



# Breaking the Barriers to Services Trade in Central and Eastern Europe

Jasna Tonovska<sup>1</sup>

Received: November 6, 2023

Accepted: January 31, 2024

Published: May 28, 2024

## Keywords:

Services;  
Services Trade Restrictiveness  
Index;  
Central and Eastern Europe



Creative Commons Non-Commercial CC BY-NC: This article is distributed under the terms of the Creative Commons Attribution-Non-Commercial 4.0 License (<https://creativecommons.org/licenses/by-nc/4.0/>) which permits non-commercial use, reproduction and distribution of the work without further permission.

**Abstract:** *Rapid technological advancements have caused profound shifts in the global economy, establishing services and their trade as pivotal components within the framework of economic transformation. The study investigates developments in international trade in services within five CEE countries over the last two decades, using various data sources - the Balance of Payments (BOP), the overall and the digital services trade restrictiveness index (STRI) and trade in value added. Despite CEE countries being net-exporters of services, the share of services in total external trade remains limited. Also, several 'modern services' exhibit an increase in their exports and services supplied internationally through mode 3 are substantial. As reflected in the modest share of services exports in GDP, services in CEE exhibit low tradability. Both STRI and Digital STRI data suggest that services sectors in CEE have open regulatory environment for trade. The findings highlight the importance of prioritizing digitalization and leveraging technological advancements to enhance services trade and foster economic growth in the CEE region.*

## 1. INTRODUCTION

The profound changes in the global economy resulting from swift technological advancements have positioned services and the trade thereof as central elements in the process of economic transformation. These transformations pose a direct challenge to conventional perspectives that have historically regarded services as an inferior avenue for achieving economic growth and development. Today, the services sector not only surpasses agriculture and industry combined in terms of job creation (constituting 50% of global employment) and economic output (comprising 67% of the world's GDP), but it is also increasingly assuming this role in economies at earlier stages of development (WTO & World Bank, 2023). Therefore, the trade of services and the formulation of pertinent policies play a pivotal role in harnessing the potential of a services-driven approach to development.

Fueled by advancements in information and communications technologies (ICT), the global export of commercial services experienced an almost threefold increase between 2005 and 2022. This period was marked by significant shifts in the composition of the services trade, notably with a nearly fourfold growth in exports of digitally delivered services. Within this timeframe, developing economies progressively contributed a larger portion of less conventional services exports. The expansion of these exports in developing economies is increasingly linked to services provided across borders through digital channels, a phenomenon often referred to as the 'servicification' of the global economy. While the services trade sector endured severe setbacks due to the COVID-19 pandemic, digitally delivered services played a pivotal role in leading the recovery of global services trade and proved to be fundamental in enhancing economic resilience.

<sup>1</sup> Faculty of Economics – Skopje, Ss. Cyril and Methodius University in Skopje, Bul. Goce Delcev 9V, 1000 Skopje, Republic of North Macedonia

The countries in Central and Eastern Europe (CEE) have traversed a three-decade journey of transitioning to market capitalism and striving for convergence with Western Europe. However, it is evident that the convergence process, particularly for the more advanced CEE nations, has decelerated since 2007. This slowdown suggests that the current growth model may be approaching its limitations, prompting the need to contemplate a new growth paradigm for the region. In that sense, the policymakers in CEE countries should consider designing policies that would enable moving from the existing specialization in various manufacturing-oriented functions across the value chains to more profitable segments encompassing mainly services - design, research and development, marketing, and various contemporary business services.

This research investigates the international trade in services among CEE countries and assesses the prospects for deepening this trade by addressing existing regulatory constraints. The remainder of the paper is structured as follows: Section 2 offers a brief empirical and historical background on trade in services and its relevance for the CEE countries as a new engine for economic development. Section 3 provides more details on the developments in various aspects of the services trade in the CEE region from the data on Balance of Payments (BOP) and trade-in value added. Section 4 analyses the results of the Services Trade Restrictiveness Index (STRI) and Digital Services Trade Restrictiveness Index provided by the Organization for Economic Co-operation and Development (OECD), whereas section 5 discusses the policy recommendations that could provide an impetus for further growth in services and services trade. Section 6 concludes.

## 2. BACKGROUND

This study relates to two broad streams of literature. First, the topic of the paper is closely linked to the ever-evolving body of research on international trade in services and the impact of the policies. Second, it is linked to the research on the determinants of trade and economic development in the economies of CEE.

The newer studies collectively highlight the complex and interrelated factors shaping international trade in services. They underscore the importance of regulatory coherence, digital policies, evolving trade restrictions, and external shocks in understanding this dynamic landscape. [Lawless \(2021\)](#) emphasizes regulatory frameworks and policy coordination as key to promoting international trade in services, particularly in the digital age. This is in line with [Van der Marel and Ferracane \(2021\)](#), who highlight the impact of restrictive data policies, showing that they reduce imports of data-intensive services, particularly in countries with less advanced digital networks. [Benz et al. \(2020\)](#) provide a broader perspective, showing that trade restrictions vary significantly across countries and sectors. Recent years have witnessed an increase in services trade restrictions, with a focus on limiting the movement of people and tightening investment screening. Their research establishes a strong negative relationship between STRI and trade in services. Examining the impact of global events, [Ando and Hayakawa \(2022\)](#) reveal that the COVID-19 pandemic had a more pronounced negative impact on services trade than on goods trade, particularly in services reliant on international movement. In contrast, cross-border supply services, like computer services, were less affected. Finally, [Hoekman and Shepherd \(2021\)](#) use machine learning to recreate the STRI, finding that services policies are typically more restrictive than tariffs on goods imports. The resulting Services Policy Index (SPI) is a powerful predictor of bilateral trade in services at sectoral and aggregate levels.

The literature on CEE countries' trade and economic development provides a comprehensive view of the challenges and opportunities in the CEE region's economic development. [Römisch \(2001\)](#)

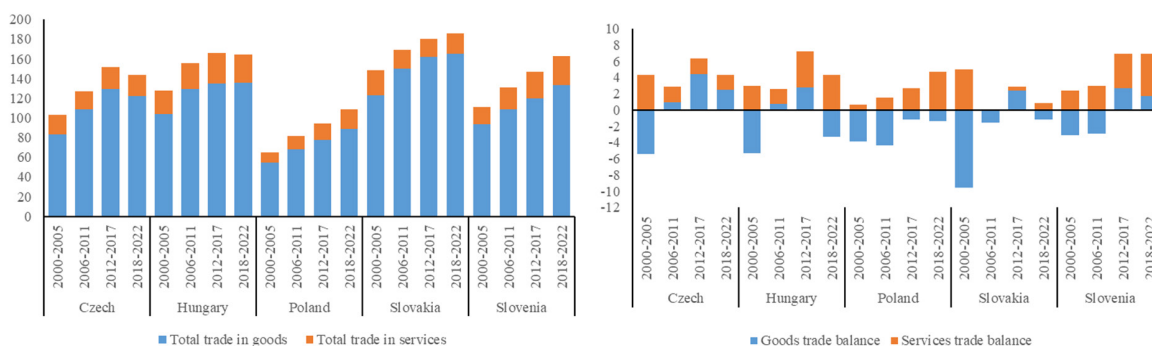
emphasizes the role of services trade as a catalyst for modernizing CEE economies and offers both theoretical and empirical perspectives on services trade in several CEECs, with a specific focus on the Czech Republic, Hungary, and Poland. Vidovic (2002) extends this analysis to seven CEE transition countries, examining developments in their services sectors, comparing them to European Union (EU) countries, and highlighting the impact of foreign direct investment (FDI) on the services sector's growth. The accession to the EU and the implementation of highly permissive trade and FDI policies enabled the CEE countries to integrate themselves into European production networks. Consequently, this integration resulted in an alignment in their production and export structures. This convergence underscores that the manufacturing capabilities of the CEE region extend beyond low-tech sectors (e.g., food and beverages) or resource-intensive industries (e.g., wood or basic metals) and encompass more sophisticated sectors, such as electronics and motor vehicles, which have gained particular significance for the region.

Nevertheless, the IMF (2016) reports that TFP growth in CESEE countries slowed post-crisis due to various factors like stagnant potential growth in advanced Europe and reduced global trade and supply chain expansion. Specifically, the CEE countries, notably those within the Viségrad group, exhibit a pronounced specialization as manufacturing-oriented economies, emphasizing production, which represents the least financially rewarding segment of the value chain. Given their income levels, the CEE countries within the EU should have, by now, transitioned towards greater specialization in the more profitable segments of the value chain. This entails areas that are by their nature, predominantly services, encompassing design, research and development, marketing, and various contemporary business services. McKinsey Global Institute (2013) offers a growth model for CEE economies that emphasizes investment-led growth, export expansion, productivity enhancement, and institutional reforms as key drivers for future development, aiming to attract FDI. According to WIIW (2021), digital transformation possesses the potential to invigorate economic growth in CEE countries. Specifically, the Czech Republic, Hungary, Poland, Romania, and the Slovak Republic are better positioned than other CEE nations to forge a new growth model anchored in value chains linked to advanced digital production technologies. Quality educational systems and digital proficiencies of the young population would serve as advantageous human capital foundations in many CEE countries, which, in turn, could provide the impetus for economic growth built upon innovative digital services.

### 3. SERVICES IN BOP DATA AND BEYOND

We proceed by examining the stylized facts of services trade in the CEE region. This research covers the sample of 5 CEE countries: Czech Republic, Hungary, Poland, Slovak Republic, and Slovenia, for the period from 2000 to 2022. The principal source for services trade data that is used is the Balance of Payments. In addition, we scrutinize other datasets, to complement the general analysis and provide deeper insights into different aspects of services and their role in economy and international trade.

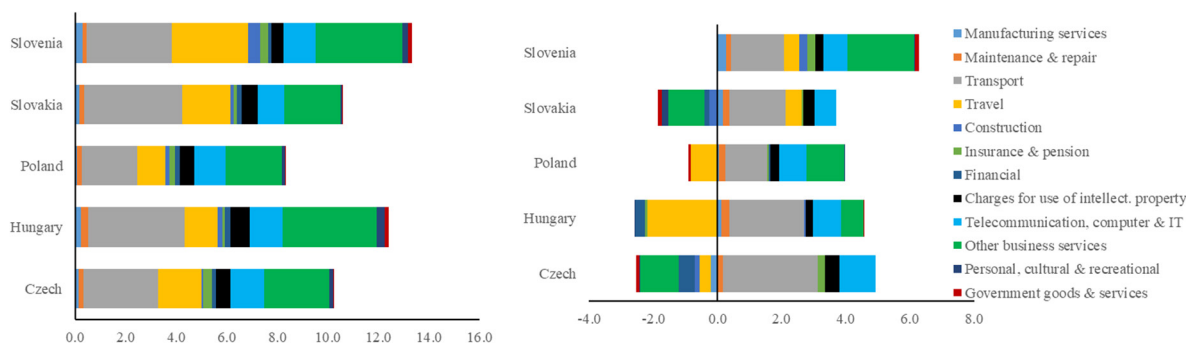
Albeit services in general play an important role in the domestic economy, their importance for international trade considerably lags. For the CEE countries, trade in services represents only a marginal component of the total external trade. Trade in goods consists of the majority of trade, with a notable rise in its share across the sub-periods. On the other hand, the participation in services trade is modest and broadly amounts to 20% of GDP and with a stable relative share in total trade. Regarding the balance of trade, all the countries are net-exporters of services. In contrast, the results with goods are heterogeneous in the most recent period, with the Czech Republic and Slovenia being net-exporters and Hungary, Poland and the Slovak Republic being net-importers of goods.



**Figure 1.** Total trade and balance of trade in goods and services (% of GDP)

Source: IMF, 2023; Own calculations

The sectoral distribution shows that services exports across CEE countries in 2022 are dominated by transport and travel services, which is a usual pattern in global services trade. In addition, ‘other business services’ and ‘telecommunication, computer and information services’ comprise an important component of the services exports for the CEE countries. These categories reflect the technological advances in the period under review and represent segments of modern services – services that can be supplied electronically and are generally associated with higher sophistication and productivity. Compared to 2000, the largest increase is registered in transport services. Within modern services, the fastest growing subsectors are ‘telecommunication, computer and information services’, ‘charges for use of the intellectual property’ and business services.



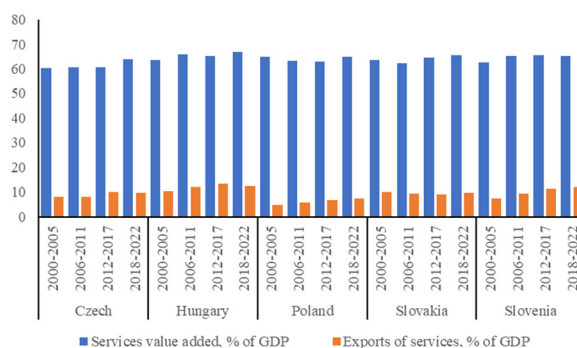
**Figure 2.** Sectoral decomposition of exports in services, 2022 (% of GDP) and change in the sectoral decomposition of exports in services, 2022 -2000 (p.p.)

Source: IMF, 2023; Own calculations

The comparison of the share of services value added with the share of services exports in GDP indicates whether the importance of the services sector for the domestic economy translates into competitiveness externally. In the CEE countries, the share of services value added in GDP has been stable across the sub-periods and now accounts for the most total value added (about 60%). On the other hand, relatively limited and stable services exports (less than 10% of GDP) suggest that services in this region exhibit low tradability. Further diagnostics might reveal whether the reason is the nontradable nature of services produced in the region or other causes, such as the presence of regulatory obstacles.

Services supplied internationally through mode 3 are rather substantial, which is signaled by the developments in FDI in services worldwide. In CEE countries, services sectors are now the predominant destination of FDI, or in other words, FDI is becoming the most common channel

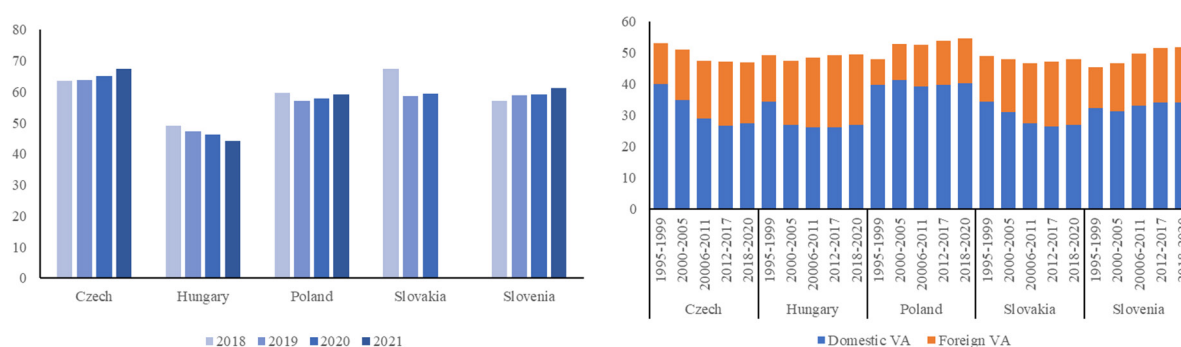
for foreign suppliers to provide services. For the period 2017-2022 on average, services account for about two-thirds of total inward FDI in the region, which is in line with the contribution of services FDI in global FDI as of late. Due to the presence of FDI, the region may in the future reap benefits in the form of the transfer of services-related know-how and technology, as foreign firms introduce new types of services that may be better suited to the needs of clients or provide existing services at lower cost than was available before they entered the market.



**Figure 3.** Exports of services (% of GDP) and services value added in GDP (in %)

Source: IMF, 2023; Own calculations

To provide more systemic and comprehensive empirical evidence about the real contribution of services in world trade we must examine services that are exported indirectly, namely services that are embodied in other goods or services. Trade in value-added statistics enables highlighting the reliance on domestic versus foreign inputs of production destined for domestic and foreign markets. When exports are measured in value added terms rather than gross terms, services account for more than half of the total exports. Disentangling between value added from gross figures provides insights into the importance of the domestic content of trade. For the period 2018-2022 on average, the share of services value added in gross exports in CEE countries amounts to about 50%. The data on trade in value added demonstrate the important implications for services trade by the servitization of the manufacturing sector – referred by Baldwin et al. (2015) as “changes in the sources of value in manufacturing, specifically the increased role of services in manufactured goods”.



**Figure 4.** FDI in services (% of GDP) and services content of gross exports (in %)

Source: IMF, 2023; OECD, 2023a; Own calculations

#### 4. SERVICES TRADE RESTRICTIVENESS

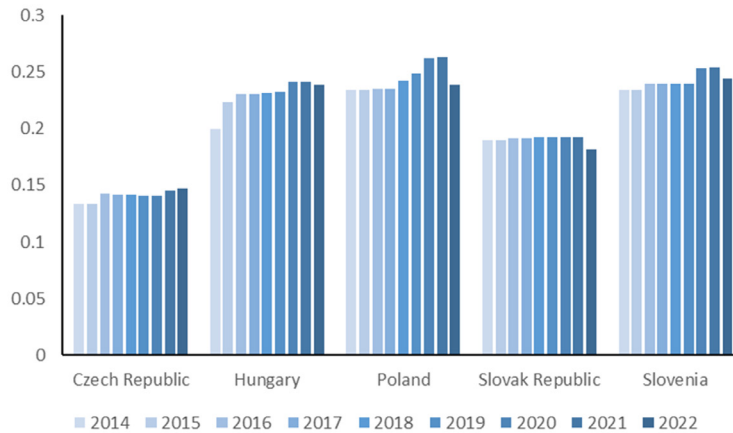
The following diagnostics should reveal whether the reason for the modest results in services trade in CEE countries is the nontradable nature of services produced in the region or other causes, such as the presence of regulatory obstacles. To tackle this issue, the study primarily



relies on the STRI and the Digital STRI data, provided by the OECD. This data encompasses de jure services trade policy restrictions.

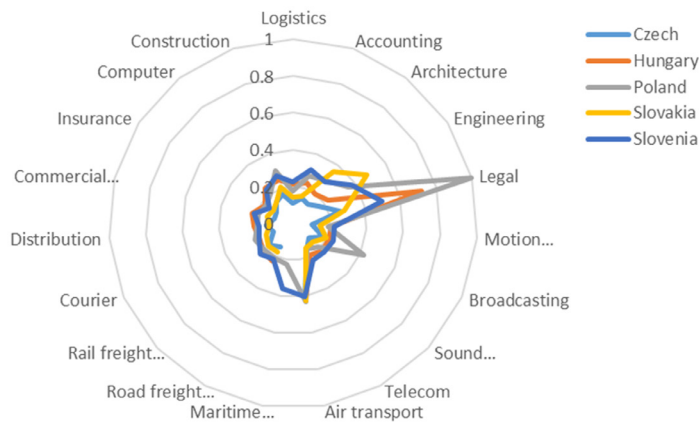
The STRI scores serve as a distinctive empirical instrument, collecting pertinent information about services trade constraints across 19 key service sectors. Utilizing qualitative information available within the database, composite indices are computed to quantify the identified restrictions within five standard policy categories (Restrictions on foreign entry, Restrictions on movement of people, Other discriminatory measures, Barriers to competition and Regulatory transparency). These indices produce values ranging from zero (indicating complete openness to international trade) to one (indicating complete closure to trade).

The STRI data provide evidence that, on average, services sectors in CEE countries have an open regulatory environment for trade in services, especially the Czech Republic. Nevertheless, there are two areas with noticeably higher barriers to trade and competition - legal services and air transport.



**Figure 5. Services Trade Restrictiveness Index**

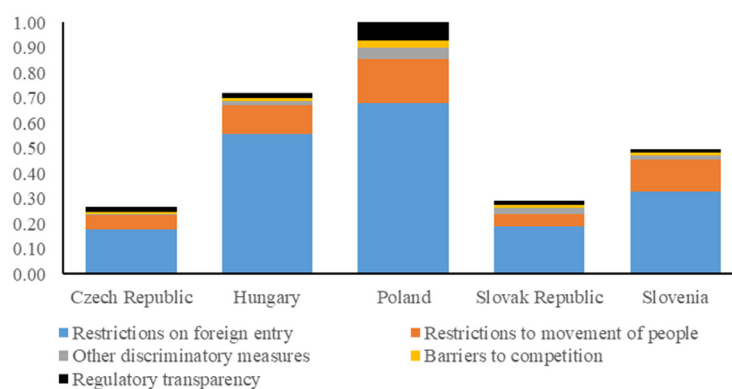
Source: OECD, 2023b



**Figure 6. Services Trade Restrictiveness Index decomposition, 2022**

Source: OECD, 2023b

In all countries, albeit to a varying degree, conditions on the entry of natural persons seeking to provide legal services in the country temporarily as contractual services suppliers remain the most cumbersome. This implies some potential for a further rise in exports of services in these economies, driven by a diminishment of the remaining barriers to services trade.

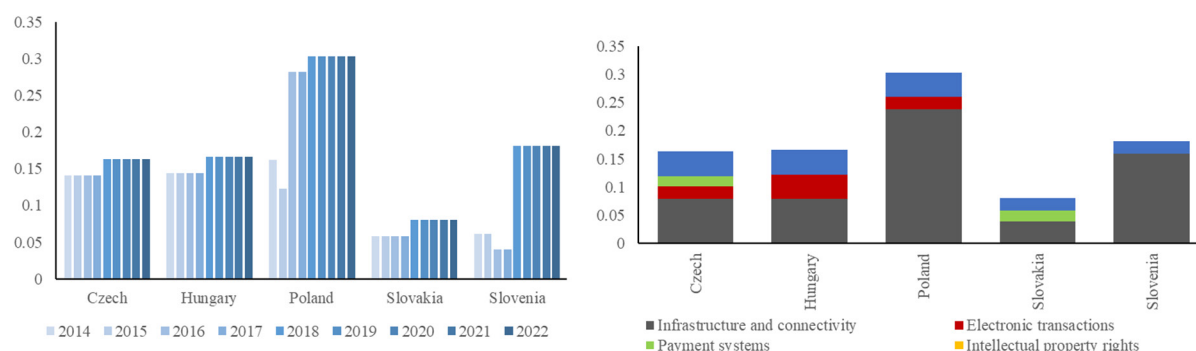


**Figure 7.** Services Trade Restrictiveness Index decomposition barriers for legal services, 2022

Source: OECD, 2023b

The analysis that follows is focused on the developments of the Digital STRI for the sample of CEE countries. The Digital STRI identifies and quantifies barriers that affect trade in digitally enabled services. The Digital STRI captures cross-cutting impediments that affect all types of services that are traded digitally. The Digital STRI framework is categorized in the following areas: Infrastructure and connectivity, Electronic transactions, Payment systems, Intellectual property rights and Other, and, similarly to STRI, it ranges from zero to one (implying closure to digitally enabled trade).

The results for CEE countries point to an open regulatory setting for trade in digitally enabled services. The Digital STRI score for Poland stands out, pointing to more closed trade in digitally enabled services for the country. The results are driven by measures affecting infrastructure and connectivity. This is due to the lack of efficient regulation on interconnection as well as burdensome conditions on cross-border data flows beyond those imposed to ensure the protection and security of personal data.



**Figure 8.** Digital Services Trade Restrictiveness Index and decomposition, 2022

Source: OECD, 2023b

In summary, trade in services represents only a marginal component of the total external trade for the CEE countries, whereas all the countries are net-exporters of services. Within the last two decades, several services sectors that account for ‘modern services’ exhibit an increase in their exports. Still, as reflected in the modest share of services exports in GDP, services in this region exhibit low tradability. Both STRI and Digital STRI data suggest that, on average, services sectors in CEE countries have a fairly open regulatory environment for overall trade in services and in digitally enabled services. Still, there are discernible areas where barriers to trade and competition still exist.

## 5. POLICY RECOMMENDATION

Considering the findings presented so far, the primary reason for the limited export performance of services in CEE countries is the low tradability of these services, rather than the regulatory barriers which present only a secondary hindrance to trade. Therefore, prioritizing digitalization and leveraging technological advancements is vital for boosting trade and economic growth. To this end, we suggest several recommendations for policymakers in the CEE region:

First, the process of digital transformation holds substantial potential for significantly augmenting economic growth within the CEE region. Several countries in this region possess the capacity to establish a fresh growth model that centers around value chains connected to advanced technologies. These developments present an opportunity to broaden specialization towards digital services crucial for facilitating advanced technologies. The region's relatively robust education systems, coupled with the advanced digital competencies of its youthful demographic, serve as assets in this endeavor. Nevertheless, this transformative journey faces a critical challenge in the form of IT professional shortages resulting from substantial outward migration.

Secondly, positive expected outcomes may occur because of reorienting the specialization of the CEE countries towards more profitable segments of the value chain. In that sense, the countries from this region should actively attract and host a greater number of corporate headquarters, encompassing functions like design, research and development, marketing, and various modern business services. A heightened focus on logistics, marketing, research and development, and other non-production tasks within the CEE region is paramount.

Thirdly, another crucial priority revolves around the complete embrace and effective utilization of the ongoing digital revolution, which has received considerable momentum from the COVID-19 pandemic. The barriers to entry in the digital realm are generally lower, as the infrastructure required for a modern digital economy is comparably more straightforward to implement than that for traditional manufacturing. Human capital plays a paramount role in the digital economy, and this stands as a realm of relative strength for much of the CEE region.

## 6. CONCLUSION

This study investigates the international trade in services among CEE countries and assesses the prospects for deepening this trade by addressing existing regulatory constraints. Specifically, the services trade for five CEE countries is dissected: Czech Republic, Hungary, Poland, Slovak Republic, and Slovenia, over the period from 2000 to 2022.

The analysis points to several relevant findings. First, trade in services represents only a marginal component of the total external trade for the CEE countries, whereas all the countries are net-exporters of services. Also, several services sectors which account for 'modern services' exhibit increases in their exports. In addition, services supplied internationally through mode 3 are substantial. As reflected in the modest share of services exports in GDP, services in CEE exhibit low tradability. Moreover, the empirical findings derived from the STRI data reveal that, on average, services sectors in CEE countries exhibit a relatively open stance towards international trade. Nevertheless, there are discernible areas where barriers to trade and competition are notably elevated, specifically in the domains of legal services and air transport. Similarly, the results from the Digital STRI point to an open regulatory setting for trade in digitally



enabled services. The results are driven by measures affecting infrastructure and connectivity, which could be due to the lack of efficient regulation on interconnection as well as burdensome conditions on cross-border data flows. These observations imply the presence of untapped potential for a further expansion of services exports in these economies. Such expansion could be driven by the reduction of the remaining impediments to services trade within these sectors.

These findings hold significant relevance for policymakers in CEE countries in the realm of trade, and economic development, as well as researchers. They emphasize the need to prioritize digitalization and harness technological advancements to boost services trade and stimulate economic growth in the region.

## References

- Ando, M., & Hayakawa, K. (2022). Impact of COVID-19 on trade in services. *Japan and the World Economy*, 62, 101131. <https://doi.org/10.1016/j.japwor.2022.101131>
- Baldwin, R., Forslid, R., & Ito, T. (2015). Unveiling the Evolving Sources of Value Added in Exports. Institute of Developing Economies.
- Benz, S., Ferencz, J., & Nordås, H. K. (2020). Regulatory Barriers to Trade in Services: A New Database and Composite Indices. *The World Economy*, 43(11), 2860–2879. doi:10.1111/twec.13032
- Hoekman, B., & Shepherd, B. (2021). Services Trade Policies and Economic Integration: New Evidence for Developing Countries. *World Trade Review*, 20(1), 115-134. <https://doi.org/10.1017/s1474745620000439>
- IMF. (2016). Central, Eastern, and Southeastern Europe: How to Get Back on the Fast Track. *Regional Economic Issues*.
- IMF. (2023). <https://www.imf.org/en/Publications/WEO/weo-database/2023/October>
- Lawless, M. (2021). Cross-border Trade in Services, *Research Series*, No. 129, The Economic and Social Research Institute (ESRI), Dublin, <https://doi.org/10.26504/rs129>
- McKinsey Global Institute. (2013). A New Dawn: Reigniting Growth in Central and Eastern Europe. McKinsey & Company.
- OECD. (2023a). <https://stats.oecd.org/index.aspx?queryid=106160>
- OECD. (2023b). OECD Services Trade Restrictiveness Index: Policy trends up to 2023.
- Römisch, R. (2001). Trade in Services in the Central and East European Countries. *wiiw Research Report*. No. 274
- Van der Marel, E., & Ferracane, M. F. (2021). Do Data Policy Restrictions Inhibit Trade in Services? *Review of World Economics*. doi:10.1007/s10290-021-00417-2
- Vidovic, H. (2002). The Services Sectors in Central and Eastern Europe. *wiiw Research Report*. No. 289, September 2002
- WIIW. (2021). A New Growth Model in EU-CEE. Friedrich Ebert Foundation, Central and Eastern Europe Department.
- WTO & World Bank. (2023). Trade in Services for Development: Fostering Sustainable Growth and Economic Diversification.

