

CONCLUSIONS AND POLICY
RECOMMENDATIONS

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Discussions and analyses on international trade and investment have been centered on manufacturing. Services trade remains poorly understood and its drivers and effects are rather elusive compared with “traditional” trade in merchandise goods. The traditional dichotomy in terms of tradability has largely treated services as nontradable, with less potential to globalize than trade in goods; although, trade in services has flourished since the General Agreement on Trade in Services came into force in 1995, at the end of the Uruguay Round of multilateral trade negotiations. Yet, businesses and consumers are finding greater and practical ways of transforming services tradable across borders. More recently, the uptake of digital technologies is propelling all regions of the world into the Fourth Industrial Revolution, and digital enablement has ushered in a powerful new phase of services unbundling.

Services trade is growing fast, not only because consumer preferences are changing as incomes rise, but also due to the “servicification” of manufacturing. And a wide variety of services, such as financial services, professional services, and logistics are becoming an integral part of global and intra-industry trade as stand-alone industries or as part of the back-office or in-house arms of large manufacturing businesses. While economies are endeavoring to develop domestic service industries, cross-border service transactions are growing exponentially. Digitalization is reinforcing this rapid transformation toward a services economy by fostering the easier, faster, and cheaper transaction of services for the convenience of suppliers and consumers alike, and lowering costs by cutting out intermediary agents. This “third unbundling” is likely a worldwide phenomenon, enabling the fragmentation of “jobs” into more specialized “tasks”—for example, separating software engineering, data analytics, remote high-tech service providers, knowledge product providers, or web designers, among others, which allows separate tasks to be performed remotely but to interact in real time. Those who embrace this evolutionary transformation will thrive, whereas those who are clumsy will fall behind.

This book, in shedding some light on the latest episode in the services globalization story, clearly describes the transition from traditional trade in services, through digital enablement, to trade in “digitally delivered” and “digitally deliverable” services, or more simply trade in digital services. The “digital” aspect of the issues dealt with in this book highlights the key role of data, the internet, and other technology-related infrastructure as the bedrock of flourishing digital services and digital services trade. Its cross-border transaction nature also implicates regulatory and governance environment across economies.

One big challenge in discussing digital services trade is its conceptual vagueness and the blurry boundary of its current scope. This book attempts to provide clearer delineation of digitally deliverable services trade based on the frameworks of the Organisation for Economic Co-operation and Development (OECD), the World Trade Organization (WTO), and the United Nations Conference on Trade and Development (UNCTAD), and to describe regional and sector performances based on this framework.

The analysis shows that Asia and the Pacific is at the forefront of digital services trade, having demonstrated the fastest rate of growth in this sector over recent decades. The region is also showing rapid growth in the relative share of digital services trade in total services trade, although has yet to catch up with the global average. Cross-country analysis has shown that the region is still far behind economies in the European Union and North America in the share of digital services exports in total goods and services exports. This leads to a lower revealed comparative advantage for the region.

Within Asia and the Pacific, economies are also at different stages of development in trade of digital services—from nascent through emerging to strong players. The range of digital services traded in the region reflects this diversity. It spans traditional call center services based on cost, location, and time zone advantages; advanced artificial intelligence and cloud-based services based on skills and domain competence; services linked to goods trade and manufacturing competitiveness; embedded services; and services supporting e-commerce such as fintech.

To plug the gap with other regions and economies more advanced in digital services trade performance, this book emphasizes four key dimensions where economies in Asia and the Pacific need to put focus: (i) human capital development, (ii) digital connectivity, (iii) information and communication technology (ICT) investment, and (iv) an enabling policy and regulatory environment, including for freedom to access the internet.

The length and quality of education is associated with greater trade in digital services, with the total expected years of schooling seen to be positively associated with an economy’s performance in trade in digital services. In addition, the importance of upskilling and reskilling the workforce cannot be overstated,

especially considering existing skill-based barriers to the uptake of digital technology. Digital technologies are also the foundation for fostering innovation that allows small and medium-sized enterprises to become competitive providers of digital services. The development of digital services exports in the region therefore hinges on the availability, accessibility, affordability, and quality of broadband services. Rapid growth of mobile penetration bodes well. ICT investments, which constitute the physical underpinnings of digital services trade, should therefore comprise internet infrastructure, computing facilities, software programs, and data processing equipment. Freer internet regulations could enable even economies with low digitalization to better reap the benefits of digital services trade. The policy environment should enable business opportunities in digital services to thrive while ensuring consumer protection.

As part of their development strategy, governments can pave the way for digital services exports—positively associated with economic growth—by adopting policies and programs that improve the country’s performance in one or more of the four key dimensions as drivers of digital services competitiveness. Other efforts could include investing in digital infrastructure and skills, not only expanding the digital competency base but reducing the digital divide, supporting startups by providing funding, tax incentives, and piloting opportunities, while enacting supporting legislation on cross-border data transfers and data protection, among other measures.

Simulation scenarios of trade liberalization and deregulation of digital services sectors through computable general equilibrium modeling using ADB’s Multi-Regional Input-Output Table data demonstrate positive impacts on digital services trade from both types of policy measure, while the impacts on other sectors are smaller. Both scenarios also lead to clear gains in backward and forward global value chain participation regionally and globally across manufacturing and services sectors. Indeed, the gains are not confined to the digital services sectors where a positive policy shock is simulated but are spread over other sectors. Interestingly, both trade liberalization and the deregulation of digital services sectors could garner real income impact for regional economies, with deregulation generating larger gains by far. From a welfare perspective, this reinforces the importance of implementing nondiscriminatory regulatory cost reduction measures besides trade policy reforms at the border. Trade liberalization efforts should therefore embrace reform in domestic markets.

Digital services trade and other sectors of the economy can generate mutual synergies. Growth in e-commerce for merchandise goods, itself enabled by digital services platforms, creates opportunities for digital services exports such as financial services, logistics, and software development. Growth of manufacturing provides opportunities for embedding digital services and applications in

manufacturing design, production, and shipment, enabling indirect exports of digital services.

On the other hand, restrictive data-related policies, in particular on cross-border data flows, could significantly limit digital services trade. Using a unique dataset, this book assesses which of the restrictions on (i) data localization policies, (ii) local storage requirements, and (iii) conditional flow regimes on cross-border data exchange most impinge trade in digital services for Asia and the rest of the world. The results show that globally, data localization and local storage requirements, in particular, hold back digital services trade, but that the role of conditional flow regimes is more complex. While many of the data flow restrictions are adopted and implemented from various legitimate policy perspectives such as protection of privacy and personal data, and protection against the threat of cybersecurity, economies need to weigh their positive effects against their negative impact on digital trade flows.

In enhancing the competitiveness of digital services and narrowing the digital divide, governments should consider the possible trade-offs and differential impacts—for example, for skilled versus unskilled workers and urban versus rural areas. While expansion in digital services trade could help reduce poverty and improve welfare through its overall positive impact on wages and cost reductions, the worsening income inequality among those with different skill sets as well as potentially yawning divergence between urban and rural households remain concerns. This requires policy makers' continued attention to the sector, geographic, and gender distribution effects of the benefits from digital services trade.

International trade rules need to catch up with the fast-changing regulatory environment for digital services trade. WTO trade rules as well as bilateral and regional trade agreements provide an emerging international regulatory framework, governing conditions for digital services production, marketing, dissemination, and sales. The transition into the digital economy and growing awareness of the need to fill the void in regulatory space will likely prompt more discussion and negotiation about regulation in the areas of data flows, privacy, data protection, and cybersecurity, among other realms. Although more and more digital trade-specific trade agreements are expected to emerge, heightened effort is needed to create clearer guidelines for digital services trade and digital trade at large. The WTO Joint Initiative on Trade-Related Aspects of E-Commerce would constitute a significant step forward in filling some gaps in international digital services trade governance. WTO members in Asia and the Pacific could also consider joining the WTO's Joint Initiative on Services Domestic Regulation, given that a commitment to principles for good regulatory practice will help to cut trade costs, including for digital services.

Widespread adoption of international standards in ICT has already demonstrably increased interoperability and security across technology platforms, decreased barriers to trade, ensured quality, and built trust in digital services. Beyond trade negotiation, it is clearly in the interests of digital services competitiveness for regional governments to participate in opportunities for digital regulatory cooperation. The adoption of common standards could help economies avoid redundant efforts and technical duplication, achieve better interoperability, and reduce trade costs. Recognition of regulatory outcomes, whether autonomous or by mutual arrangement, and preferably reducing the risk of discrimination to a minimum by designing mutual recognition agreements in an open and transparent manner, provides guarantees to any party wishing to join.

International trade and regulatory cooperation require specific skills and expertise on trade and international economic laws that developing economies may not always possess, to engage in discussions, evaluate proposals, draft legislation and agreements, and develop constructive negotiating positions. In ensuring an inclusive process, the importance of capacity-building assistance cannot be overstated. Developing economies need assistance to enhance awareness and understanding on how to align digital regulatory regimes with international standards, principles, and guidelines, as well as support in designing and drafting the necessary domestic reforms. Technical assistance is, therefore, urgently needed for developing economies that want to improve and upgrade data protection laws and regulation in the context of greater digitalization. The WTO negotiations offer an opportunity for more developed WTO members to commit to this effect.

While digitalization brings more convenience and efficiency, it can entail greater vulnerabilities in security and pursuant social and economic costs. The importance of putting in place appropriate risk management tools against cybersecurity crimes cannot be emphasized enough. As cybersecurity increasingly becomes a precondition for cross-border data flows, economies aspiring to competitiveness in digital services exports will need to strive for greater international regulatory cooperation on cybersecurity. Asia and the Pacific should encourage the use of transparent, globally competitive and market-driven cybersecurity standards and practices, and avoid adoption of domestic measures that constrain competition and innovation. The objective should be to ensure interoperability of cybersecurity frameworks while reducing the costs of regulatory friction.

Digital services are important in current discussions on international tax policy. Digitization means that mode 1 is trending in the direction of taking over as the dominant mode for services trade. Absent common frameworks for taxation of cross-border digital services, unilateral measures to capture tax revenue associated with cross-border delivery of digital services have proliferated in the

region. Meanwhile, an international push is under way to resolve the underlying issues through international agreement on new taxation frameworks for digital services trade. Ongoing international tax cooperation could ensure fair taxation across borders.

The prospects for developing economies in Asia and the Pacific to take part in digital services trade are promising. Opportunities are likely to intensify in the post-pandemic period as consumers and producers continue to embrace online purchasing, digital transactions, and remote delivery of services. These long-term shifts in behavior, production structure, and labor market needs offer all economies new possibilities to develop competitive advantages in digital services. Whether policy makers are ready to seize this opportunity, which supportive measures they take to nurture an enabling environment, and how effectively they open the windows for necessary investments and innovation will characterize the future landscape of digital services and digital services trade for the region.