

# EURO AREA TRADE IN SERVICES: SOME KEY STYLISTED FACTS

## ARTICLES

Euro area trade in services: some key stylised facts

*The euro area appears to be the largest exporter of services worldwide, accounting for almost one-quarter of total world exports of services. In part, this substantial share reflects a large domestic market for services, which seems to be a key factor in developing export capacity in this and other sectors of the economy. At the same time, euro area trade is relatively balanced in terms of specialisation, with exports evenly spread across many manufacturing and services sectors. By contrast, other major world exporters of services, such as the United States and the United Kingdom, are more specialised in specific sectors such as financial services. Notwithstanding these differences, in most countries trade in services still remains relatively subdued compared with trade in goods. While this is due partly to the intrinsically lower tradability of services, greater and more pervasive barriers to trade in services also seem to play a role. Looking ahead, measures to integrate further the EU's internal market for services may boost the international competitiveness of the euro area both in services and in manufacturing and also lead to sizeable welfare gains for the euro area economy.*

## 1 INTRODUCTION

Services provide the bulk of employment and income in most developed countries. In areas such as finance or telecommunications, they also provide vital input for the production of other services and goods. However, despite their dominant role in the domestic economy of the euro area and of other industrialised countries, trade in services has not expanded as vigorously as trade in goods.

Against this background, this article reviews the key stylised facts pertaining to euro area trade in services. Furthermore, it assesses the performance of the euro area in this area of economic activity relative to global trends and in comparison with other major developed and emerging market economies. The article also discusses the importance of boosting trade in services by streamlining the regulation of the services sectors of the euro area.

Sections 2 and 3 look into the main trends in the euro area's trade in services in terms of economic importance and patterns of specialisation. Section 4 investigates whether the euro area is moving into the services sectors where global export growth is most dynamic. Section 5 assesses the role regulatory barriers play in hindering the cross-border tradability of services and discusses the potential welfare gains from the liberalisation of trade. Finally, Section 6 concludes.

## 2 MAIN TRENDS IN EURO AREA TRADE IN SERVICES

In 2005 the total value of euro area exports of goods and services (including intra-euro area trade) was about €3.160 billion.<sup>1</sup> Exports of services represented about one-fifth of this figure and 8% of euro area GDP. At the same time, about 19% of total extra-euro area exports were in services, accounting for 5% of GDP (see Chart 1). Imports of services were of broadly similar magnitudes. The relatively small share of services in euro area trade appears to be in sharp contrast to their contribution to the euro area domestic economy. For instance, in 2005 services represented 72% of the euro area's total value added, while a similar percentage of the euro area workforce was employed in services industries. Moreover, the importance of services in total euro area production has been rising over time, as opposed to the declining shares of agriculture and industry. In other major industrialised economies, such as Japan, the United Kingdom and the United States, as well as in emerging market economies, including India and China, trade in services accounts for a broadly similar share of overall economic activity.<sup>2</sup> In all of these countries, exports of services represent less than 10% of GDP.

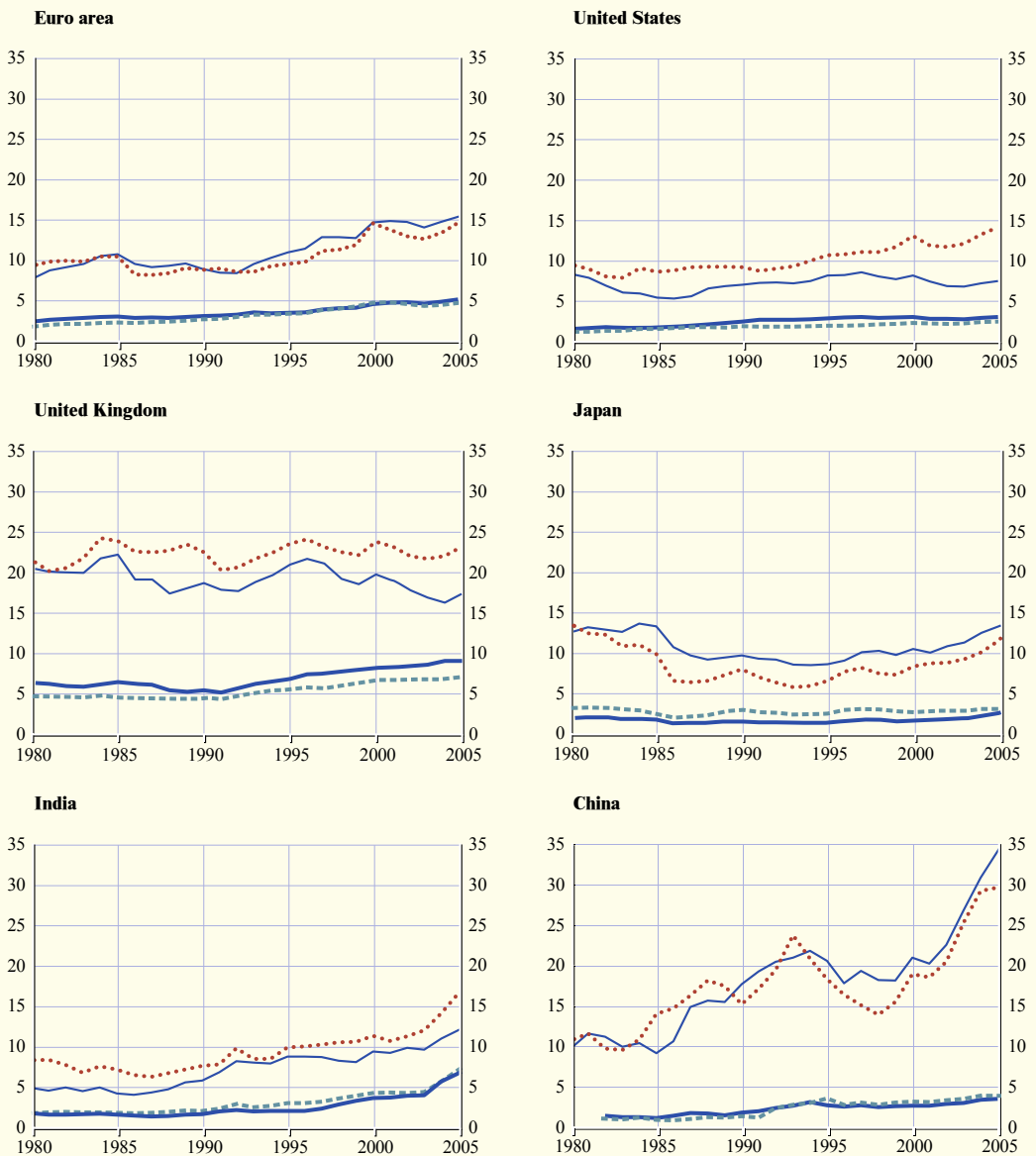
1 The article does not cover trade in services for the period after 2005, as data are only partially available for the years 2006 and 2007.

2 The choice of these countries reflects their status as some of the major world exporters of services.

## Chart 1 Trade in goods and services for the euro area and selected trading partners

(as a percentage of GDP)

— services exports    - - - services imports  
 ..... goods imports    — goods exports



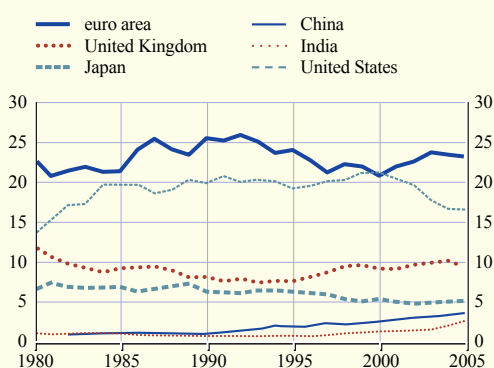
Sources: International Monetary Fund Balance of Payments Statistics Yearbook (as reported by the World Bank's World Development Indicators) and ECB calculations.  
 Notes: Trade in goods and services is based on nominal data. The last observation refers to 2005. Euro area data exclude Cyprus, Malta and Slovenia.

In nominal terms, the euro area appears to be the largest exporter of services worldwide. In 2005 it supplied the rest of the world with 23% of the services traded globally (see Chart 2). The

euro area's positive performance reflects a large domestic market and regional, cultural, linguistic and historical ties that, in many services sectors, play a key role as a platform for developing

**Chart 2 Shares in the world export market for services**

(percentages of world exports of services)



Sources: Eurostat, World Bank and ECB calculations.

Notes: Export market shares are measured in nominal terms. The last observation refers to 2005. Euro area data exclude Cyprus, Malta and Slovenia.

export capacity (see Box 1). Moreover, the euro area's share of world exports of services has been relatively stable over the past decade, unlike its share of world manufacturing, which has declined. By contrast, the United States, which is the second largest exporter of services in nominal terms (accounting for 16% of world exports), has in the recent past experienced sizeable declines in its share of global trade in services, possibly reflecting to some extent valuation effects derived from the weakening of the US dollar. For their part, the United Kingdom (which accounts for 9% of world exports) and Japan (which accounts for about 5%) have had broadly stable world market shares, while China and India (supplying around 3% each) have respectively doubled and quadrupled their market shares in the last decade, albeit from a very low base.

**Box 1****DETERMINANTS OF TRADE IN SERVICES**

In many services sectors, a large and open domestic market plays a key role as a platform for developing export capacity. Empirical estimates derived from standard gravity models lend support to this view, indicating that the greater the economic size and economic freedom of the exporting country (and, to a lesser extent, of the importing country), the greater the trade in services. Moreover, estimates have been found to be robust to different measures of size (value of GDP, population and value added) and economic freedom.<sup>1</sup>

Regional, linguistic, cultural and historical ties are also important. Empirical estimates indicate that existing regional trade agreements – designed to facilitate trade in goods among neighbouring countries – have a positive effect on trade in services. Moreover, services exports are estimated to be about 50% larger between countries using the same language, other things being equal. Linguistic, cultural and geographical elements are particularly important in the successful marketing of services in sectors such as education, traditional medicine and information services. Diaspora populations have also proven critical in many sectors, for example in information technology and audiovisual services.

Distance also matters. As the distance between the importing country and the exporting country increases, trade in services declines faster than trade in goods, owing perhaps to the fact that many services require proximity between producers and consumers. Finally, while a common border greatly enhances bilateral trade in goods, it does not seem to play a role in trade in services.

<sup>1</sup> See, for example, F. Kimura and H. H. Lee, "The gravity equation in international trade in services", *Review of World Economics*, 142, 2006, pp. 92-121, and D. Mirza and G. Nicoletti, "What is so special about trade in services?", Research Paper 2004/02, Leverhulme Centre for Research on Globalisation and Economic Policy.

The geographical distribution of the euro area's trade in services seems to confirm the findings of empirical gravity studies. In addition to featuring a strong regional component, it is influenced by the economic size of trading partners, as well as by cultural, historical and linguistic ties. Indeed, intra-euro area exports account for around 39% of total intra and extra-euro area trade in services. Moreover, 25% of all extra-euro area exports are destined for the United Kingdom, followed by the United States and Switzerland (with 19% and 10% respectively). On the imports side, about 23% of services originate from the United States. The euro area's second most important supplier is the United Kingdom (accounting for 21% of imported services), followed by Switzerland (which accounts for 9%). By contrast, the trade in services of the United States is geographically more diverse, reflecting its different regional, historical and cultural ties (see table).

#### Geographical breakdown of euro area and US trade in services in 2005

(percentages)

Trading partner	Exports	Imports
<b>euro area</b>		
United States	19	23
United Kingdom	25	21
Japan	3	2
Switzerland	10	9
Other European countries	13	17
Emerging Asia	8	7
Argentina, Brazil, Chile and Mexico	2	2
Rest of the world	20	19
<b>United States</b>		
Euro area	19	23
United Kingdom	11	10
Japan	13	7
Canada	9	7
Emerging Asia	14	17
Argentina, Brazil, Chile and Mexico	10	9
Rest of the world	24	27

Sources: Eurostat, OECD and ECB calculations.

Notes: Data refer to extra-euro area trade. Euro area data exclude Cyprus, Malta and Slovenia.

### 3 PATTERNS OF SPECIALISATION

Notwithstanding the euro area's sizeable global market share as an exporter of services, the question arises of how the euro area compares with its major competitors in terms of trade specialisation in services. While the focus of the analysis is on services, in order to provide a benchmark for such an assessment, evidence for manufacturing and commodities is also reported. Chart 3 shows export specialisation indicators for the euro area, China, India, Japan, the United Kingdom and the United States across nine broad economic sectors. These include four services sectors (insurance and financial services, travel, transport, and the composite sector of computer, information and other business services<sup>3</sup>) and five goods sectors (manufacturing, agriculture, fuel, food, and ores and metals). A value greater than 1 on the specialisation index indicates that a country specialises in exports in a given sector, as it implies that the share of the sector in the country's exports is higher than the share of the same sector in world exports. Conversely, an index value smaller than 1 indicates that a country lacks specialisation in a given sector,

since the share of that sector in world exports outweighs its share in the country's exports.<sup>4</sup>

On the basis of this indicator, the trade specialisation of the euro area appears quite balanced across services and manufacturing. The euro area has a specialisation index value moderately greater than 1 for computer, information and other business services (1.1) and index values equal to 1 for travel services and transport services, two sectors which account for almost half of all euro area exports. Finally, the euro area has a relative lack of specialisation in insurance and financial services.

3 "Other business services" covers merchanting services, other trade-related services, operational leasing services and miscellaneous business, professional and technical services, including legal services, accounting, auditing, business and management consulting, and public relations services, etc.

4 Indicators of specialisation are measured by an index of revealed comparative advantage (RCA) following Balassa (1965):

$$RCA_{k,i} = \frac{X_{k,i} / \sum_{k=1}^n X_{k,i}}{X_{k,world} / \sum_{k=1}^n X_{k,world}}$$

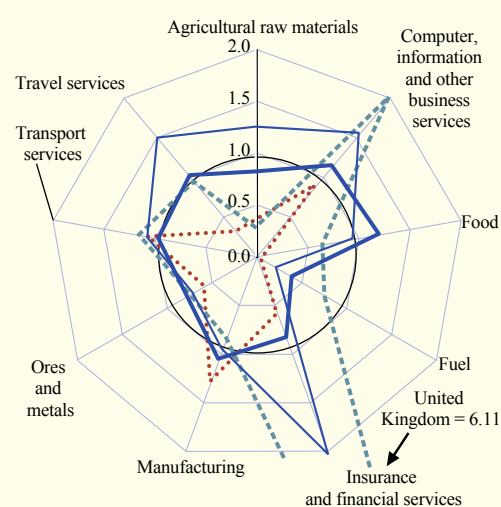
The numerator represents the share of sector  $k$  in the total exports of country  $i$  and the denominator represents the same share in world exports.

Chart 3 Specialisation in services exports

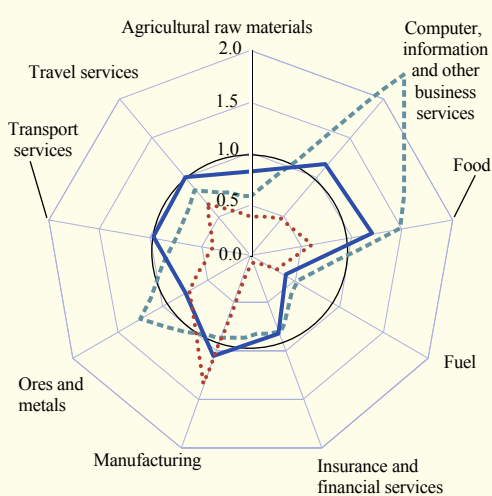
(Balassa index of revealed comparative advantage relative to average world specialisation)

**Euro area, Japan, United Kingdom and United States**

— euro area  
 ..... Japan  
 - - - United Kingdom  
 — United States

**Euro area, India and China**

— euro area  
 ..... China  
 - - - India



Sources: Eurostat, World Bank and ECB calculations.

Notes: Data are averages for the period 2003-05. Specialisation in services exports for the euro area has been calculated on the basis of total euro area exports (the sum of intra and extra-euro area exports). Euro area data exclude Cyprus, Greece and Malta.

The balanced patterns of specialisation observed for the euro area stand out compared with more selective specialisation patterns for individual euro area countries (see Box 2) and for other major world exporters. Indeed, while Japan and China are relatively more specialised in manufacturing, the United States, the United Kingdom and India are relatively more specialised in some services sectors. The United States seems to specialise primarily in insurance and financial services, travel services, and computer, information and other business services. Within this last group, royalties and licence fees, including payments for patents and other intangible property rights, are the main source of revenue. Similarly, the United Kingdom appears to be relatively successful in computer, information and other business services, with a sizable share of revenues accruing in the form of royalties and licence fees. However, it specialises most in insurance and financial services (being

six times more specialised than the world average). Finally, the emerging Indian export industry shows significant specialisation in computer, information and other business services.

Looking at imports, the euro area appears to be a large consumer of extra-euro area transport services and travel services (see Table 1). These two sectors together account for about 45% of total extra-euro area imports of services. At the same time, the share of total imports accounted for by computer, information, insurance and financial services is relatively small (below 5%). These sectors, however, appear to be more intensively traded within the euro area.

Turning to net trade balances, it emerges that, overall, the euro area is a net exporter of services. In particular, it records net exports of computer and information services, travel services, transport services, financial services

**Table 1 Euro area trade balances in services sectors**

(EUR billions)

	Exports	Imports	Net exports
<b>Total</b>	<b>381.7</b>	<b>351.8</b>	<b>29.9</b>
Communication services	8.4	8.7	-0.3
Computer and information services	19.9	10.0	9.9
Construction services	11.9	7.6	4.3
Financial services	18.7	13.9	4.8
Insurance services	9.0	11.6	-2.6
Personal, cultural and recreational services	3.8	6.5	-2.7
Royalties and licence fees	15.2	28.0	-12.9
Transportation	88.8	82.0	6.9
Travel	85.2	78.3	6.9
Other services	120.9	105.3	15.6

Source: Eurostat.

Notes: Data refer to averages for the period 2004-05. Euro area data exclude Cyprus, Malta and Slovenia.

and construction services. Conversely, it is a net importer in the sectors of personal, cultural and recreational services, insurance services and communication services, while also recording a negative net balance for royalties and licence fees.

**Box 2****PATTERNS OF TRADE IN SERVICES ACROSS EURO AREA COUNTRIES**

Trade in services appears to play a larger role in smaller euro area economies, owing possibly to the tendency for a number of smaller countries to specialise in services sectors such as financial services or tourism. Luxembourg is an extreme case, with imports and exports of financial services representing 68% and 111% of GDP respectively. Turning to developments over time, patterns are diverse across euro area countries. In the last decade, growth in traded services relative to GDP has been very strong in Ireland and Luxembourg (see table). Meanwhile, Germany, Greece, Spain, Cyprus, Austria and Finland have also experienced significant increases in exported services relative to domestic GDP, although these started from low levels. In other euro area countries (including France, Italy, the Netherlands and Portugal) trade in services has developed at a pace broadly in line with GDP.

The euro area is heterogeneous also in terms of trade specialisation. Germany, for instance, specialises in exporting construction services and transportation services, while France has a particularly strong comparative advantage in the exporting of personal, cultural and recreational services (see Chart A). Spain, France, Italy and Portugal are important exporters of travel services, while for Germany this sector occupies a prominent position in its imports. At the same time, Austria specialises in imports and exports of insurance services. In line with the important role of the IT sector in the Finnish economy, Finland specialises in imports and exports of computer and information services. Finally, Belgium is a large importer of computer and information services and financial services, while specialising in exports of communication and construction services.

Euro area countries' trade in goods and services<sup>1)</sup>

(as a percentage of GDP; percentage points)

	Goods				Services			
	exports		imports		exports		imports	
	2005	1995-2005 <sup>2)</sup>	2005	1995-2005 <sup>2)</sup>	2005	1995-2005 <sup>2)</sup>	2005	1995-2005 <sup>2)</sup>
Belgium	90.2	25.8	85.9	25.1	14.4	0.3	13.6	0.4
Germany	34.7	13.0	27.7	8.4	5.3	2.2	7.2	2.0
Ireland	54.4	-4.9	33.7	-11.5	28.1	20.5	34.6	19.9
Greece	7.6	-1.6	24.0	3.0	15.1	6.4	6.3	3.0
Spain	16.6	2.7	24.8	7.3	8.2	1.9	5.8	2.1
France	21.6	3.6	23.4	5.1	5.4	-0.4	4.9	0.2
Italy	20.8	1.9	21.5	4.3	5.0	-0.3	5.0	0.1
Cyprus	6.1 <sup>3)</sup>	-6.3 <sup>4)</sup>	35.7 <sup>3)</sup>	-4.0 <sup>4)</sup>	38.1 <sup>3)</sup>	6.1 <sup>4)</sup>	16.6 <sup>3)</sup>	3.5 <sup>4)</sup>
Luxembourg	50.4	5.4 <sup>5)</sup>	59.5	1.8 <sup>5)</sup>	110.5	41.1 <sup>5)</sup>	68.1	19.7 <sup>5)</sup>
Malta	40.9	-12.5	64.6	-22.4	27.9	-6.3	17.0	-5.9
Netherlands	64.5	15.2	57.5	12.6	12.5	1.1	11.6	0.8
Austria	40.5	17.0	41.2	13.4	17.4	3.2	16.0	5.4
Portugal	20.8	1.8	33.3	3.6	8.2	0.8	5.4	-0.3
Slovenia	54.2	4.5	58.5	4.4	11.6	-0.5	8.4	0.3
Finland	34.2	4.3	30.5	6.1	8.7	2.6	7.8	-0.4
Euro area	31.2	7.9	30.2	7.7	8.0	1.8	7.7	1.7

Sources: World Development Indicators and ECB calculations.

1) All trade figures refer to total (i.e. intra and extra-euro area) trade.

2) Difference in percentage points between the average for the period 2003-05 and the average for the period 1993-95.

3) Data refer to 2004.

4) Owing to a lack of available data, changes refer to the difference between the average for the period 2003-2004 and the average for the period 1993-95.

5) Owing to a lack of comparable data, changes for goods refer to the difference between the average for the period 2003-05 and the average for the period 1999-2001, while changes for services refer to the difference between the average for the period 2003-05 and the average for the period 1995-97.

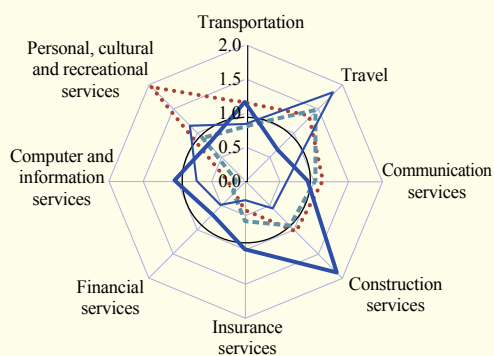
Turning to trade balances, in recent years most euro area countries have either consistently recorded positive net exports of services or have always been very close to balance. Germany and Ireland are exceptions, with traditionally large net imports of services.

## Chart A Specialisation in trade in services

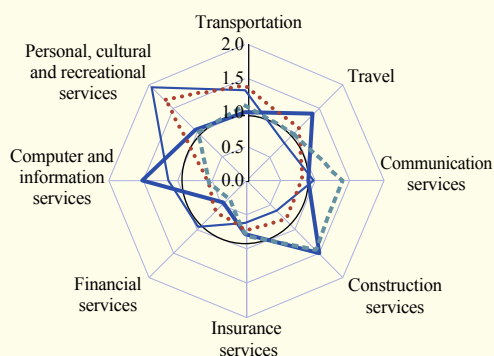
(Balassa index of revealed comparative advantage relative to the euro area)

## Exports of Germany, Spain, France and Italy

— Germany    - - - Italy  
 ..... France    — Spain



## Imports of Germany, Spain, France and Italy



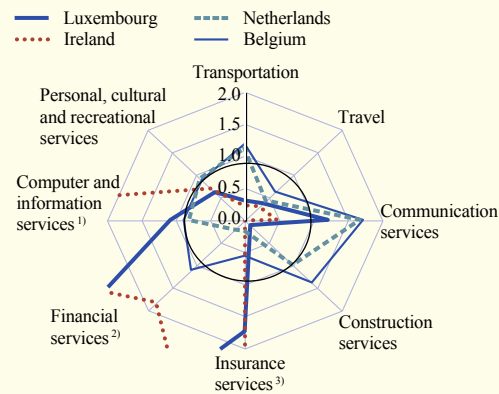
Sources: Eurostat and ECB calculations.

Notes: Data are averages for the period 2003-05. Owing to a lack of available data, figures for Greece and Malta are not reported.

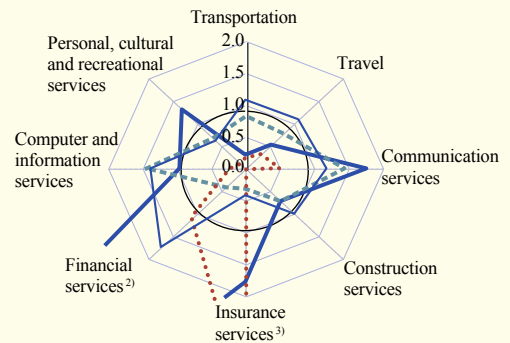
## Chart A Specialisation in trade in services (cont'd)

(Balassa index of revealed comparative advantage relative to the euro area)

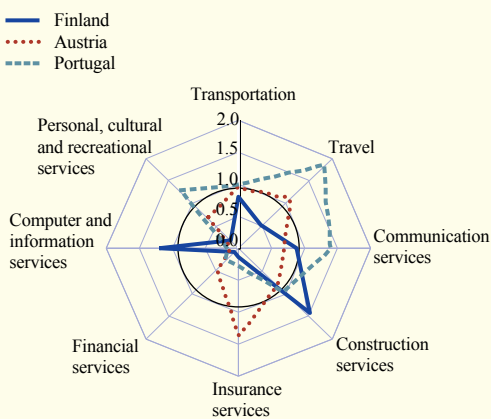
### Exports of Belgium, Ireland, Luxembourg and the Netherlands



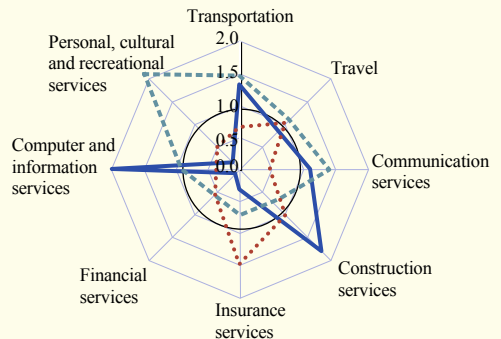
### Imports of Belgium, Ireland, Luxembourg and the Netherlands



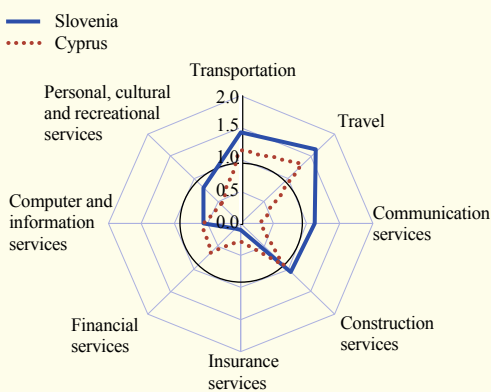
### Exports of Austria, Portugal and Finland



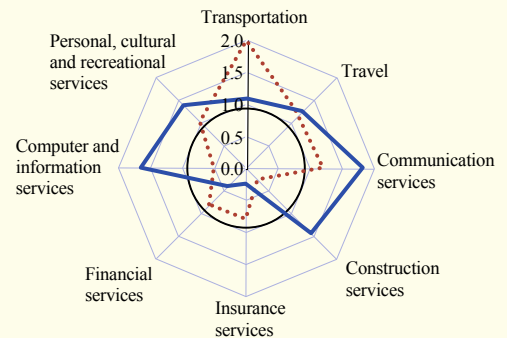
### Imports of Austria, Portugal and Finland



### Exports of Cyprus and Slovenia



### Imports of Cyprus and Slovenia



Sources: Eurostat and ECB calculations.

Notes: Data are averages for the period 2003-05. Owing to a lack of available data, figures for Greece and Malta are not reported.

1) The Irish revealed comparative advantage in exports of computer and information services is 6.5.

2) The Luxembourg revealed comparative advantage in financial services is 11.2 for exports and 13.5 for imports.

3) The Irish revealed comparative advantage in insurance is 6.2 for exports and 3.7 for imports.



#### 4 EVOLUTION OF EXPORTS AND WORLD DEMAND

This snapshot of the euro area's specialisation relative to its main trading partners leads to another question, namely whether the euro area is specialising in the most dynamic sectors in terms of world demand. Chart 4 brings together sectoral evidence on recent changes in export specialisation in the euro area and the other major service-exporting countries of the world (China, Japan, India, the United Kingdom and the United States).<sup>5</sup>

For each country, bubbles of different sizes indicate the relative importance of a sector in the country's overall exports. Sectors with increasing specialisation are located on the right-hand side of each chart, in the upper or lower quadrant, depending on whether the worldwide exports in the given sector are growing at a rate higher or lower than the average cross-sector growth rate of total world trade. Conversely, sectors with declining specialisation appear on the left-hand side of each chart, on the upper or lower quadrant, where global trade growth in that sector is respectively higher or lower than average total world trade growth across sectors. For example, financial services, the global trade performance of which is very dynamic, are identified as a fast-growing sector. Hence, the bubble corresponding to this sector is located towards the top of each chart, respectively in the upper-left or upper-right quadrant for countries whose export specialisation in financial services has decreased or increased over the reference period.

While, in general, it appears advantageous to specialise in fast-growing areas and move out of those that are growing slowly, in practice indications from such classifications should be interpreted with caution. These classifications are based on a methodology that does not take into account other important factors such as differences across sectors in value added per worker and the natural comparative advantages of countries.

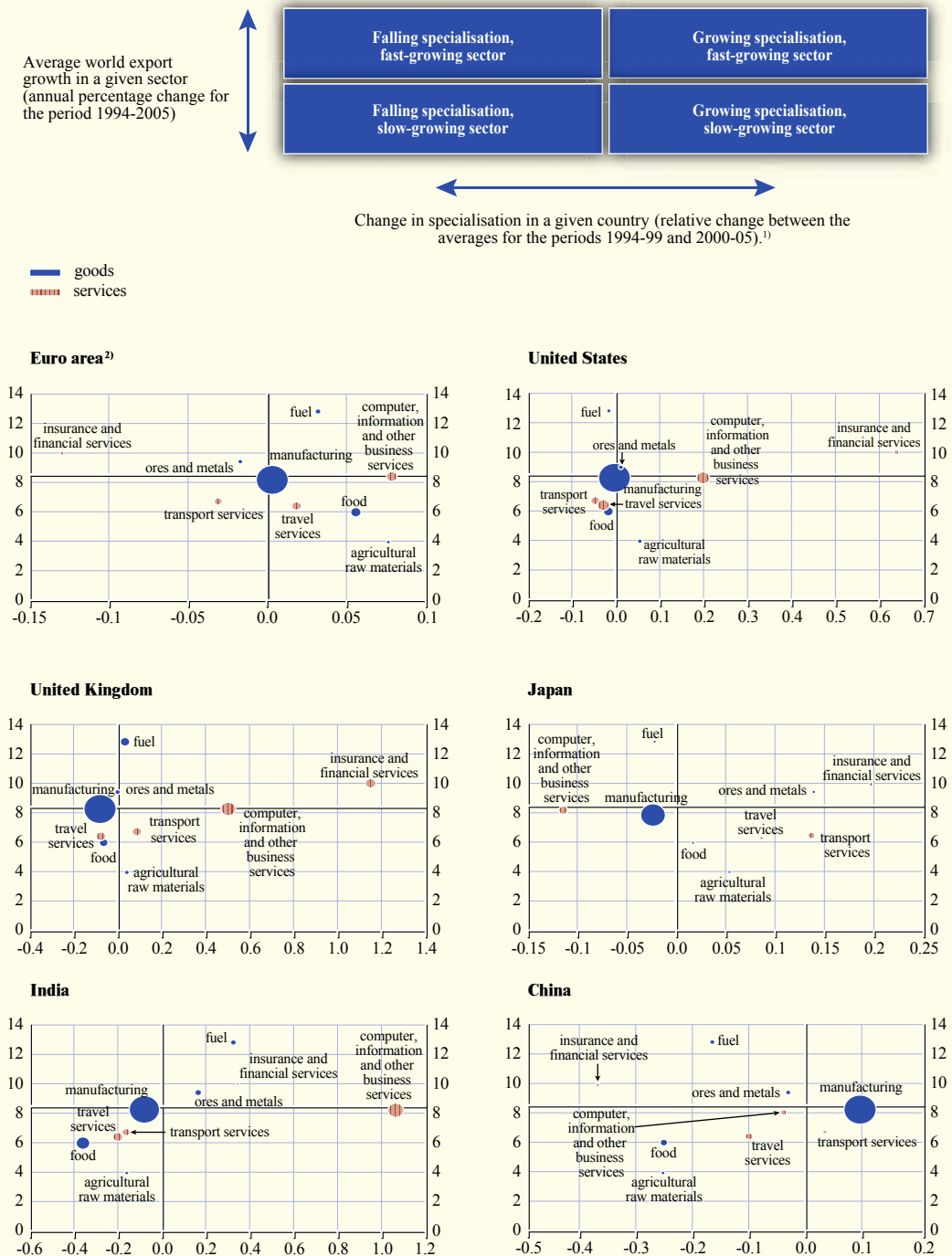
The change in specialisation over the two periods 1994-99 and 2000-05 would suggest that, of

the faster-growing services sectors in terms of world demand, the euro area has increased its specialisation mainly in the computer, information and other business services sector. This sector comprises the services with the fastest-growing world demand after insurance and financial services, where the euro area has in fact reduced its overall specialisation. Furthermore, the euro area's export specialisation has increased in travel services (which also includes personal, cultural and recreational services). This group of services has experienced sluggish global growth in the recent past but may, however, recover if emerging market economies increase their consumption of travel services. Meanwhile, the euro area has reduced its export specialisation in the transport services sector in line with the sluggish global growth of this industry. In the case of goods, the euro area continues to specialise in manufacturing, in line with past trends, while it is also increasing its specialisation in the food, fuel and agricultural raw materials sectors.

Turning to the other major world exporters of services, the United States also appears still to be specialising in manufacturing. At the same time, this country is increasing its specialisation in most of the fastest-growing services and goods sectors, while retreating from large sectors with sluggish growth in world demand. The same holds for the United Kingdom, which, while retreating from manufacturing and the sluggish travel services and food sectors, is specialising in the fast-growing insurance and financial services and computer, information and other business services sectors. India, whose share of exports in computer, information and other business services is twice as large as the euro area's share, is also positioning itself in the fastest-growing industries, while retreating from sectors with sluggish growth in world demand. Finally, Japan and China seem to be following a different pattern, with Japan retreating from some fast-growing services and goods sectors and China clearly focusing on manufacturing.

<sup>5</sup> These charts are based on those of the International Trade Centre (see <http://www.intracen.org>).

Chart 4 Changes in the export specialisation of the euro area and major trading partners



Notes: The size of the bubbles is determined by the sector's share in total exports. The solid horizontal line shows the average total world export growth across all sectors for the period 1994-2005.

1) The change in export specialisation is defined as the change in the Balassa index of revealed comparative advantage. This has been calculated on the basis of nominal data.

2) For the euro area, the change in specialisation has been calculated on the basis of total euro area exports (the sum of intra and extra-euro area exports).

## 5 IMPEDIMENTS TO TRADE IN SERVICES

Barriers seem to play a significant role in limiting trade in services (see Box 3). At the same time, empirical analysis shows that potentially very large gains are associated with the liberalisation of trade in services. The findings of studies that analyse the potential gains from the liberalisation of trade in services vary on the basis of the estimated size and nature of initial trade barriers, as well as the theoretical approach and data used therein. In general, they nonetheless indicate that the gains from the liberalisation of trade in services are larger than those from the liberalisation of trade in goods, with some studies suggesting that the former can be as much as five times the size of the latter.<sup>6</sup> This outcome stems from a number of distinctive features of the liberalisation of trade in services:

- Higher levels of protection. Current levels of protection are higher and more pervasive in trade in services than in trade in goods, which naturally means that there are larger gains to be had from liberalisation.
- Improved mobility of people and capital. A major benefit of liberalising trade in services is the improved mobility of people and capital, leading to spillover benefits for the whole economy.
- Opening up of services markets. The removal of barriers to market access for service providers will open services markets to new entrants – both local and foreign. While the removal of barriers to trade in goods benefits primarily foreign exporters, important gains from the liberalisation of services are likely to stem from increased domestic competition and efficiency of production.
- Infrastructural role of services. The term “services” covers a heterogeneous group of activities spanning banking, insurance, transportation, telecommunications, consulting, legal services and retail and wholesale trade. Part of this activity plays the important infrastructural role of facilitating transactions, providing the economic function of intermediation either through time (banking, insurance, legal) or space (telecommunications, transportation, retailing, wholesaling), which, when explicitly modelled as such, can make a crucial contribution to overall economic efficiency and growth.

<sup>6</sup> See J. Nielson and D. Taglioni, “Services Trade Liberalisation: Identifying Opportunities and Gains”, OECD Trade Policy Working Paper No 1, 2004.

### Box 3

#### WHY IS TRADE IN SERVICES GENERALLY MORE LIMITED THAN TRADE IN GOODS?

Notwithstanding cross-country differences in trade specialisation, for most countries, trade in services is relatively subdued compared with trade in goods. However, the assumption behind most discussions about trade in services is that it can be assessed using the same models and assumptions as for trade in goods. While there is a certain appeal to equating services to goods when discussing trade, empirical observations highlight three distinctive features of services, which contribute to the different levels of trade in goods and services and should be taken into account when discussing trade in services.

First, as mentioned previously, services are less tradable than goods. Once provided, many services are simultaneously consumed and, accordingly, cannot be resold. In addition, the supplier and consumer often need to be in physical proximity at the time of the provision of the

services. While this is the case, for instance, for personal services such as face-to-face medical consultation or hairdressing services, it should also be noted that for important services, such as financial services, this is not the case. Moreover, the possibility of electronic delivery has somewhat reduced the need for such physical proximity for a range of services. In particular, remote call centres and the internet are reducing the need to establish a commercial presence close to customers. Unfortunately, data on the extent of this phenomenon are not easily available owing to measurement difficulties.

Second, conventional trade statistics systematically underestimate trade in services by large amounts. Unlike trade in goods, trade in services includes not only cross-border trade (e.g. an engineer from Germany planning the urban road design for a city in the United States), which is generally well documented by trade statistics but estimated by the World Trade Organization to account for only 35% of total trade in services.<sup>1</sup> It also includes: (i) the temporary movement abroad of labour suppliers (e.g. a nurse from the Philippines working temporarily in London); (ii) the temporary movement abroad of consumers (e.g. a French resident requiring the services of a Brazilian lawyer in Brazil); and (iii) commercial presence abroad (e.g. a Greek tourist office opening sales offices in Russia or a French museum opening a subsidiary in Hong Kong, China. While trade in services delivered through the temporary movement abroad of labour suppliers or consumers (which accounts for about 15% of overall trade in services) is somewhat underestimated by conventional trade statistics, commercial presence abroad, which the World Trade Organization estimates to account for about 50% of total trade in services, is hardly captured by such statistics.

Finally, barriers seem to play a significant role in limiting trade in services. Services are the area in which most economic regulation is concentrated.<sup>2</sup> Moreover, the nature of barriers to trade in services differs from that of barriers to trade in goods in one important respect. Given that delivery of services often takes place not across the border but within the same country, tariffs cannot ensure effective trade protection.<sup>3</sup> Thus, barriers to trade in services primarily take the form of government regulations (e.g. provisions on licensing or on technical standards). Like most non-tariff barriers, “beyond-the-border regulation” is not only difficult to quantify but also hard to remove, as it is usually linked to wider public policy objectives (e.g. addressing market failures or pursuing public interest objectives).<sup>4</sup>

1 World Trade Organization, “Manual on Statistics of International Trade in Services”, 2005.

2 See, for example, P. Conway and G. Nicoletti, “Product market regulation in the non-manufacturing sectors of OECD countries: measurement and highlights”, OECD Economics Department Working Paper No 530, 2006.

3 See B. Hoekman and C. Primo Braga, “Protection and trade in services: a survey”, *Open Economies Review* 8(3), 1997, pp. 285-308.

4 Regulation can be aimed, for example, at protecting consumers from information asymmetries (which are a common feature of professional services) or can take the form of prudential regulation of financial services, protecting against systemic risks. Furthermore, as natural monopolies are a feature of some services sectors where it can be inefficient to have several providers – or even more than one (e.g. the railways or providers of telecommunications infrastructure), regulation can be necessary in preventing the misuse of monopoly power.

Notwithstanding the potential large gains associated with the liberalisation of trade in services, there is a public interest in curbing barriers to trade in services when the barriers increase costs (for example, by limiting the scope for outsourcing abroad), thereby distorting market conditions, or if they have the effect of reducing competition (for example, by limiting the number of producers in a given

industry, thereby creating rent for incumbent firms while hampering productivity growth and preventing prices from converging to their efficiency level).

A recent study by the OECD has quantified, at the level of individual sectors, regulations that curb efficiency-enhancing competition. The resulting indicators, which cover regulations in

21 OECD countries for the period 1975-2003, suggest that, overall, anti-competitive regulation in services has fallen considerably since 1998 for both the euro area and the other OECD countries considered.<sup>7</sup> A multi-year project started by the Australian Productivity Commission and the Australian National University goes further. It allows restrictions on trade in services to be quantified in a way that distinguishes measures that apply to domestic and foreign suppliers alike (non-discriminatory measures) from measures that mainly restrict entry into the domestic market by foreign suppliers (discriminatory measures), while also extending the analysis to non-OECD countries.<sup>8</sup> According to these indicators, the euro area, the United States and the United Kingdom appear to have relatively similar levels of non-discriminatory and discriminatory measures, although regulation in the euro area and in the United Kingdom remains somewhat tighter than in the United States. By contrast, Japan appears much more restrictive in terms of non-discriminatory measures but has relatively lower discriminatory barriers against foreign providers. At the same time, regulation in South-East Asian countries is by far the most discriminatory in terms of limiting foreign service providers' entry into domestic markets.

The results for the whole euro area mask relatively diverse levels of barriers across individual countries and sectors, in terms of both discriminatory and non-discriminatory restrictions. In broad terms, estimated restrictions seem to follow a geographical pattern, with overall barriers to services in southern euro area countries higher than in northern euro area countries. Meanwhile, sector-specific indices for the euro area show that barriers are considerably higher in the euro area than in the United Kingdom and the United States in services sectors with the important infrastructural role of facilitating transactions, such as legal services and distribution.

Looking ahead, the Services Directive, which was adopted by the European Parliament and the Council in December 2006 and which is scheduled to be transposed into national legislation by the Member States by the end of

2009, is expected to reduce barriers to services traded within the EU. The Directive aims to create a genuine internal market in services by removing legal and administrative barriers to the development of cross-border services. This implies that Member States must not only remove discriminatory barriers and cut red tape, but also modernise and simplify the legal and administrative framework and make their administrations cooperate much more systematically. For instance, businesses in services sectors should in the future be able to obtain all necessary licences and permits more quickly in order to establish themselves in other Member States, instead of waiting for months or years. The simplification and harmonisation of the administrative framework is expected to reduce the entry costs of new businesses, eliminating the need to spend time and money on discovering what the legal and administrative formalities are. In addition, since Member States will be prohibited from applying "economic needs tests", service providers will benefit from considerable cost savings and a higher degree of certainty when filing applications for authorisation to set up a business in another Member State.

All in all, the objective is to make it easier for businesses to provide and use cross-border services in the EU, thus increasing cross-border competition in services sectors, bringing down prices and improving quality and choice for consumers. The Directive also aims to strengthen the rights of users of services. The activities to which the provisions of the Services Directive apply directly represented roughly 30% of the total value added and 40% of total employment in the euro area in 2005.<sup>9</sup>

7 See P. Conway and G. Nicoletti, "Product market regulation in the non-manufacturing sectors of OECD countries: measurement and highlights", OECD Economics Department Working Paper No 530, 2006.

8 For a discussion of the methodology used, see P. Dee, K. Hanslow and T. Phanduc, "Measuring the cost of barriers to trade in services", (2003) in T. Ito and A. Krueger (eds), *Trade in Services in the Asia-Pacific Region*, NBER-East Asia Seminar on Economics, Volume 11, 2003, pp. 11-46, and P. Dee, "A compendium of barriers to services trade", World Bank, 2005.

9 Source: EUKLEMS. Figures for 2005 for market services excluding post, telecommunications and financial intermediation.

The impact on the economy is expected to be broader. Indeed, as discussed above, many services constitute key inputs in other sectors. Hence, the latter would also greatly benefit from increased domestic and intra-EU competition and efficiency of production in the services sector. Large benefits are indeed expected to stem from lower prices and improved quality in the provision of services, similar to what happened with the opening up of the telecommunications sector. The Services Directive is therefore intended to improve the competitiveness not only of service providers, but also of many other European service-using industrial sectors, and is thereby expected to lead to considerable improvements in the EU's overall internal and external trade, employment and growth, as well as in the global competitiveness of its firms.<sup>10</sup>

However, important challenges remain. The Services Directive does not apply to key services such as network services industries or financial services. Despite progress in some specific sectors, such as telecommunications, others are still a long way from being fully integrated and further progress in this direction – going beyond the Services Directive – would enhance the positive effects on employment and growth.

## 6 CONCLUSION

This article provides stylised facts pertaining to euro area trade in services. The euro area appears to be the largest exporter – in nominal terms – of services worldwide. Looking at developments over time, growth in euro area trade in services has accelerated over the last decade, but has remained relatively subdued when compared with the impressive growth rates observed in manufacturing. While this also holds true for most other developed and emerging economies, the aggregate euro area figures mask the greater dynamism of some smaller countries in the euro area.

Turning to patterns of specialisation, euro area trade appears broadly balanced across services

and manufacturing. Meanwhile, other important global suppliers of services, including India, the United Kingdom and the United States, appear to specialise more in specific services sectors.

Over time the euro area has increased its specialisation in a range of traded services with relatively dynamic export growth. These include computer, communication and information services, as well as a range of smaller business services. Conversely, the euro area seems to be lagging behind in financial services, a sector where global exports are growing robustly and where important competitors, such as the United Kingdom and the United States, are highly specialised.

Regional, cultural and historical ties seem to play a prominent role in shaping cross-border trade in services. Indeed, almost half of extra-euro area trade in services is within Europe. However, a well developed domestic market also seems to be important, suggesting that a more integrated internal EU market for services – resulting from transposing the 2006 Services Directive into national legislation – should represent a step forward in enhancing the international competitiveness of the euro area in both the services and goods sectors, while also leading to sizeable welfare gains for the euro area economy.

<sup>10</sup> For more detailed information on the potential macroeconomic consequences of the Directive, see the article entitled “Competition in and economic performance of the euro area services sector” in the May 2007 issue of the Monthly Bulletin.