with certain industries, although long-distance interaction may be possible, having a permanent physical presence in a market is a prerequisite in order to establish a *significant* market presence[4]. This is partly due to the continued importance of personal interaction despite advances in informatics, and partly due to the requirement for local market knowledge[5]. This makes long-distance servicing of a market a poor substitute for physical market presence in services more so than with goods.

This preference or requirement for physical market presence in the international trade of services has caused the question to be raised whether foreign direct investment (FDI) in services industries should be considered trade in services. If this were to happen, there would be a far a broader scope for service trade liberalisation negotiations under the WTO and the volume of services trade measured would increase significantly. The World Investment Report 1995, estimates that some 50% of all FDI stock is in the services sector. This implies that in 1993 there was a total FDI stock in services of US$1,070 billion, generating annual sales of approximately $2,620 billion. This stock was also growing at a rate of $110 billion per year. This compares to traditionally recorded services trade of $1,020 billion for the same year. Hence, of the total international sales of services in 1993, only 28% was through the traditional measurement of trade while 72% was through the sales of foreign affiliates of multinational companies[6]. In comparison, some 59% of international goods sales came from trade and only 41% from the sales of multinational companies However, despite the obvious case for inclusion of FDI in the calculation of services trade, international standard practice dictates that trade in services be so defined as to not include foreign direct investment in services.

2.2 Size and Growth of World Services Trade

In 1994, world trade in goods and services totalled US$5,190.1 billion, of which services trade made up 21.2%, or US$1,100.2 billion (see *table 2* below for details). World trade in services has experienced high growth rates over the past 15 years. The boom years of the 1980's led to services trade growth reaching double digits in the later part of the decade. However, growth did slow in the early 1990's in response to the global recession. These high growth rates have also been consistently more than one percentage point higher than that of goods trade for the past 15 years helping raise the share of services in world trade.

Table 2: Value and Growth of World Trade in Goods and Services ($ billions)

	1980	**1985**	**1990**	**1994**
SERVICES				
Value ($m)	312.7	470.4	853.0	1100.2
Avg. Growth over Period	-	8.2	11.9	6.4
Share of Trade	18.2	19.4	20.4	21.2
GOODS				
Value ($m)	1403.9	1955.3	3333.5	4089.9
Avg. Growth over Period	-	6.6	10.7	5.1
Share of Trade	81.8	80.6	79.6	78.8

Source : IMF Balance of Payments Statistics Yearbook 1995

The high growth rates of services trade over the past few decades can be attributed to two fundamental sources - namely the high

[4] 4) A significant market presence would suggest a significant market share in a country.
[5] 5) Gray (1989).
[6] 6) These figures were calculated using the World Investment Report and IMF Balance of Payments 1995 data.

growth of services production world-wide over this period, and the increase in the tradability of services[7]. World production of services has grown at an average annual rate of 7.4%, compared to only 5.2% for world goods production during the period 1980 to 1994[8]. These higher growth rates can be attributed to *higher income elasticities, strong links with goods production* and *statistical growth* arising from the separation of producer services from goods production.

The proportion of services production traded has increased marginally since 1980 from 5.4% to 6.6% in 1994. Although significant, this increase compares poorly to goods which increased the proportion of production traded from 30.1% to 41.1% over the same period. This increased tradability has been the result of

technological changes - developments in information and telecommunic-
ations technology (informatics) has facilitated easier service transactions internationally. They have also lowered the costs of transactions making international provision more cost-effective;

trade liberalisation - some liberalisation of services trade has occurred through the General Agreement on Trade in Services (GATS) that came out of the Uruguay Round of trade talks. In addition, there have also been some big gains for services with increasing liberalisation of trade in a number of regional trade blocs;

internationalisation of production - the growing internationalisation of production has seen the traditional service providers to multinational companies expanding internationally to service them in other nations;

increased proportion of goods traded - the increase in the proportion of goods traded has led to a similar growth amongst services that are tied to goods trade such as freight transport and insurance. However, it is not a one way process and developments in these services have also had a positive impact on the volume of world goods trade (e.g. containerisation in freight industry has lowered the costs of transport and therefore stimulated trade);

structural change - the high growth service sectors are the information and communication sectors which are more tradable than most other service industries.

Calculations reveal that only 25.4% of the growth in services trade from 1980 to 1994 can be attributable to the increased tradability of services. The remaining three-quarters of the growth is linked to the general increase in world production of services over the same period.

Future Growth

This discussion raises the question whether services will ever become a dominant force in international trade as they have become in world output. It is speculated that services will increase their share of world trade but it will be insufficient to make services more than a marginal aspect of international trade. The factors leading services to increase their share are continued efforts at trade liberalisation and an expected high output growth. The factor restricting the share of services in world trade is low tradability. The three dominant areas of trade are tourism, transport and business services. Tourism is very tradable and a large industry, yet it will never dominate international trade flows. Transport is highly tradable yet will always remain a constant and small proportion of goods trade. The big growth in world production of services and the hope for increasing tradability is business services. However, the need for local market knowledge and a physical market presence make foreign direct investment the preferred means of delivering these services internationally. This is demonstrated by the fact that services have began to dominate world FDI in a similar manner to their domination of output.

2.3 Product Structure of World Services Trade

Table 3 represents a break down of services trade into a disaggregated form following the guidelines of the fifth edition balance of payments manual of the IMF (BPM5). The shares of sub-sectors of 'business services' are not available for any year prior to 1994 when BPM5 guidelines were first introduced. Although most figures represent data from all reporting countries, the shares of the sub-categories under 'business services' have been calculated from a sample of countries only.[9]

Table 3 : Breakdown of World Trade Shares of Service Items (1994)

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[7] 7) See amongst others Bhagwati (1987) pp. 21-25.

[8] 8) The growth rates of world production are calculated from country s tatistics published in the World Bank Development Report 1996 and the Unite Nations Statistical Yearbook 1995.

[9] 9) Although the sample accounted for 55.7% of exports and 52.8% of imports it will contain some biases as the country selection was not random but based only on those that had reported at this level of detail.

Service Item	Share in 1988	Share in 1994	Avg. Growth 1988 - 1994
Travel	**29.1**	**29.2**	**8.7**
Transport	**25.6**	**22.8**	**6.7**
Passenger	21.5	22.7	7.6
Freight	50.0	50.1	6.7
Other	28.5	27.2	5.9
Business Services	**38.6**	**43.5**	**9.7**
Communication	n/a	4.2	n/a
Construction	n/a	6.6	n/a
Insurance	n/a	6.5	n/a
Financial	n/a	8.2	n/a
Computers & Information	n/a	0.8	n/a
Royalties & License Fees	n/a	9.4	n/a
Other Business Services	n/a	61.3	n/a
Personal, Cultural, Recreational	n/a	3.1	n/a
Government	**6.7**	**4.5**	**2.2**
Total	**100.0**	**100.0**	**8.7**

Source : IMF Balance of Payments Statistics Yearbook 1995

Broadly, consumer services can be defined as including the travel section only, community/social services as including government services and producer services as including transportation and business services. With this classification, the most noticeable feature of the product breakdown of trade in services is the complete dominance of producer services and the lack of community/social services. Producer services account for 66.3% of services trade, consumer services 29.2% and community/social services only 4.5%.

The low share of ***community/social services*** is to be expected considering both the low tradability of the sector and more importantly, the small international market for such services. Delivery of most of the community/social services require a physical presence and so are untradable internationally. Examples are health, education, defence, public administration and municipal services such as sanitation. Although the occasional student or patient can move to another country to receive the service, this does not occur on a mass scale and so the vast majority of services provided will continue to take place by local providers. Further, these services are primarily provided by the public sector and so only a small private market for such services exists in each country. This obviously then limits the extent to which private providers from other nations can enter the market.

Consumer services, consisting of travel services, are also location-bound services like community/ social services. However, that problem is solved by the movement of the consumers to the location *en masse* which makes the sector infinitely more tradable than consumer/social services. International travel has grown at an incredible 8.7% between 1988 and 1994 enabling it to maintain its share of world services trade. The tourism component of the travel section is income elastic and so has benefited from growing world income. The business travel component has benefited from the growing internationalisation of production and the growth in world trade in goods and business services. It is expected that these trends will continue, enabling travel to maintain or even slightly increase its share of total services trade.

Producer services have been the fastest growing component of services trade. However, its two main categories, transportation and business services, have had very differing fortunes. Within transportation, passenger services have been the fastest growing (7.6%) which is a reflection of the rapid growth in the travel industry, both business and personal. The fortunes of non-passenger transportation are completely dependent on the growth of goods trade. From 1988 to 1994, the value of these services have remained around 4.7% of total goods traded. If one expects continued strong growth of travel and a growth in goods trade that will

lag slightly behind that of other services trade, then one can expect the share of transport in total services trade to carry on dropping slightly.

Business services have experienced the highest growth rate of all sectors at 10.7% resulting in an increasing share of total services trade. This is partly because they encompass some of the most rapidly growing sectors (information, communication and financial services) but also because they have been primary beneficiaries of the forces driving increasing services trade. Recent efforts at trade liberalisation in services have tended to concentrate on business services. They also benefit to a greater extent from the growing internationalisation of production and the statistical growth due to the separation from manufacturing. It can probably be expected that business services will continue to be the highest growing sector in services trade and will continue to increase its share of total trade.

An analysis of the individual sub-sectors of business services is clouded by concern over the accuracy of the available data for 1994. The component 'other business services' accounts for an unusually large share of the total. This may be accurate or it could be that the difficulty in measuring the other categories has resulted in a large residual being dumped into 'other business services'. However, if the residual item is ignored then it is noticeable that financial intermediation services (financial and insurance services) make up a very significant component (38%) of what is left. The financial services component can be traced to the development and growth of international capital markets and the internationalisation of business. The insurance component is dominated by freight insurance and therefore reflects the growth in international goods trade. The other surprisingly significant component is royalties and license fees. These items concern the international sale of technology and their size is a reflection not only of the importance of technology in modern production but also the growth of international technology markets.

2.4 Country Structure of World Services Trade

The usual approach to an analysis of the patterns of international trade, is to make use of Ricardian, Hecksher-Ohlin and 'new trade theory' models of international trade. However, the work in this area has been primarily concerned with goods trade. So before embarking on an analysis of country shares and specialisations in world services trade, the fundamental question needs to be asked whether these theories apply equally well to services trade.

Trade Theory and Services

The obvious question when examining trade theory and services is whether a theory that was developed primarily for goods trade, is applicable to services trade. The traditional Hecksher-Ohlin model, extended to include additional factors of production like human capital and technology, applies equally to services as it does to goods trade. The fundamental reason why the model should apply equally to services is that it is based purely on the interaction between country factor endowments and product factor intensities - i.e. it is based on factor inputs only. Whether the product is wine or insurance, the same range of factor inputs are used and their costs will be determined by their relative abundance within a country. Therefore there can be no logical basis for dismissing the theory of international trade as a fundamental explanation of services trade. The additions of the new trade theorists, such as economies of scale, innovation and historical accumulation, are also relevant to services.

However these theories offer an incomplete explanation of trade. There are some additional factors which can be seen to have a significant influence on the pattern of world trade in services. These are *artificial policy distortions, geographical proximity* and *the extent of a country's share of international trade and investment*.

What trade theory cannot account for is the distortions in the market brought about by trade barriers and the plethora of bilateral and multilateral agreements. Services trade has not been subject to the same trade instruments as goods (i.e. tariffs) for the simple reason that there is no easily identifiable unit of measurement in services that can be used in order to implement such a system. Barriers to trade in services generally involve *restrictions on market access* (e.g. reservation of supply to nationals and temporary work visa restrictions), *discriminatory national treatment* (e.g. discriminatory taxes on business income and profits, subsidies to local firms and discriminatory government procurement), *general government regulation* (e.g. licensing of professionals, exchange controls and inadequate protection of intellectual property rights) and some *natural trade barriers* (e.g. language and culture). The services sector is considered by many to be the most regulated and distorted of all economic sectors. In fact, Hindley and Smith (1984) consider it difficult to draw any conclusions on the factors influencing comparative advantage for different service sectors. A prime example is the airline industry where bilateral agreements covering landing rights effectively regulate completely the flow of international trade in the industry.

The service sector also differs significantly from goods in its requirement, or preference for, close geographical proximity. On one level this heavily influences the decision on where to locate production for the servicing of a market. With goods the decision is based on lowest cost but with services costs may often not be a significant factor in the decision. The result is lower levels of trade and also the production of all services in all locations. On another level, this desire for close physical proximity will influence the pattern of the trade in services that does occur. Countries close to the target market will have a distinct competitive advantage over

those countries located at a distance. Probably the best understood is the tourism industry. Travellers are unable or unwilling to traipse any great distance for short holidays and weekend trips, limiting themselves to countries and locations which are close to home. Another example is many business services where the client often prefers the provider to be a minimum distance away in the event that personal interaction is required at relatively short notice. Even the highly electronic financial services industry is influenced by geographical proximity as evidenced by the emergence of regional hubs in this sector.

The final additional influence on services trade flows is extent of a country's share of international goods trade and investment. Many services are traded in conjunction with international business transactions and goods trade. This makes the direction and volume of trade in these services dependent on the extent of international business transactions and goods trade by a country. Some concrete examples of this influence are communication services, business travel and financial services. In communication services, trade arises from terminating calls and third-party routing services. Incoming and outgoing international calls will be influenced by trade and investment links internationally in addition to the price factor. With business travel, the destination is determined by business needs and not the relative cost of travel.[10] The financial services traded in administering the flow of capital and investment in and out of a country is naturally dependent on the size of this flow as well as the cost and efficiency of the services.

Patterns of Trade in Services

A breakdown of the share of world goods and services trade by development status and region appears in *table 4*. The most defining features of the export and import shares of the different regions are the complete dominance of the industrial countries, the rise of Asia and the decline of Africa. Discussion on each of these features follow.

Table 4 : Share of World Goods and Services Trade by Development Status and Region (1988 &1994)

Category	Services				Goods			
	Exports		Imports		Exports		Imports	
	1988	1994	1988	1994	1988	1994	1988	1994
Industrial Countries	**79.1**	**75.2**	**75.1**	**72.3**	**73.2**	**69.5**	**74.6**	**68.5**
Asia	7.4	7.1	12.2	11.6	11.2	10.8	7.7	7.5
Europe	52.6	48.5	45.6	45.8	45.9	42.4	46.0	40.6
Americas	19.2	19.6	17.4	14.9	16.1	16.3	20.8	20.4
Developing Countries	**20.7**	**24.7**	**24.4**	**26.7**	**26.8**	**30.5**	**25.4**	**31.6**
Africa	1.9	1.5	3.0	2.4	2.6	2.0	2.3	2.0
Asia	9.1	13.0	8.6	13.0	13.1	18.1	12.8	18.5
Europe	3.2	3.4	2.3	2.2	3.2	2.3	3.1	2.7
Middle East	2.8	2.4	6.3	4.7	3.6	3.5	3.7	3.2
Americas	3.7	4.0	4.2	4.4	4.3	4.6	3.5	5.2

Source : IMF Balance of Payments Statistics Yearbook 1995

1 ***Industrial Country Domination of Exports and Imports***

Industrial countries accounted for three-quarters of all service exports and 72.3% of all service imports in 1994. This is a greater

[10] 10) The exception to some extent is the international conference industry.

level of domination than industrial countries display in goods trade. Given the type of service products traded, it is understandable why the industrial countries dominate the export of services. A simple Hecksher-Ohlin analysis would suggest that the industrial countries have a comparative advantage in the production of the dominant item - producer services - due to their relative abundance of human and physical capital. This is supported by calculations of revealed comparative advantage measures for different development levels and regions outlined in *table 5*. As expected, the industrial countries have a revealed comparative advantage in services as a whole and in the producer services of transport and business services.

Table 5 : Revealed Comparative Advantage Measures for Services as a whole and for each Service Category by Development Status and Region (1994)

	All Services	**Transport**	**Travel**	**Business Services**
Industrial Countries	**1.06**	**1.09**	**1.03**	**1.07**
Asia	0.71	1.09	0.34	0.75
Europe	1.11	1.09	1.04	1.20
Americas	1.15	1.08	1.40	0.91
Developing Countries	**0.84**	**0.79**	**0.93**	**0.84**
Africa	0.79	0.98	1.15	0.34
Asia	0.78	0.62	0.72	0.96
Europe	1.35	1.41	1.75	1.14
Middle East	0.74	0.90	0.61	0.76
Americas	0.89	0.94	1.43	0.45

Source : IMF Balance of Payments Statistics Yearbook 1995

However, comparative advantage analysis takes us only so far in explaining trade flows. It is only designed to explain the relative specialisation's of countries and not their *absolute* trade shares. A case in point is the very high RCA measures for developing Europe despite the low absolute shares of this region. Another unexplained phenomena is the measured comparative advantage of the industrial countries in international travel despite this sector displaying characteristics which would seem to favour developing countries. The reason why industrial countries have a high absolute share of world services trade is due in most to their dominance of world goods trade and investment (most of which occurs between themselves), their close geographic proximity to the major markets for international services (i.e. each other), and their large share of the world *stock* of human and physical capital.

The important influence of these factors in explaining absolute trade flows can be demonstrated within the travel industry. Industrial countries will dominate the business component of the travel market because the vast majority of trade and production takes place in and between industrial countries. Within the tourism component of the market, some competitive advantage stems from the close proximity to the major consumers of tourism, namely the citizens of other industrial countries. This locational advantage is an important factor for the European industrial countries in particular.[11] Also the extent of tourism infrastructure (i.e. physical capital) will determine the production capacity of each country. This infrastructure, and hence capacity, is far more extensive in the industrial countries. A final influence is, of course, consumer preferences because different locations are not perfect substitutes. The combination of these factors has resulted in Europe and the Americas being the most popular international travel destinations, hence dominating world travel services. Europe accounted for 59.5% of arrivals and the Americas 19.7% of arrivals in 1995.[12]

The import shares of different countries can be explained almost entirely by the relative income levels and share of world trade and investment. As discussed earlier, producer services and international travel are both highly income elastic. The significantly higher income levels of the industrial countries and the extensive amount of goods trade and investment between themselves, means that they will consume the lion's share of world services trade.

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[11] 11) This is also a major determinant of domestic tourism within each country, which is not reflected in international travel figures.

[12] 12) WTO statistics quoted in Satour, (1996:1). Note that although these figures do include the developing countries in these regions, the industrial countries do dominate the arrivals.

2 *A Rapidly Increasing Trade Share for Developing Asia*

The slight decline of the industrial country share of world services trade can be attributed almost entirely to the gains made by the developing Asian economies. These Asian countries accounted for 13% of exports and imports in 1994, representing an incredible increase of 43% for exports and 51% for imports since 1988. The same factors that explain the high share of services trade by industrial countries can explain the rising share of the Asian developing economies. Firstly, the developing Asian countries are rapidly increasing their share of world goods trade (13% to 18% from 1988 to 1994) and investment. Secondly, the rapid increase in output and household incomes within the Asian region has given the Asian countries a locational advantage in servicing this large and growing component of international service consumers (this includes private households, business firms and governments). Thirdly, the rapid growth of the Asian economies combined with huge investments in the human capital of the region, have increased the region's share of the world stock of physical and human capital. This has both increased the capacity for service production in the region and shifted the relative specialisation of the region towards services. The shift in specialisation is evident from an increase in the RCA measure from 0.74 to 0.78 between 1988 and 1994.

3 *A Decreasing Trade Share for Africa and the Middle East*

It is expected that the import and export share of industrial countries will diminish over time as other countries develop, yet Africa and the Middle East are the only developing regions which have seen their share of both exports and imports decrease. Over the period 1988 to 1994, both regions have seen their service trade shares drop by about 20%. During this time Africa has not only failed to make large investments in the human capital of the continent, but has also failed to accumulate significant amounts of physical capital through either domestic investment or attracting foreign capital to the continent. This has resulted in a drop in its share of the world stock of these factor inputs. In addition, Africa's has a small and declining share of world output and goods trade which has meant a minimum amount of services trade generated either through goods trade and investment or through close proximity to large regional markets. Africa's poor income growth has also impacted negatively on its share of world imports of services.

3 SOUTH AFRICAN TRADE IN SERVICES

This section takes a close look at South Africa's trade in services. Data for this section was compiled from SARB and IMF balance of payments data. This was augmented by data on local rand salary payouts to foreign migrant workers which constitutes part of the travel item in services trade. Using this data, the size and growth of total services trade is examined first. This is followed by a more detailed look at the product structure of imports and exports, and a breakdown of the regional patterns of South African trade in services.

3.1 Size and Growth of South African Services Trade

South African trade in services has experienced fluctuating fortunes over the past 15 years, as with the rest of the South African economy. As outlined in *table 6* below, both the export and import of services experienced negative growth in the first half of the 1980's, saw a rapid increase in the late 1980's, before slowing down in the first half of the 1990's. This general trend applies equally to goods trade and is based on the underlying and fluctuating fortunes of the South African economy over the period. The S.A. economy peaked in 1981 on the back of an extremely high gold price before joining in a world-wide recession. The economy bottomed out in 1985, having experienced an average annual dollar shrinkage of 7.3% from 1980. In the late 1980's the economy improved, being driven in part by increased exports which were promoted to cover the capital account deficit from disinvestment. The economy recovered to its previous level by 1988 and recorded an average annual dollar growth rate of 12.3% for the period up to 1990. The first half of the 1990's saw slow GDP growth of 3% in dollar terms which is in part due to the enormous uncertainty during the lengthy negotiations to bring about democratic elections in 1994. These factors have determined the underlying trend in the trade performance while other factors have determined the relative performance of specific sectors.

Table 6 : Value and Growth of South African Trade in Goods and Services (US$ millions)

	Exports				**Imports**			
	1980	**1985**	**1990**	**1994**	**1980**	**1985**	**1990**	**1994**
Services								
Value ($m)	3,517	2,511	4,395	4,365	4,021	2,517	4,252	5,456
Avg. Growth over Period	-	-6.7	11.2	-0.1	-	-9.4	10.5	5.0

Share of Trade	12.1	13.5	15.7	14.8	18.1	19.6	20.2	20.3
Goods								
Value ($m)	12,540	9,186	16,515	18,700	18,181	10,344	16,775	21,433
Avg. Growth over Period	-	-6.2	11.7	2.5	-	-11.3	9.7	4.9
Share of Trade	43.1	49.3	59.1	63.5	81.9	80.4	79.8	79.7
Gold								
Value ($m)	13,021	6,940	7,024	6,384	-	-	-	-
Avg. Growth over Period	-	-12.6	0.2	-1.9	-	-	-	-
Share of Trade	44.8	37.2	25.1	21.7	-	-	-	-

Source : IMF Balance of Payments Statistics Yearbook 1995

Service Exports

South Africa's exports of services have grown at an average annual dollar rate of 1.5% from 1980 to 1994 despite the large shrinkage from 1980 to 1985. This is a poor rate in comparison to world services trade growth of 9.0% and South African goods trade growth of 2.8% for the same period. However, the decline of the gold industry and its exports have allowed services exports to increase their share of total exports from 12.1% to 14.8% during this period. This share of total exports is well below world averages of 21.2% in 1994. One of the causes of the poor growth performance of service exports in comparison to world averages is the impact of sanctions against South Africa. Sanctions will tend to impact on services trade to a greater extent than goods trade because it is more difficult to disguise the country of origin with services. In fact, with particular items such as travel it is impossible to do so. Sanctions will also impact on those services that feed off goods trade and investment. Another important factor would be the poor economic performance of South Africa's main regional market, Southern Africa. This region has the lowest GDP and GDP/capita levels in the world and an extremely low and dropping share of world goods trade.[13]

The hypothesis whether sanctions and poor regional performance had a more serious negative impact on South African service exports than goods exports can be tested to some extent by an assessment of the changing world market shares of South African goods and services and their influence on growth. *Table 7* takes a look at overall export performance from the perspective of world market share and the export orientation of South African production. The world market share of South African service exports dropped 47% from 1984 to 1994, while that of goods exports dropped only 6%. This provides some evidence that regional influences and sanctions had a more profound impact on service exports compared to goods exports. However, one also needs to account for factors such as the more concerted effort by the state to boost goods exports after 1985 and the dynamic changes in international competitiveness of the sectors. This is demonstrated by the large increase in export orientation in the goods sector (from 30.4% in 1984 to 43.5% in 1994) while the services sector experienced a drop in export orientation (from 9.3% in 1984 to 7.3% in 1994).[14] However, despite this drop in world market share, the export orientation of the South African service sector at 7.3% of production, is still higher than the world average of 6.6% for 1994. This would suggest that overall export levels are not out of line with world trends and the below

average share of services in total exports may be either due to the dampening effect of the poor regional environment or the strong influence of gold exports.

Table 7: Share of South African Production and the Percentage of Production Traded for Goods and Services (1980 & 1994)

	Goods excl. Gold	Services
Share of SA Production		

[13] 13) In 1994 sub-Saharan countries made up all of the 10 poorest countries, and 31 of the 50 poorest countries in the world in terms of per capita income (World Bank World Development Report 1996). Also, in 1994, Africa as a whole only accounted for 2% of world trade (IMF Balance of Payments Statistics 1995).

[14] 14) The export orientation figures can be misleading. They are derived by dividing exports by manufacturing value-added which means that export orientation can increase either through an increase in exports or through a decrease in value-added in South Africa. The latter may well be the case in certain sectors.

1984	42.3	49.6
1994	39.9	55.9
Percentage of Production Exported		
1984	30.4	09.3
1994	43.5	07.3
World Market Share		
1984	00.49	00.76
1994	00.46	00.40
Source of Export Growth		
% of Exports attributable to change in World Market Share	-7.1	-47.9
Percentage of Sales Imported		
1984	33.6	08.7
1994	33.3	08.3
Source of Import Growth		
% of Imports attributable to change in Market Penetration	-0.9	-4.6

Source : IMF Balance of Payments Statistics Yearbooks 1988 and 1995 & SARB Quarterly Bulletins 1985 & 1995

Imports

Aside from the slump in the early 1980's, South Africa's imports of services correspond very closely to world averages in terms of growth rates (10.5% vs. 11.9% for 1985 to 1990 and 5.0% vs. 6.4% for 1990 to 1994) and share of total imports (20.3% vs. 21.2% in 1994). However, the root causes of the growth in South African Service imports is very different to that of the common world trend presented in section two. While 25% of the growth in world trade in services can be attributed to the increasing tradability of services, the growth in South African imports has occurred on the back of diminishing market penetration by imports. As shown in *table 7*, the percentage of sales imported fell from 8.7% to 8.3% from 1984 to 1994. This drop in market penetration had the effect of dampening import growth to the extent that overall levels in 1994 were 4.6% lower than what they would have been had the level of market penetration been maintained.

This drop in market penetration can feasibly be linked to two causes, namely increasing isolation under sanctions and an improving competitive performance by the South African services sector. As already mentioned, increasing isolation during sanctions would negatively impact trade in those services which feed off interaction with the global economy (such as insurance services, business travel and communication services). This applies equally to imports as well as exports. After eliminating increased market penetration as a source of import growth, it has to be concluded that the strong growth in imports of services from 1984 to 1994 is due to the rapid growth of services production and consumption in South Africa. The service sector grew at an average annual dollar rate of 5.8% from 1984 to 1994, compared to only 3.3% in the goods sector for the same period. This has allowed services to increase its share of total output from only 49.6% in 1984 to 55.9% in 1994.

3.2 Product Structure and Performance of South African Services Trade

Table 8 provides a share breakdown of South African exports and imports of services for the years 1988 and 1994. The travel item has been broken into migrants and non-migrants because they represent an important component of South Africa's travel industry. There is no further breakdown of business services due to a lack of reliable data. Analysis is also supported by *table 9* which presents the dollar trade balance, export-to-import ratio and RCA measures for each service item and sub-category.

Table 8 : Breakdown of South African Service Trade into Shares of Service Items (1988 & 1994)

Service Item	Exports			Imports		
	1988	1994	Growth	1988	1994	Growth
Travel	**42.9**	**45.0**	**4.9**	**28.9**	**34.0**	**10.0**
Migrant Workers	52.8	20.1	-11.2	1.2	0.5	-3.0
Other	47.2	79.9	13.7	98.8	99.5	10.1
Transport	**25.5**	**30.1**	**6.9**	**46.8**	**44.0**	**6.3**
Passenger	24.4	27.4	8.8	13.6	24.4	16.1
Freight	24.6	22.5	5.4	62.2	51.5	3.1
Other	51.0	50.1	6.6	24.2	24.1	6.2
Business Services	**31.2**	**20.4**	**- 2.9**	**23.3**	**18.2**	**3.2**
Government	**0.5**	**4.4**	**41.6**	**1.0**	**3.7**	**28.6**
Total	**100.0**	**100.0**	**4.1**	**100.0**	**100.0**	**7.3**

Note : All growth rates are based on dollar values.

Source : IMF Balance of Payments Statistics Yearbook 1995 & the SARB Quarterly Bulletins 1985 & 1995

Product Structure and Performance of Service Exports

The share distribution of South Africa's services exports is quite different from world trends but has a definite similarity to the rest of Africa. This is not totally unsurprising as South Africa's service exports account for 25.6% of total African service exports.[15] In comparison to the world averages, South Africa relies to a much greater extent on the export of travel services which make up 45% of exports compared to 29.2% for the world and 32.2% for the developing world. Transport service exports also make up a larger share of total exports compared to world averages (30.1% compared to the world average of 22.8%). The above average shares of these items is at the expense of business service exports which made up only 20.4% of exports in 1994. This distribution of trade shares is in line with, and to some extent a reflection of, the relative factor endowments of South Africa. Exports are dominated by the labour- and low-skill intensive travel sector with the lowest share being in the capital- and high skill-intensive business services sector.

Travel Services. At the highest level of aggregation, travel services is the only sector to demonstrate a revealed comparative advantage (i.e. a RCA measure greater than one). *Table 9* shows that in 1994 the RCA measure was 1.08. The share of travel in the services account has always been significant because of the expenditure of migrant workers. Although the tourism industry suffered during the apartheid years, the expenditure of migrants helped maintain the high level of travel expenditure during this period. As *table 8* shows, migrants accounted for just over half of the foreign travel receipts in 1988. However, the decline of the gold mining industry and restrictions on the number of migrants on the mines has led to a decline in this source of expenditure. This has been more than compensated for by the rapid growth of the South African tourism industry since the beginning of transformation in 1990. The non-migrant travel expenditures have increased at 13.7%, making it the second fastest growing item over this period after government services exports. However, as demonstrated in *table 9*, this item still has a negative trade balance with an export-to-import ratio of 84.9%. But with such a growth rate, it is expected that this item will move into a positive balance in the near future. Another way to analyse travel exports is to break them down into business and personal travel as stipulated under the BPM5 guidelines. If this is done, then in 1994 business travellers accounted for 19.6% of all foreign arrivals.[16] Although these statistics represent arrivals rather than spending, the share of spending should be similar. The remaining 80% of personal travellers were made up of the following: 67.4% were holiday makers, 0.8% arrived for study, 1.8% arrived for

[15] 15) This figure is slightly misleading as data for some African countries does not exist, therefore boosting the share of those countries which do provide data to the IMF.

[16] 16) Calculated from CSS Tourism and Migration Statistics, 1996.

work, 4% were contract workers, and 6.4% were either in transit or on border concessions.

Table 9 : Measures for the Assessment of South African Export Performance (1994)

Trade Item		Exports as a % of Imports		RCA Measure	
	Trade Balance (1994, $m)	1988	1994	1988	1994
Services	**-1,091**	**96.9**	**80.0**	**0.67**	**0.70**
Travel	+106	143.9	94.6	0.98	1.08
Migrant	+385	6441.7	3950.0	n/a	n/a
Other	-279	68.7	84.9	n/a	n/a
Transport	-1,087	52.8	54.8	0.66	0.93
Freight	-941	20.9	23.9	0.33	0.42
Passenger	-226	95.1	61.5	0.75	1.12
Other	+79	111.0	113.8	1.19	1.71
Business Services	-104	129.4	89.6	0.54	0.33
Government	-6	44.4	97.0	n/a	n/a
Merchandise	**-2,733**	**81.5**	**87.2**	**0.68**	**0.81**
Gold	**+6,384**	**n/a**	**n/a**	**45.96**	**45.25**

Source : IMF Balance of Payments Statistics 1995 & South African Reserve Bank Quarterly Bulletins

Government Services. These services have been the fastest growing item on the export account, increasing at an incredible 41.6% from 1988 to 1994. However, this has been due to the expansion of foreign embassies and representation in international organisations following the transformation to a democratic and internationally acceptable state. This can be seen by the extremely low share of government services in 1988 and its expansion to a level which is in line with international averages (the average world share of government services is 4.5%). This growth is expected to taper off in line with world trends once all these foreign relations have been re-established.

Transportation Services. The only other service item to experience a growth in its share of exports is transportation services which grew from 25.5% to 30.1% of exports. The overall growth rate of 6.9% is the highest of all non-government services at that level of aggregation and this relatively good performance is reflected in the high jump in the RCA measure from 0.66 in 1988 to 0.93 in 1994. Despite this seemingly good performance, the negative balance of $1,087m accounts for almost all of the deficit on the services account of $1,091m. In addition, the export-to-import ratio remains more or less unchanged in the low 50 percents and is the lowest of all sectors by a huge 30% margin.

The fastest growing component of transportation services is passenger services, which is an indication of the rapid growth of international tourism and business travel to South Africa. In fact, growth has been so rapid that the national carrier, South African Airways, has been forced to concede market share to foreign carriers in order to cope with demand. This has caused the share of

exports in total international passenger services to and from South Africa to drop from 48.7% in 1988 to 38.0% in 1994.[17] However passenger transportation forms only a small component of the total trade in this category. The dominant item is freight transport where South Africa has an extremely low RCA of 0.42 in 1994. This poor rating is reflected in the large negative trade balance of $941m in 1994 and an extremely low export-to-import ratio of 23.9%. Other transportation services (i.e. port and handling fees) forms just over half of South African exports in this item which is a reflection of the lack of foreign competition in this sector. Local port and handling services have to be performed on South African soil and therefore foreign competition is non-existent.[18] It is also assisted by the operation of a central port and rail network through which much of the trade from other Southern African countries is directed. The dominance of this component demonstrates further the weakness of South Africa in the highly capital-intensive transportation sector.

Business Services. The poorest performing sector over the period 1988 to 1994 was business services. Business service exports experienced negative growth and has seen its share of total exports diminish from 31.2% to 20.4%. This contrasts dramatically with world trends where business services is the fastest growing item of services trade and has an average share of total trade of 43.5%. However, this is in line with African trends where business services make up only 18.5% of total service exports. This poor performance is reflected in an extremely low and dropping RCA measure of 0.33 in 1994. This suggests South Africa has a severe comparative disadvantage in this highly skill-intensive sector.

However, this poor export share and performance may also be linked to a general lack of trade in business services by South Africa due to geographical and isolationist reasons. In the Southern Africa region where South Africa has an inherent competitive advantage, demand for income elastic business services is extremely low due to low GDP levels. In other regions, South Africa faces a geographical constraint which will force it to adopt a stronger FDI approach to the international sale of services. Therefore, the demand for services in the Southern African region will have a significant influence on the performance of South African business service exports. An indicator of the lack of demand in this region is reflected in the fact that Africa as a whole accounted for only 2.4% of world service imports in 1994. This hypothesis is supported by the fact that the overall trade deficit in business services in 1994 was very low ($104m) and the export-to-import ratio high at 89.6%.

Attempting to break down the business service exports into the different categories listed in the IMF BPM5 guidelines is currently not feasible without an extensive survey. The data that does exist is incomplete and sometimes misleading. For instance, data on insurance services is available in both the IMF and SARB statistics, but these are presented on a gross basis - i.e. premiums only - while the true measurement should be on a net basis - i.e. premiums less claims. The only data that is reasonably accurate is that of royalties and some telecommunications. In 1994, royalty and license fee exports were valued at $51 million, which is 5.7% of total business service exports. In the same year Telkom reportedly earned $370 million in international telecommunications revenue, which represents 41.5% of total business service exports for that year.[19] This share of telecommunications is incredibly high in comparison to the estimated 4.2% world average presented in table 6. Part of this above average performance could be attributed to the considerable amount of routing that is done for other sub-Saharan countries. However, it is mostly a reflection of the poor performance by other business services rather than exceptional telecommunication revenues.

Product Structure and Performance of Service Imports

The share distribution of different service item imports for South Africa is very different to most regions of the world yet displays some similarities to the developing economies in the Americas. The item with the largest share is transportation services which accounted for 44% of imports in 1994. This is similar to both Africa (40.2%) and the developing Americas (38.0%) and is a reflection of the extremely capital-intensive nature of this service, a factor of production which is relatively scarce in both continents. The share of travel service imports in South Africa, at 34%, shows a greater similarity to industrial countries (average 29.7%) than to developing ones (average 21.8%). Finally, the purchase of foreign business services forms an extremely small share of total imports at 18.2% in 1994.

Transportation Services. The dominant transportation import is the highly capital-intensive freight transportation services. What is heartening is that the growth of imports in these services is lower than the growth of exports which is helping to diminish the trade imbalance on this item. Passenger transport has been the fastest growing component of imports which is both a result of increased travel to South Africa (business and personal) and the increased market share of foreign carriers on South African routes. This latter development is, as mentioned above, partly because of the inability of the national carrier SAA to respond to such a sudden surge in demand, but also because as new routes are opened in response to new demand, traffic is shared between the national carriers of the two countries.

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[17] 17) Calculated by dividing exports of passenger services by total trade in passenger services.

[18] 18) Foreign implies foreign resident and not foreign ownership.

[19] 19) Telkom revenue data sourced from BMI-Techknowledge Communications Handbook 1995.

Travel Services. South Africa has a higher share of total imports in travel than other poorer African countries because of the income elasticity of this product. However, to have such a high share of total service imports is also a reflection of the highly unequal income distribution within South Africa. When a country's average income is very low, then total demand for luxury goods and services like international travel will tend to be higher with a skewed income distribution than with a more equal income distribution. The impact of the unequal income distribution on the share of travel services in service imports is also apparent in the Latin American countries where the share is close to South Africa's at 31.5%.

Business Services. The final defining feature of South African service imports is the incredibly low share of business services at only 18.2%. If it is accepted that a sizeable proportion of business service trade is determined by geographical proximity and levels of interaction in the world economy, then this low share is understandable. Countries with close geographical proximity to South Africa have business services sectors which are not competitive with South Africa's, and hence have negligible penetration of the South African market. Those countries which are competitive with the South African business services sector are sufficiently far away to limit their penetration of the South African economy from a trade perspective. This is not to say that penetration of the market through direct investment has not occurred in the South African economy.[20] The lack of integration in the world economy and the benefits of high protection levels (e.g. in financial and telecommunication services) have also limited import penetration.

3.3 Regional Structure of South African Services Trade

The share of South African services trade with different regions of the world is important for an understanding of services trade and for informing the policy process. Unfortunately, public data on the exact regional share distribution of exports and imports for different services items trade is non-existent. This implies that either extensive surveys of firms engaged in services trade is performed or proxies are found for these trade shares, imperfect as they may be. The latter approach has been taken and what follows is an attempt to map the regional shares of trade for the three main service trade categories, namely travel, transportation and business services.

Travel Services

The travel sector is the most publicly researched service trade item in South Africa due to the importance of the industry for foreign exchange, employment and income, and the fact that part of the responsibility for marketing the sector lies in the public domain. Unfortunately, most of the research efforts have understandably concentrated on the export of travel services (i.e. foreign arrivals in South Africa) and very little is readily available on the import of travel services (i.e. international travel by South Africans). For the export of travel services, the best proxy for the share of world regions is to examine the regional breakdown of all foreign arrivals in South Africa. This data is presented in *table 10* for each world region. This is imperfect as it reflects numbers of persons and not spending.

Table 10 : Regional Breakdown of South African Foreign Arrivals and Departures by Residents (1995)

Region	All Foreign Arrivals (%)	Departures by SA Residents (%) 1
Africa	73.7	78.6
Europe	15.4	10.2
Americas	3.4	3.2
Asia	3.4	4.7
Oceania	1.3	1.2
Unspecified	2.8	2.2
Total	**100.0**	**100.0**

1 The CSS provides a destination breakdown for air travel only yet one can safely assume that all road and rail travel is to other African countries. Further, sea travel represents a negligible amount of foreign travel. Therefore, these shares were calculated using the regional shares of air travel and allocating all non-air travel to the Africa region.

[20] 20) This alternative route to penetrating the market seems apparent in the IT industry where the distance to Europe and the USA makes servicing the S.A. market from there impossible, especially for emergency support. Therefore all the major international IT professional services firms have associate firms based in South Africa. (see Hodge & Miller, 1996).

Source : CSS Tourism and Migration Statistics, 1995

Despite this shortcoming, the data on foreign arrivals is instructive as a rough guide to which regions account for most of South Africa's travel exports. As *table 10* shows, Africa completely dominates foreign arrivals accounting for 73.7% of all arrivals. The only other region with a significant share is Europe with 15.4%, while all other regions each have less than 3.5% of all arrivals. These figures demonstrate the importance of two factors in trade in services; namely geographical proximity and the extent of goods trade and investment. With South Africa relatively geographically isolated from much of the world, its foreign arrivals will be dominated by the African region. The high share of the European region is a reflection of the extensive goods trade and investment links with this region in addition to the high per capita incomes of the region.[21] Europe accounted for 46.1% of all goods trade with South Africa in 1995. The proportion of business and personal travellers for Africa and Europe are very similar with 13.0% of travellers from Africa arriving for business versus 14.2% of Europeans.[22]

For the import of travel services, the best available proxy for the regional share of travel spending is the regional breakdown of all departures from South Africa by South African residents. As with the export data, it must be acknowledged that this is not a perfect proxy for the regional share of spending. In fact, it is probably less instructive than foreign arrivals data because the cost of travel to different regions can vary enormously, a factor which is controlled for with foreign visitors to South Africa. Despite these interpretative problems, the data on departures is useful in pointing out again the complete dominance of the African region in the import of travel services. Africa accounts for 78.6% of all departures by South African citizens which is a higher than for the export of travel services. As with exports, the only other significant share is held by Europe with 10.2% and all other regions have less than a 5% share each.

Transportation Services

To develop proxies for transportation service imports and exports, it is best to split the analysis between passenger and freight services. For passenger services, the combined regional breakdown of foreign arrivals into and residents departures from South Africa can be used while for freight transport the best proxy is probably the direction of trade statistics (combining both imports and exports). This data is presented in *table 11* below.

As expected, passenger travel is dominated by the Africa region followed by Europe. However, after accounting for the shorter distances travelled and the use of own transport, one can expect the share of the Africa region in imports and exports to diminish significantly. What should be reasonably accurate is the proportions between the non-African regions, as distances are more or less similar and almost all the passengers will be transported by the same mode of transport (namely air).

Table 11: Regional Breakdown of South African Goods Trade and Passenger Travel (1995)

Region	% Share of Passenger Travel	% Share of Goods Trade
Africa	75.4	9.9
Europe	13.6	46.1
Americas	3.3	13.4
Asia	3.8	28.9
Oceania	1.3	1.76
Unspecified	2.6	-
Total	**100.0**	**100.0**

Source : Customs & Excise Abstract of Monthly Statistics 1995

For freight services the Africa region does not dominate. Europe has the largest share with just over 46% followed by the Asia region with just under 29% and the Americas with 13.4%. Oceania is again negligible while Africa comprises just under 10% of

[21] 21) The extent of these links can be attributed to factors such as colonial linkages, relatively close geographical proximity compared to other industrial countries and the fact that many non-European MNCs use European subsidiaries to service the African region.

[22] 22) CSS Tourism and Migration statistics 1995.

all goods trade. This proxy does suffer from the problem that it reflects the value of the goods transported and not the value of the services used to transport them. These two values can differ significantly as the cost of transportation will depend on the physical weight and volume of the product transported, the distance travelled and the mode of transport used.

Business Services

No data or even suitable proxies exist for the regional shares of the export and import of business services in South Africa. However, some broad patterns are not that difficult to determine using knowledge of the South African economy and the sectors involved. What follows is a qualitative discussion of these patterns for a number of business service trade items.

Communication Services. Exports and imports of communications services are determined by the number of incoming and outgoing calls plus any additional third party routing services provided. The regional share of calls will reflect the extent of business and personal links between the different regions and South Africa. As such, one would expect dominance of exports and imports by Europe and Africa with very small shares for the other remaining regions. The Africa region will have a higher share than the extent of business and personal links suggest because South Africa has established itself as a regional hub for routing international calls to and from sub-Saharan Africa[23]. This is a result of South Africa's better telecommunications infrastructure compared to the rest of Africa.

Insurance Services. International insurance services are dominated by freight insurance, whether it is the insurance of the actual goods and vehicles or insurance against currency fluctuation. As such one would expect the regional shares of imports and exports to be similar to the goods trade shares presented in *table 15*. In fact, these figures may be an extremely good proxy as they represent the value of the goods traded which, along with risk, is one of the prime determinants of insurance cost. These figures show that Europe dominates with almost half of all trade, followed by Asia with almost 30%.

Financial Services. Trade in financial services is dominated by the international flow of short and long-term capital into and out of South Africa. To understand the regional make-up of these flows one needs to find out both which regions have substantial investment capital and which regions are partial to investing in South Africa. The former would suggest that industrial countries are the main traders in this area and the latter would probably point to the European countries due to the substantial historic and trade links with South Africa.

Royalties and license fees. Royalties and license fees reflect payments for technology and ideas. It is therefore expected that South Africa will import most of these services from the industrial countries. Based on trade, FDI and historical links, Europe should heavily dominate as a source of imports followed by the Americas and then Asia. The export of these services represent the sale of South African generated technology and ideas. These exports will most likely be to countries whose economies are of a similar or less developed nature than South Africa and who have similar technological needs to South Africa. Therefore one would expect the Africa region to dominate the purchase of S.A. exports of these services which is further supported by the fact that South African firms have a large FDI presence in these markets.

Construction Services. The export of construction services from South Africa is heavily dominated by the Africa region. South African contractors have had considerable success in penetrating the African market due to their expertise and low cost compared to industrial country firms. They are also often taken on as partners by international consortiums operating in Africa because of their knowledge of operating on the continent. Some consultants have made inroads into European markets due to their lower cost but this is limited. The import of contractor services only occurs for large projects because the local industry is well developed. This tends to be dominated by European firms who have considerable experience and knowledge in these technically demanding projects. These firms also make inroads into other African countries through the disbursing of aid money from their home countries, but this has not been a factor in South Africa.

Personal, Cultural and Recreational Services. This category is dominated by entertainment services such as music, films and television. As such it is relatively predictable that the USA will dominate as a source of imports of these services followed by the UK. Africa will represent only a small portion of total imports yet they are likely to almost dominate the purchases of these services from South Africa. Most of the South African exports will be either music or television, both of which have successfully penetrated the sub-Saharan market but not the rest of the world.

In total it appears as though trade in business services with South Africa is dominated by either Africa or Europe. The former demonstrating the importance of the close regional proximity and the latter showing the importance of trade, investment and historical links.

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[23] 23) BMI-Techknowledge Communications Handbook 1995.

CONCLUSION

Services trade has recently become quite a significant component of world trade. This is despite the dominance of direct investment over trade as the preferred means of penetrating a foreign market. However, much of this growth has been built on the growing share of services in total world demand for goods and services, and very little is attributable to an increasing tradability of this sector. In fact, the inherent low tradability of services will always limit its role in world trade. The issue of the tradability of services also impacts on the product mix of world trade. Services trade is dominated by producer services (transport and business services) and the travel industry. The former offers a distinct comparative advantage to the industrial nations because of the high skill and capital intensity of its production. The latter offers production advantages to developing countries yet remains dominated by industrial countries. This is because factors such as geographic proximity, high levels of international business travellers and consumer preferences have served to override traditional comparative advantage. However, the travel industry is not alone in having other influences disturb the factor endowment predictions of trade flows. Most producer services are influenced to some extent by policy interventions, geographic proximity or the level of integration within the international trading system.

Understanding the influence of these other factors on service trade volumes and patterns is important when analysing South African services trade. South Africa's service export and import volumes have been negatively affected historically by low goods exports, poor regional growth and sanctions, which limited the level of integration of the country in the world trading system. The product mix of South Africa's service trade has been influenced by both the comparative advantages and disadvantages of the country, and its geographic location. The developing nature of the economy means that South Africa performs relatively better in the travel industry, which is low skill and non-capital intensive, compared to the transport industry, which is very capital intensive. South Africa's location in the poorest region in the world and some distance from major markets has, amongst other things, limited the extent of trade in business services. As a result, these make up an unusually small component of total services trade in South Africa. The importance of regional location in services trade is reflected in the fact that African countries dominate South Africa's services trade. This is in contrast to goods trade where Africa represents only a small proportion of total trade.

Probably the main policy lessons for South Africa are:

> ***Overall Trade Levels*** - the international sale of services will continue to be dominated by FDI and not trade. This requires a different trade strategy to manufacturing where the emphasis lies in protecting local production and promoting exports. Foreign FDI into South Africa is to be encouraged because of the investment and expertise that comes with it. For local FDI abroad, although it may not generate massive domestic employment, there are definite spin-offs in terms of foreign exchange earnings, some local employment, the potential sourcing of goods from South Africa and support to South African multinationals abroad;
>
> ***Exports*** - there is considerable scope for improving South African exports and much improvement may well arise naturally from increasing trade and investment in South Africa. However this will be constrained to some degree by the poverty of the region and therefore an important way to boost foreign earnings in the service sector will be through supporting FDI in countries further afield;
>
> ***Imports*** - it is very difficult to control the volume of certain service imports as they occur naturally when interacting within the world economy and in most cases cannot be replaced by domestic production. Yet this not a serious concern as low tradability and our regional dominance should prevent service imports from being more than a marginal aspect of total imports;
>
> ***Domestic Production and Liberalisation*** - the low tradability of services and influence of close geographic proximity means that South Africa should always have a significant domestic services sector. Growing liberalisation of services trade will probably influence ownership patterns (i.e. result in greater levels of foreign ownership) but should not impact on the overall level of domestic output and employment significantly.

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