

Fourth Meeting of the Voorburg Group on Service Statistics

Ottawa, 2 - 5 October 1989

A NOTE ON THE CONCEPT OF SERVICES

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New York, August 1989

I. INTRODUCTION

1. It can hardly be contested that the role of services in economic and social life has substantially increased since the middle of this century. If services are more important, statistics have to tell more about them. However, the first basic question encountered in this context is what are services and how can they be defined?
2. The System of National Accounts (SNA) has a relatively well elaborated definition for goods and services. This definition delineates services quite well from such flows as factor incomes, transfers, capital gains and losses; however, it does not separate services from goods. It is true, the SNA definition of goods and services may change to some extent by each revision of the national accounting system. However, these changes are relatively small and do not cause any major problem for the statistics of services. In the present note it will be assumed that the definitions of the SNA are generally accepted; only those problems of the concept of services which go beyond the SNA definitions will be considered here.
3. SNA defines only goods and services and not services as such. This relates not only to SNA; strangely enough, there is no international recommendation on how to separate services from goods. The lack of an internationally agreed upon definition on services does not prevent researchers (and also statistical agencies) from publishing abundant statistics on the share of services (in terms of GDP or employment). However, it is questionable to which extent these statistics are comparable. It is often experienced that various statistics on shares of services contradict each other.
4. This is why, already at the very beginning of the "Voorburg round," participants were urged to do something on the concept of services. The Statistical Office of the United Nations (UNSO) prepared a first note on this subject in 1987 (this was submitted for consideration at the Stockholm meeting of the Voorburg Group); somewhat later, information was collected from national statistical offices on this matter via the trade in services questionnaire, circulated jointly by the UN and the IMF. On some of the related issues views are converging, on others it is still not clear what conclusion is to be drawn.
5. The present note tries to summarize the state of affairs on the concept of services issue. The paper draws on the work of the UNSO, although its content is the sole responsibility of the author.

II. EARLY EXPERIENCES: SERVICE DEFINITIONS BASED ON ONE SINGLE CRITERION

6. Prior to the Voorburg Round most of the attempts to define services were based on one single criterion. Neither of these attempts enjoyed general acceptance. Let us have a short review on these "one dimensional" definitions, without going much into detail.

7. Services are intangible, while goods are tangible. - This is true for most cases, but not for all cases. Main criticism: at the end of a number of service activities there is something tangible available. For instance a photo (end result of photographic services), a study (end result of advisory services). Additional criticisms: the tangible character of some goods (like electricity) can also be questioned.

8. Services cannot be stored (they are produced and consumed simultaneously), while goods can be stored. - Again true for most cases but not for all cases. There may be a considerable time span between the compilation (production) and utilization of an advisory service.

9. Services cannot be transported/transferred and must be consumed at the place of production. - This may have been generally true a long time ago, but with the development of modern information techniques, this definition does not seem to hold any more.

10. Services are "changes in the condition of a person or of a good belonging to some economic unit, which is brought about as the result of the activity of some other economic unit with the prior agreement of the former person or economic unit". - The merit of Hill's (1977) definition is that it is based more on economic than on formal (e.g. transportability) characteristics; however, by itself, this definition falls short of distinguishing services from goods since, for instance, a purchased video tape (a good) may cause the same "changes" on/to a person as a transmitted television programme (a service). Furthermore, what is a change in the conditions of a person or a good is open to different interpretations: for instance preventive services (e.g. police, firemen, guards) are in fact trying to prevent change from taking place in the conditions of a good or person.

11. Ten years later Hill complemented his earlier definition by pointing to an important economic characteristic of services: the contact between producer and user of the services. "... it is inherent in the idea of a service that it should be provided to some economic unit. In this context the verb

provide always carries an indirect object as well as a direct object, explicitly or implicitly. This is a marked contrast to goods production where the producer may have no idea who will acquire the goods on which he is working. A farmer may grow crops in complete isolation from his eventual customers, but a teacher cannot teach without pupils." - This explanation is very useful for understanding some important economic characteristics of services (e.g. why service producing units are generally relatively small in comparison with goods producing units), and it casts light on the treatment of some borderline cases (e.g. why postcards are goods while photos are services). However, again it cannot serve as the unique underlying criterion for the distinction. In a number of cases, even in goods producing industries, there are similar contacts between the producer and user, e.g. individualized options in specifying car characteristics or purchase of tailor-made clothing.

12. The tailor-made clothing brings us to another criterion often mentioned in distinguishing goods from services. It is argued by some authors that small alterations of a product, which do not make a new product from the old one should be treated as services; on the other hand, large alterations, which create new products from the old ones should be considered a production of goods. On this basis e.g. repairs are treated as services, but tailoring (the production of suits from fabrics) as production of goods. - This criterion applies only to one part of services; it does not work for transportation, communication and generally to those services which cause changes in the conditions of a person. In addition, in a number of cases it is difficult to determine whether an alteration is small or large.

13. It is often argued that services are more labour input intensive and less intermediate input intensive than goods. - This, as a general rule, is true; however, this is a characteristic of services rather than a criterion for distinguishing them from goods.

III. SHIFT FROM ONE CRITERION TO SEVERAL CRITERIA

14. All of the attempts to define services on the basis of one single criterion, as described in the preceding section, have contributed to a better understanding of the nature and character of the services; however, neither of these attempts enjoys general acceptance. This is why already at the very beginning of the Voorburg Round the UNSO suggested to find a solution based on several criteria defining the scope of services.

15. In the beginning of 1988 a joint UN/IMF questionnaire was circulated to national statistical offices in which views on the one criterion/several criteria issue were sought. An overwhelming majority (almost 90 per cent of the respondents) supported the several criteria approach. Since the questionnaire did not ask for specific details (e.g. what should be the hierarchy among the various criteria, what should be the general rule if several criteria contradict each other), no indications were received as to how this several criteria rule should be interpreted. Many of the replies, however, recognized that there will be a number of borderline cases where practical circumstances also have to be taken into account and that the adaption of a number of conventions seems to be unavoidable.

16. It is, presumably, right to draw the conclusion that the several criteria approach is generally accepted. If so, the next step before us is to work out this principle operationally and to delineate services from goods within the whole "goods and services" category. This is not an easy task; however, it does seem to be feasible. The most promising continuation could be to take the Central Product Classification (CPC) and to determine for each of its categories whether they belong to goods or services. If necessary, some of the smallest categories could be split between goods and services. This whole exercise should be preceded by establishing some general principles as to how to treat conflicting situations and borderline cases (e.g. which are the typical cases where the tangibility should play only a secondary role).

17. It is likely that on some of the borderline cases views will differ; however, these types of difficulties are encountered in respect of most of statistical recommendations. The most expedient procedure would seem to be to prepare a draft proposal (by the UNSO, or by several international organizations jointly) and to discuss it at regional and/or expert group meetings. Of course, the Voorburg Group could also contribute to carrying out this programme, however, owing to its time and country coverage limitations it cannot substitute for the role of the above-mentioned meetings.

18. Before launching this programme, however, there are a number of questions which have to be answered. Is it indeed worthwhile to work out an internationally agreed upon definition for services? What analytical uses can such a service concept provide? Is it feasible to use the same service definition throughout the whole statistical system? These questions will be considered in the next section of this paper.

IV. DOUBTS EXPRESSED IN RESPECT OF THE UNIQUE SERVICE DEFINITION

19. The number of countries which questioned the usefulness of a unique service definition was relatively small in the joint UN/IMF enquiry. The Netherlands and Hungary were the two countries which expressed the most doubts in this respect; some objections can also be found, however, in the replies of Australia, Czechoslovakia, France, Greece, Norway and the Philippines. Eight countries out of the sixty or so responding countries is a relatively small proportion. However, the arguments given are worth being considered. In this section the arguments given against a unique service definition will be summarized, without identifying which argument was given by which country.

20. What analytical usefulness can one expect from an overall service aggregate - is the first question addressed by some of the critics. Services as such is a very heterogeneous aggregate. One can find here the most modern activities (like some telecommunications services) but also the most traditional activities (like domestic services). Some services (e.g. haircuts) are the most labour intensive, others (like air transport) very capital intensive. Some services (like telecommunications services) become relatively less expensive with economic development, others (like repairs, beauty salons) relatively more expensive. When a country moves from a centrally planned economy into the direction of a market economy the share of some services (e.g. financial services) increases, while that of others (e.g. public administration) decreases. Does the overall service aggregate express something which is markedly characteristic? (The corollary of this question: does the overall goods aggregate express something which is markedly characteristic?)

21. Another group of counterarguments centers on the incidentality which influences whether a given thing/activity is treated as a good or as a service. Refrigerators purchased by households are clearly goods. Refrigerators which are provided by a landlord (as fixtures) are parts of a service. If a family which has two refrigerators, one which they purchased and one which they hire with the apartment, and if they take out a meal from one refrigerator and put it into the other, are they shifting their consumption from goods to services or vice versa? Of course, this last question has only a symbolical character; however, its general importance is connected with the fact that important shifts may occur between owning and hiring both in the consumption and production sphere.

22. Other examples on incidentality: a sandwich purchased in a retail shop is a good; however, the exact same sandwich purchased in a catering establishment (like MacDonald's) is a purchase of a service. The generalized message of this example is that whether a thing purchased is treated as good or service

depends on in what kind of unit (in which circumstances) was it purchased. A building constructed by one single contractor is production of a good, and the whole value added created by this process will appear as goods producing value added. However, the value added of the same building if constructed in a main contractor/sub-contractors arrangement will appear as created partly or mainly by services. (At least according to those views which consider that sub-contractors provide services to the main contractor.) This again is a more general problem than relating to construction only: contracting out some activities previously carried out by a goods producing enterprise makes them services without any change in the activities themselves. Or, if an ancillary unit (e.g. that of providing accounting or computer services within a manufacturing enterprise) starts to sell a substantial part of its services outside the enterprise, the whole of these services, including those which are used within the enterprise will be treated as service production (since the ancillary unit will be promoted to the rank of a separate establishment; before the change, ancillary activities were not separated from goods production).

23. One of the main uses of the overall service aggregate (or maybe the only use of it) is to demonstrate how the importance of services within the national economy increases (e.g. in terms of the GDP). However, is this information, e.g. that the share of the services in a given country increased from 55 to 60% within the whole gdp, to be interpreted at its face value? One should note that in this increase various and by nature very different factors could have contributed:

- real shifts from goods producing activities to service producing activities (e.g. relatively more educational or medical services are produced, and relatively less food);
- services become more expensive relative to goods (e.g. the prices of hairdressing services increase faster than the prices of clothing);
- the same activities are provided as before, only a larger part of them is contracted out;
- activities which earlier were treated as secondary or ancillary activities (and, therefore, not separated from the main activity of the enterprise) are treated in the next period as produced in separate establishments (either because of organizational changes, or simply because more information is available for distinguishing separate establishments).

24. A further doubt expressed in respect of the usefulness of a unique definition is the question of whether, indeed, the same service concept can be applied in all fields of statistics. The most controversial seems to be the issue of whether or not one can achieve having the same service concept applied in external trade statistics as in domestic transactions. As far as one can judge from the results of the joint UN/IMF survey, there are two kinds of objections. First some countries argue that in external trade statistics the most they can do is to separate merchandise transactions from non-merchandise transactions. Since in this separation statistical feasibilities play the primary role (does the good or service pass customs registration) this distinction does not coincide with the goods-services distinction as used in domestic statistics. Just one example: newspapers in domestic statistics are goods, but foreign newspaper subscriptions (since they do not pass customs registration) belong to the non-merchandise trade. Nevertheless, since most merchandise is goods and most non-merchandise is services, one can conceive the merchandise - non-merchandise distinction as some kind of approximation of the goods-services distinction.

25. The second objection comes from those who claim that there is a need for a goods-services distinction in the external trade statistics, in addition to or instead of the merchandise - non-merchandise distinction. However, the distinction line they are proposing for the external trade goods-services separation is not exactly the same as that which they propose for separating domestic transactions. Practical limitations are mostly argued, but not only practical limitations. For instance construction activities carried out abroad are suggested by the majority of the replies of the joint UN/IMF questionnaire to be treated as services (in spite of the fact that most of these countries in domestic statistics treat construction as a goods producing industry). A third group of countries insists that the definition of services in external trade should be exactly the same as in domestic transactions. However, there is not yet sufficient evidence of how this objective can be achieved in practice.

26. It should also be noted that the goods-services distinction, if done on the production side of the accounts and on the expenditure side of the accounts, will not amount to the same shares, even if exactly the same definition is applied for services on both sides of the accounts. On the production side the distinction is made on the basis of whether the value added was produced in the goods producing activities or service producing activities. On the expenditure side, however, the distinction criterion is whether the final form of the thing when it is used, is it embodied in a good or in a service. For instance a television set purchased by a household is treated as consumption of a good, including the transport and trade margins and other services embodied in the retail value of the television set. The

latter activities on the production side are treated as production of services. Similarly the amount paid for a meal consumed in a restaurant is treated in the final expenditure statistics as a purchase of a service; however, in the production statistics the value of the agricultural and food industry products embodied in the price of the meal was produced in the goods producing industry. (It should be noted, with the help of inverted input-output tables it would be possible to present goods-services expenditure categories which are distinguished on the basis of where the value added was produced; however, this is not customary, and most of the expenditure goods-services distinctions are based on the final form of the product.)

27. Finally, let us consider the role of the service definition for some specific (non statistical) purposes. Some participants at the Group of Negotiations on Services (GNS, GATT) argued that before any agreement can be signed on the liberalization of service trade, a clear definition of services is needed. While it is entirely true that any agreement must clearly define the scope of its validity, it is very doubtful that this is the overall service definition which would be needed for the GNS. Most likely the agreement will not relate to all kinds of services, e.g. excluding those which are unimportant in external trade. It is also possible that it will cover some activities which in the SNA are treated outside the scope of goods and services (e.g. factor payments like license fees). Consequently, although for the GNS it may be highly important to have good definitions for particular types of services (from the Central Product Classification (CPC) or from the Standard International Trade Classification (SITC)), it is hardly likely that a unique overall service definition would be helpful for the trade negotiations.

V. QUESTIONS TO BE ANSWERED AND OPTIONS

28. Summing up the requests made, the views expressed and the comments received in respect of the concept of services issue we can characterize the present situation as follows:

- nobody seems to deny that a definition which separates services from goods would be of some use; however, as to the relative importance of this definition, views are divided. Some consider that such a definition would be very important in the development of service statistics, others think that it is not of primary importance or is not indispensable;

- such a definition, at least an internationally agreed upon definition of services, does not yet exist. To work out this definition seems to be feasible, although not very easy, since the number of controversial borderline cases is relatively large. And it would require substantial resources (both in time spent and in financial means) and flexibility.

29. If a methodological task is very important (of high analytical value) and not difficult to achieve it, there is no hesitation to carry it out. Neither is there much hesitation in tasks which are difficult but of high importance or which are of only moderate importance but easy to achieve. However, how about the tasks which are only of moderate importance and are also difficult to achieve? Does the definition of services issue really belong to this last category?

30. The two extreme options international organizations could adopt in respect of the definition of services issues are the following:

- (1) to work out, as soon as possible, a proposal for a unique definition of services, and to have it accepted as the usual procedure of international recommendations (consultations, regional meetings, expert group meetings);
- (2) to delete from the programme of work of international organizations the issue of the definition of services, considering it as not sufficiently important.

31. There are, of course, various intermediate solutions within the above extreme variants. One could work out a proposal on the definition of services only as general guidance for countries wanting to separate services from goods without strongly recommending its use. Or, one could work out a definition as guidance with the recognition that it cannot be considered as a unique definition of services. In the case of "soft" guidelines perhaps the procedure could also be somewhat eased (without having the series of meetings, etc.); however, the working out of the proposal would still require some minimum consultation facilities and presumably some additional resources.

32. The main question raised by the present note: which of the above variants seems to be the most expedient in proceeding (or not proceeding) with the work on the concept of services. The UNSO is open to any of the above solutions; However, a consultation on this issue seems to be important before a new phase in this work is launched.

VI. POSTSCRIPTUM

33. In order to get more reaction on the issues raised in the first five sections of this paper, the present document was also submitted to the 21st General Conference of the International Association for Research in Income and Wealth (IARIW), Lahnstein (FRG), 21-25 August 1989. At least ten persons participated in the discussion of this paper.

34. In spite of the vivid interest on this subject, it is difficult to draw general conclusions on the main issues raised in this paper since most of the comments made related to particular criteria problems or borderline cases. Although nobody contested explicitly the doubts expressed in respect of the unique service definition, as described in section IV of this paper, the few speakers who expressed some views on the main issue (as presented in paragraphs 30-31 above) preferred to have some kind of services definition and suggested that further work should be carried out in this field.

35. Although it was not stated explicitly, it seems that no speaker had in mind a unique, universal service definition which should be applied rigidly in all circumstances. Thus, the IARIW views seem to support some of the intermediate solutions as described in paragraph 31; however, it did not emerge from the discussion what kind of flexible or soft guidelines would get the most support.