Unlocking the Growth Potential of Services Trade

HSBC Commercial Banking

Contents

Executive summary

Services exports are helping to support the global economy:

Breaking new ground in macro research, Oxford Economics has captured current and historical statistics on bilateral trade in services for 24 key trading nations to build a unique, comprehensive database. These previously elusive data give us unprecedented insight into the evolution of services trade.

- Services' share of total world trade rose from 20% in 2011 to 23% in 2015, as service exports grew faster than goods exports. Outsourcing of intermediate business services to specialised suppliers is driving much of this growth.
- Our projections indicate that services' share of global trade will continue expanding over the next 15 years, rising to 25% by 2030, with particularly strong gains in business-related services. We expect the value of services exported each year to increase by more than 2½ times during this period, from $4.8trn to $12.4trn.

Our analysis identifies several trends driving trade in services:

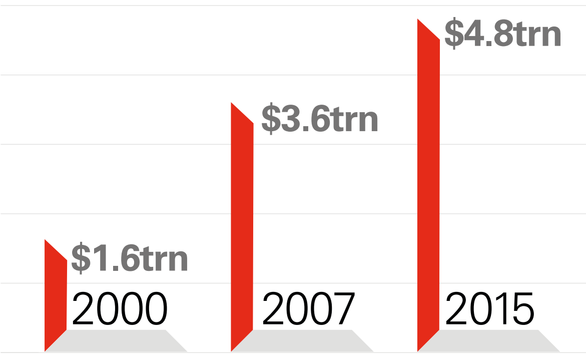
- Technological developments and advances in trade liberalisation have made services more tradable and are even generating new types of service exports. At the same time, significant structural shifts in the global economy, such as the rise of the global middle class, are rapidly boosting demand for a broad range of consumer-related services.
- Developed countries currently dominate international service exports, especially in knowledge-intensive industries like financial services, where developed nations can capitalise on their skilled workforce, infrastructure, and wealth. In contrast, developing countries' exports still tend to depend more heavily on natural resource endowments (e.g. tourism). But there are notable exceptions, such as India, which is a highly successful exporter of business process outsourcing and support services for finance, medicine, and engineering.
- In coming years, the geographic footprint of services trade will expand as emerging markets, leveraging an increasingly skilled workforce and improving digital infrastructure, erode the developed economies' dominant position. Meanwhile, Asia's growing middle class will support a rapid increase in tourism imports there.
- Capturing the full value of these trends will require support from national policy-makers and trans-national trade organisations to help lower institutional and regulatory barriers to trade. Although the difficulty of untangling the regulatory and other barriers that hamper the tradability of services should not be underestimated, the potential rewards of catalysing new growth sources make this a goal worth pursuing.

Introduction

If asked to visualise international trade, most people would picture containerships transporting manufactured products, or bulk carriers laden with commodities like wheat and copper. Any port offers abundant physical evidence of trade in goods, and we need only visit a local retail store or supermarket to find shelves filled with items bearing labels from far-flung countries.

It is much harder to conceptualise trade in services, because services are less visible and tangible. And because many services require face-to-face interaction, it's easy to assume that services are not tradable across long distances. But this is a misconception. Rapid advances in communication and information technology, and the increasing sophistication of many economies, have multiplied the opportunities for trading services across borders. Today's global economy abounds with examples of exported services, from a bartender serving visiting tourists to an engineer designing a bridge to be built overseas to a financial institution offshoring its call centre services. Shipping itself is, in fact, a service export.

While commentators have focussed attention on the disappointing performance of merchandise trade over the past few years, the more robust performance of trade in services is often overlooked. In fact, growth in services exports has outpaced growth in goods exports by a significant margin for some time, resulting in a rising share of services in total trade.



*Value of services exports shown in nominal US dollar terms
Source: Oxford Economics/WTO

One reason services trade receives less attention than the trade in goods is the limited availability and dissemination of data to track and report their value. Using an unprecedentedly thorough, proprietary dataset[1] that presents a detailed picture of services trade, we can examine the structure and drivers of service exports, and assess their evolving contribution to global trade. This analysis will aid policy-makers in formulating strategies for their countries' future growth, help businesses in need of market intelligence, and suggest ways for all participants in the global supply chain to realise value from fast-growing service sectors.

Defining international trade in services

International trade in services encompasses such a broad range of activities that it is difficult to provide a single abstract definition. Services are often regarded as intangible, non-storable activities that require physical interaction between producer and consumer, but this narrow definition has countless exceptions. For example, movies and software programs are tangible and storable, and neither requires direct interaction between the producer and end consumer.

Our study therefore uses a pragmatic definition of trade in services that encompasses the following important sub-categories (listed in order of their share of total service exports in 2015):

- **B2B and other services.**
  Business-to-business (B2B) services (e.g. legal, consulting, etc.), charges for the use of intellectual property (e.g. licence fees for the use of patented technology or the use of a registered brand name), government and recreational services.
- **Tourism and travel.**
  Spending by visitors for tourism purposes to another country (exports are defined as inbound tourism flows), including people who travel abroad for business, education or medical care.
- **Transport and distribution.**
  Services related to the international movement of goods (e.g. shipping) or transport of people (e.g. air passenger services).
- **Financial services.**
  Services provided by the financial industry, such as banking, insurance, and asset management.
- **Information, communication and technology (ICT).**
  Services relating to communication devices (e.g. telephone services), computers (e.g. online database storage), and relevant applications (e.g. software development).
- **Construction.**
  Services relating to the construction/demolition of buildings and other structures, as well as installations and building repairs (this category excludes architectural and engineering design, both of which are considered as business services).

1 The dataset and underlying methodology are described in Annex 2.

The evolution of services trade: 2000-15

- Commentators' focus on the weakness of merchandise trade in recent years overlooks the more robust performance of trade in services, whose share of total world trade expanded from 20% in 2011 to 23% in 2015.
- One explanation for this development is that services tend to be less cyclical than manufacturing. But growth in service exports is also being supported by structural shifts in the global economy, as falling travel costs, technological advances, and lower trade barriers have made services more tradable.
- A key driver of international trade in services has been the outsourcing of intermediate business services to specialised suppliers. The structural trends mentioned above have also contributed to the expansion of trade in ICT services.
- Exporters in developed countries are generally better placed than firms in emerging markets to take advantage of these trends, as they have access to a larger pool of skilled labour, better infrastructure, and greater financial resources.
- Except for tourism and travel, services tend to play a smaller role in emerging markets' trade flows. But several developing countries are challenging this pattern. In particular, India has had exceptional success in exporting modern tradable services.

2.1
Services are becoming more tradable

Technology is helping to make services more tradable

Services have often been considered the economy's non-tradable sector; since they generally require physical proximity and personal interaction, trading them across long distances can seem prohibitively costly and problematic. But services can be delivered in many ways (as described in Box 2). Lower costs of travel, improved communication and information technology, rising demand, and greater global connectivity have all contributed to the expansion of opportunities to trade services across borders in recent years.

Tax and regulatory considerations also have an important influence on patterns of services trade. As these barriers have gradually fallen, services like international air transport, provision of utilities such as electricity and water, and even large construction projects have been opened to foreign competition.

The WTO's four modes of services trade

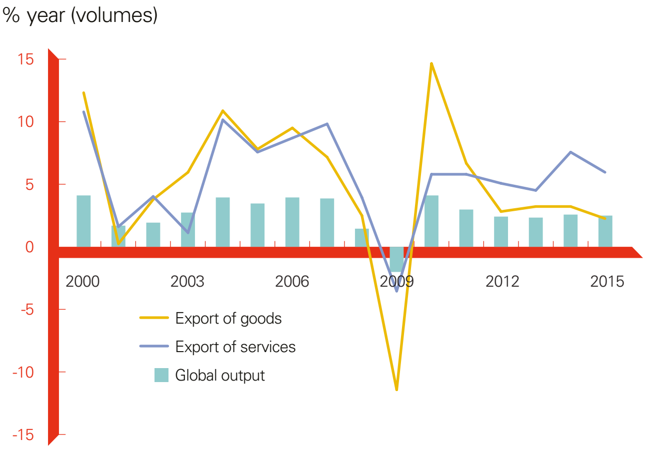
The General Agreement on Trade in Services (GATS) administered by the World Trade Organization (WTO) recognises four modes of supply of services:

- **Mode 1 - Cross-border trade:** A service is supplied from one country to another (e.g. reports sent via e-mail to a foreign client).
- **Mode 2 – Consumption abroad:** The consumer travels to another country to obtain a service (e.g. tourists visiting a restaurant).
- **Mode 3 – Commercial presence:** Service is supplied by a firm in one country via a branch, agency or subsidiary in another country (e.g. a bank establishing a foreign subsidiary to sell services to local clients).
- **Mode 4 – Temporary presence of natural persons:** Suppliers travel temporarily to another country to supply services (e.g. consultants traveling to meet a client abroad).

Identifying the various modes of supply is important for measuring overall trade in services.

Figure 1 illustrates growth trends in the volume of world trade in services and goods compared with global output[2]. It shows how both goods and services trade grew by around 7% a year on average between 2000 and 2007, more than twice the pace of global output. This steady growth was interrupted by the global financial crisis, which caused a 4% decline in the volume of services exported in 2009 and an even sharper 11% decline in exported goods. But both categories of trade bounced back strongly in 2010–11.

Figure 1. Global trade in goods and services



Source: Oxford Economics, IMF, Haver Analytics

More recently, the performance of services trade has diverged from that of goods trade. In particular, growth in world merchandise trade was unusually weak from 2012 to 2015, but services trade held up. Their outperformance appears even more pronounced when measured in value terms, thanks to the impact of lower commodity prices on the value of goods exports. So while services held a broadly stable 20% share of global trade value from 2000 to 2011, this share increased to 23% by 2015.

The more robust performance of services trade over the past few years may partly reflect that services tend to be less cyclical than manufacturing, with less-pronounced peaks and troughs. Weakness in emerging markets has been an important factor dampening trade in goods recently, especially as the sharp slowdown in heavy industry and real estate in China has hit demand for commodities and investment goods. But there is also evidence that trade in goods has been dampened by structural factors, such as the trend toward "near-shoring" of production as manufacturers seek to reduce supply chains that have become too geographically fragmented or costly to maintain. In contrast, there is no evidence that these structural factors are hurting services trade.

Measuring trade in services

Although services account for two-thirds of output in most developed economies, they still represent only around 20%–25% of international trade. One reason is that official statistics almost certainly understate the true importance of services trade to the global economy. This reflects a number of well-known measurement issues:

- Whereas data on trade in goods are recorded by customs officials, data on cross-border trade in services are more difficult to capture as they must rely on a range of surveys and administrative sources.
- Services trade tends to be underestimated because so many services are delivered through a commercial presence in another country[3]. As foreign affiliates and subsidiaries are often considered resident in the country, their production does not count as an export. Estimates suggest that the value of services exports delivered through foreign affiliates is around the same as the value of measured exports[4].
- It is difficult to capture transactions carried out electronically across borders, which have increased rapidly in recent years as their cost has plummeted. For example, McKinsey estimates that cross-border data flows (measured in gigabits) have risen 45-fold since 2005[5]. The origin of transactions can also be unclear, as intermediaries may sell services on behalf of clients based in different countries.
- Services are often embedded within exports of traded goods, but standard data do not capture this. An example would be the design services used to produce a shirt, or the branding and marketing services used to promote the shirt's sale in foreign markets. Similarly, services may be bundled with goods, such as aircraft engines that are sold with servicing contracts or enhanced warranties included in the price. One estimate by Subramanian and Kessler[6] using value-added trade data suggests services' share of world trade may be closer to 40% than the 20% traditional statistics imply.

While we recognise these limitations, our database is built around official definitions and statistics to allow for a consistent cross-country analysis of trade in services.

2 Data on the volume of trade in services are not available at the global level, so we have estimated this series based on country-level data for 31 large economies.
3 There are notable exceptions to this rule. For example, services exports in some countries may be overstated by the presence of multinationals that record profits from foreign subsidiaries as inflows.
4 For example, see Drake-Brockman (2011), *"The importance of measuring the delivery of services via commercial presence of offshore foreign affiliates: Some case studies from Australian business experience"*, Asia Development Bank Institute Working Paper No.295
5 McKinsey Global Institute (2016), *"Digital Globalization: The New Era of Global Flows"*
6 A. Subramanian and M. Kessler 'The Hyperglobalisation of Trade and Its Future' Global Citizen Foundation Working Paper No.3 June 2013

2.2
Business outsourcing underpins growth

As the services sector is extremely diverse, any analysis of trends at the aggregate level necessarily obscures a significant amount of important sub-sector detail. Clearly, not all sub-sectors are influenced by the same socio-economic trends. As detailed in Box 1, our analysis incorporates both commercial and government services (although the latter are relatively small in terms of trade) with important sub-categories of services identified. Figure 2 below illustrates how each of these sub-categories has grown over the past 15 years.

Trade in business and ICT services has flourished…

A key driver of international trade in services has been the outsourcing of intermediate services to specialised suppliers–for instance, when a Chinese company uses a law firm in London to draw up contracts, or a government in the Middle East hires a US management consultant to carry out a study. In some cases, such outsourcing is meant to reduce costs; in others, to benefit from expertise not available domestically. The category **B2B and other services** has averaged growth of 9% a year from 2000 to 2015, increasing its share of total service exports from 28% to 33% during the period (Figure 3). Similar trends have also influenced the expansion of trade in **ICT services**–examples would include an Indian company maintaining a US company's website. Although ICT services account for a smaller overall share of services trade than B2B services, their growth has been even more impressive, averaging 12% a year over the past 15 years.

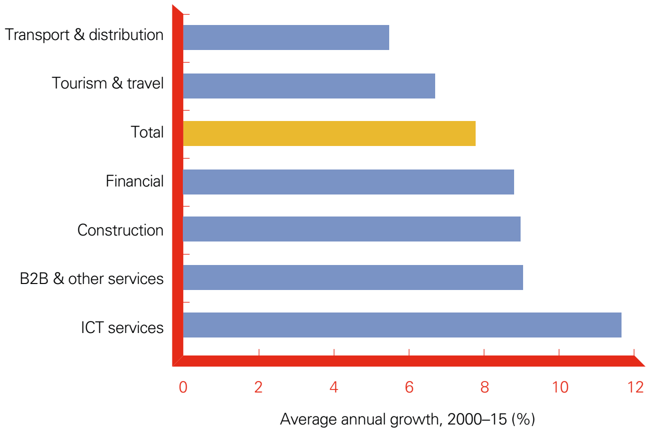
Advances in technology have powered these developments, increasing the tradability of many service categories and even creating new kinds of tradable services—for instance, internet security and website design.

… but regulatory changes are hampering financial services

Financial services exports performed strongly in the years preceding the global financial crisis, rising to 12% of world service exports from less than 10% in 2000, with average annual growth (in nominal US dollar terms) of 16% in this period. But that rate has slowed markedly since 2008 as a result of the enhanced regulatory framework and financial institutions' focus on balance-sheet repair. Financial-service export growth averaged less than 3% per year in 2007–15.

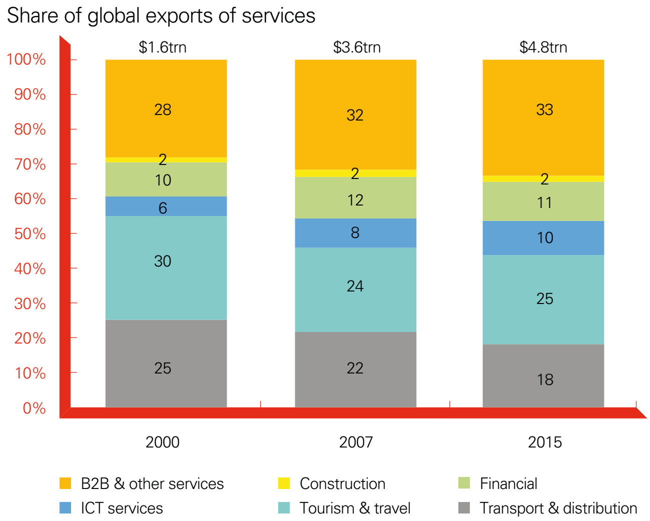
The recent slowdown may seem a little surprising, given the equity markets' relative buoyancy since 2010. One factor may be the regulatory changes that have encouraged banks to pull back from international exposures. In 2000–07 Bank for international settlement-members expanded their cross-border exposures aggressively, and world financial services exports boomed in tandem. But since 2007, these cross-border claims have stagnated—correlating with the weak performance of world financial services exports.

Figure 2. Growth in global exports of services*



*Growth in value of services exports measured in nominal US dollar terms
Source: Oxford Economics/WTO

Figure 3. Structure of world services exports*



*Value of services exports shown in nominal US dollar terms
Source: Oxford Economics/WTO

The weakness of goods trade has dampened transport services

Since freight accounts for over half of global exports of transport and distribution services, the slowdown in merchandise trade growth after the financial crisis has dampened activity in this sub-sector. Of course, transport and distribution services play a critical role in the world economy, moving goods through global supply chains and connecting manufacturers to consumers. But these service exports have been hurt by the recent slide in shipping rates, while supporting and auxiliary services (such as marine logistics and port agency services) have also suffered. One bright spot has been air passenger traffic, which benefitted from the fall in oil prices last year—though not enough to offset the downturn in goods transport.

Lower air fares and rising incomes have supported tourism flows

Globally, tourism and travel is the second-largest service export sector today, behind only B2B and other services. In terms of growth, tourism exports have lagged slightly behind transportation, finance, and ICT service exports. Tourism and travel can be both cyclical—growth fell sharply during the global recession in 2009—and vulnerable to external shocks such as terror attacks. Nevertheless, growth in tourism export earnings has overall been strong, outpacing world GDP growth during the last 15 years. International tourist arrivals now number more than 1 billion, with more than $1 trillion in tourism spending abroad globally. Tourism service exports today are larger than finance and ICT exports combined.

Behind global tourism's strong growth are several economic and connectivity drivers. Rising incomes have created a new class of consumer able to afford regular travel abroad for leisure. The demographic group most likely to travel internationally—working-age people—is growing, and there is a clear trend amongst millennials to prioritise personal experiences above spending on consumer goods or houses. Combined with the ongoing decline in air fares, these trends have transformed tourism from a rare luxury into a leisure activity enjoyed by a much broader spectrum of society. Lower oil prices have boosted tourism flows as well.

Similar demographic trends are driving international education, which also falls within tourism and travel. The ranks of university-age people are growing, and higher incomes allow more of them to enrol in university. Meanwhile, a steady proportion of students choose to study overseas, supported by home country scholarships. Countries including China, Malaysia, and the UAE are challenging established education destinations like the US, the UK, Canada, and Australia. Distance learning and campuses abroad are also contributing to strong growth in international education.

Construction services remain more domestically focussed

Exports of construction services have kept pace with growth in overall services, and their 2% share of total service exports has remained broadly stable over the past 15 years. This sector has benefitted from the gradual lowering of regulatory barriers to trade and the opening of government procurement to private-sector participation. Still, several factors tend to give construction a domestic slant. Projects must usually be managed on site, thus requiring a commercial presence in the foreign market and/or personnel at the construction site. In addition, construction is highly labour- and material-dependent.

The industry is also very cyclical, as is evident from its trade patterns. Construction service exports performed worse than any other service export sector in 2015, plunging by 15% as activity dropped in developed and developing economies. Oil-producing nations in Africa and the Middle East have scaled back particularly sharply on construction projects.

2.3
Emerging markets have begun to scale up services trade

Developed economies still dominate services trade…

Service exports remain concentrated amongst a small number of origin economies. The 10 countries in Table 1 together accounted for 53% of global exports of services in 2015, and the US leads the world in service exports, accounting for close to 16% of the total. Travel and tourism contributed the largest chunk of US service exports (25%), with B2B services (22%) and charges for the use of intellectual property (18% of exports) not far behind. This last category, which relates to use of patents, copyrights, and trademarks, is especially large by international standards, highlighting the US's leading role in developing and marketing new technologies.

Table 1. Leading exporters of services (2015)*

Rank (change from 2000)	Exporters	Share of world services exports (%)
1 (-)	USA	15.6
2 (-)	UK	7.1
3 (+1)	China	5.9
4 (+1)	Germany	5.3
5 (-2)	France	5.0
6 (-)	Japan	3.4
7 (+7)	India	3.2
8 (+2)	Singapore	2.9
9 (+2)	Ireland	2.8
10 (-1)	Hong Kong	2.2

Source: Oxford Economics, IMF

* Ranking of the 24 countries analysed in this report.

Globally, services make up a growing share of exports by advanced economies, accounting for 33% in the US (up from 27% in 2000) and 44% in the UK (vs. 30% in 2000). In fact, despite a slowdown in the UK's financial services exports since the 2008–09 crisis, UK exports have become more dependent on services in recent years as other business services and creative sectors like advertising, design, and architecture have boomed.

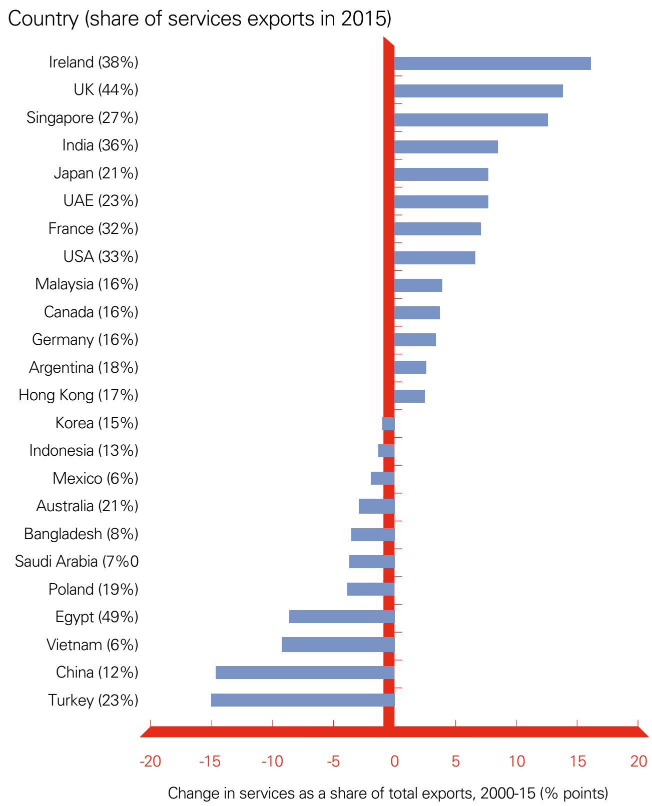
As highlighted in Figure 4, Ireland leads the advanced-economy pack in terms of services' share of total exports, while it ranks second only to Singapore in terms of the share of services exports in GDP (Figure 5). The country is a major supplier of offshored ICT services from other developed economies. However, data on Irish service exports may be overstated, since they include the large number of multinationals that are headquartered in Ireland and record sales from foreign subsidiaries as exports. As a result, the country's high ranking in the league table of global services exports should be interpreted with caution.

... but emerging markets have gained market share in tourism...

Table 2 highlights the bilateral export flows that have experienced the largest increase in value over the past 15 years. The ranking is mainly dominated by trade between developed markets, although there are exceptions such as the surge in tourism flows from China to Hong Kong.

Indeed, emerging economies, too, are tilting toward services trade. For example, of the countries listed in Figure 4, Egypt has the highest proportion of services in its total exports, even though this share has declined somewhat in recent years. Like many other developing economies, it enjoys natural resource endowments that fuel its strength in services, with tourism accounting for 48% of total services exports and transport (mainly linked to remittances from the Suez Canal) accounting for a further 38%.

Figure 4. Change in services share in total exports, 2000-15



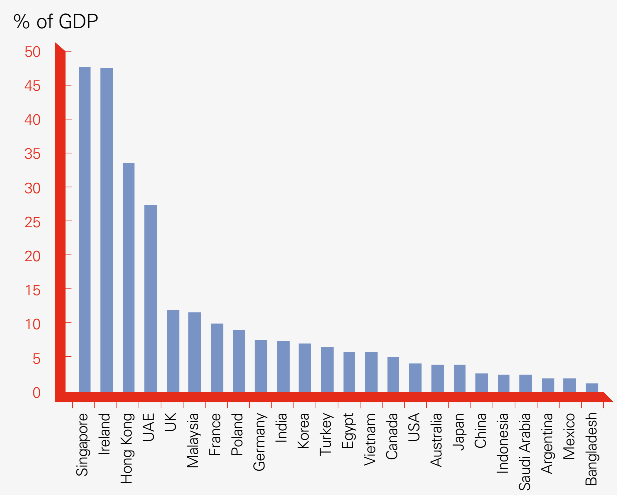
Source: Oxford Economics, IMF

Table 2. Leading bilateral export flows (increase in value, 2000-15)

Rank	Origin	Destination	Sector
1	United States	Ireland	B2B and other services
2	United Kingdom	United States	B2B and other services
3	Hong Kong	China	Tourism
4	United States	China	Tourism
5	Japan	United States	B2B and other services
6	Germany	United States	B2B and other services
7	United Kingdom	United States	Financial services
8	United States	United Kingdom	Financial services
9	Canada	United States	B2B and other services
10	United States	Canada	Tourism

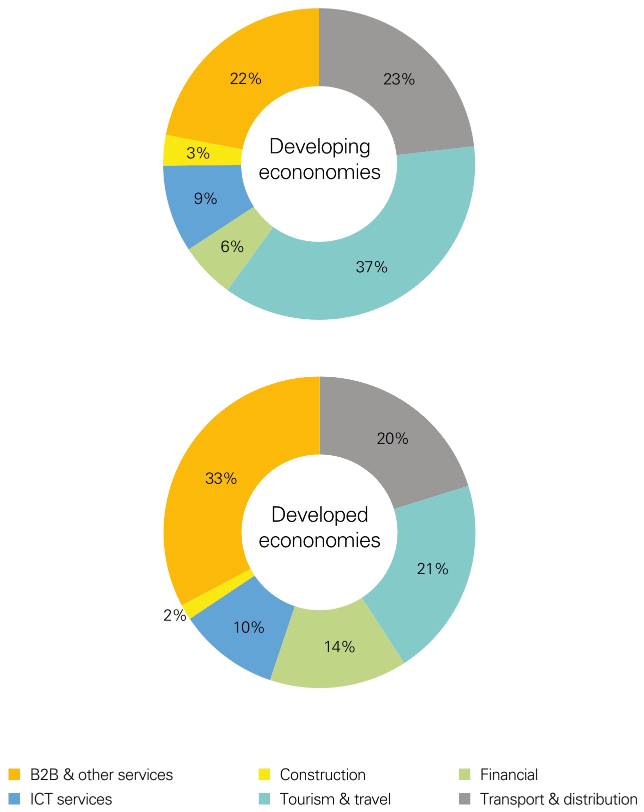
Source: Oxford Economics

Figure 5. Share of services exports in GDP, 2015



Source: Oxford Economics, IMF

Figure 6: Structure of services exports, 2015



Source: Oxford Economics, IMF, WTO

Figure 6, which shows services trade by sector, illustrates developing economies' relatively higher share of exports that depend on natural resource endowments (e.g. tourism, transport) or are labour-intensive (e.g. construction). They tend to lag developed economies in their share of knowledge-intensive exports like financial services, hindered by shortages of skilled personnel, lack of infrastructure, and limited financial resources.

China, Hong Kong, Malaysia, Singapore, India, UAE, and Turkey have moved up the global league tables for tourism export earnings, while more established destinations like the US, France, and UK (while still growing) have lost market share. UAE has enjoyed the most spectacular tourism export growth over the last 15 years, led by Dubai, which has enhanced its air transport connectivity, hotels, and attractions.

China now ranks as the third-largest global exporter of services, with travel and tourism contributing 40%. Despite their robust growth, however, services have fallen as a share of total trade, reflecting the country's prioritisation of manufactured exports and its areas of comparative advantage.

…and some developing countries are moving into B2B services

Yet some developing economies have capitalised on their supply of low-cost labour to escape from a narrow focus on tourism. One is India, whose large, tertiary-educated workforce and widespread use of English have helped it conduct business with foreign companies from English-speaking economies. India is now a highly successful exporter of business process outsourcing and support services for finance, medicine, and engineering. Services account for 36% of India's total exports, up from 28% in 2000. Bangladesh also has become an attractive location for business process outsourcing and ICT services, ranging from data entry to software development.

Services imports to developing countries are also rising, led by China

As Table 3 shows, most of the world's largest importers of services are also its biggest exporters. Notably, the US and UK are large net exporters of services, with this positive trade balance helping to offset a deficit in goods trade. In contrast, Germany and Korea run service trade deficits. China has a significant trade surplus in goods but is a net importer of services, largely because of sharp increases in imports of travel and tourism as Chinese citizens jet around the world. China accounted for one-quarter of the expansion in global outbound tourism spending over the last 15 years and is now the world's biggest market, up from No. 8 in 2000.

Table 3: Leading importers of services (2015)*

Rank (change from 2000)	Importers	Share of world services imports (%)
1 (-)	USA	10.1
2 (+6)	China	9.7
3 (-1)	Germany	6.2
4 (+1)	France	4.8
5 (-1)	UK	4.4
6 (-3)	Japan	3.7
7 (+3)	Ireland	3.5
8 (+3)	Singapore	3.0
9 (+5)	India	2.9
10 (-1)	Korea	2.4

Source: Oxford Economics, IMF

* Ranking of the 24 countries analysed in this report.

Outlook for trade in services: 2016-30

- The value of services exported each year is expected to increase by more than 2½ times by 2030. Services' share of global trade will also rise, from 23% in 2015 to 25% by 2030.
- The fastest expansion is likely to occur in business support services, where ongoing advances in technology help to facilitate increased offshoring. And the growing middle class in Asia will support a rapid increase in tourism flows.
- The geographic footprint of services trade is set to expand as emerging markets export more services. Trade between emerging markets will grow in importance as demand for services expands with rising incomes.
- But service providers face regulatory and institutional impediments to trade that are often more costly than those faced by manufacturers. Tackling these regulatory and institutional constraints could catalyse trade in services and jump-start global economic growth.

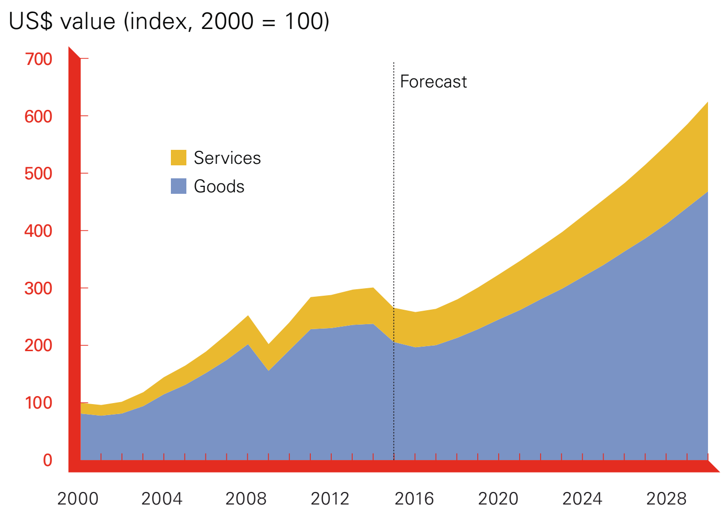
3.1
Future trends in global services trade

As part of our forecast, we identified five global trends that will be critical for determining the outlook for trade in services:

- **Technological advances.** As the global digital economy evolves, advances in technology are likely to make services increasingly tradable.
- **Trade liberalisation.** Past advances in trade liberalisation will continue to yield dividends in coming years. A number of multilateral and bilateral accords currently under negotiation would help to further lower barriers to trade in services if successfully implemented, although our baseline projections do not take these into account due to their uncertain fate..
- **Outsourcing of support services.** Companies will continue outsourcing support services to lower-cost providers, helping to boost overall productivity while economies focus on areas of comparative advantage.
- **Rise of the 'global middle class'.** Rising incomes in the developing world (especially Asia) are generating an emerging middle class with increased demand for a broad range of services.
- **Rebound in merchandise trade.** There is significant correspondence between trade in goods and services, so a cyclical recovery of growth in global goods trade in coming years will support trade in services.

Our forecasts show the US-dollar value of global service exports rising at an average annual rate of over 6% over the next 15 years, with total value more than doubling by 2030 (see Figure 7). Notwithstanding an expected cyclical recovery of trade in goods, this implies that services' share of global trade will continue to rise, edging up from 23% to 24% in 2020, with a further increase to 25% by 2030.

Figure 7: Global exports of goods and services



Oxford Economics/WTO

Table 4: Impact of global trends by sector

	Transport & distribution	Tourism & travel	ICT services	Financial services	Construction	B2B services
Technological advances	Medium	Medium	High	High	Low	High
Trade liberalisation	High	Medium	Medium	Medium	Medium	High
Outsourcing of support services	Low	Low	High	Medium	Low	High
The global middle class	Medium	High	Medium	High	Low	Medium
Rebound in merchandise trade	High	Low	Medium	Medium	Low	Medium

Scale of impact Low Medium High

3.2

Business support services and tourism will drive growth

The outlook for total trade in services masks significant differences in performance at the sub-sector level. Those performance gaps reflect uneven impact from the five key trends we have identified, as summarised in Table 4.

The most rapid expansion is likely to occur in business support services, where ongoing advances in technology help to facilitate offshoring. In particular, exports of **B2B and other services** have until now been driven mainly by outsourcing of administrative support functions, but we expect more skill-intensive services (e.g., R&D, marketing, and design) will go offshore as an increasingly well-educated workforce in emerging markets offers lower-cost alternatives. As illustrated in Figure 8, the share of B2B and other services in total trade is forecast to rise from 33% in 2015 to 37% by 2030. Similarly, ongoing demand for innovative software and the need to address IT security are likely to fuel continued robust growth in **ICT services**, pushing up its share of global trade in services.

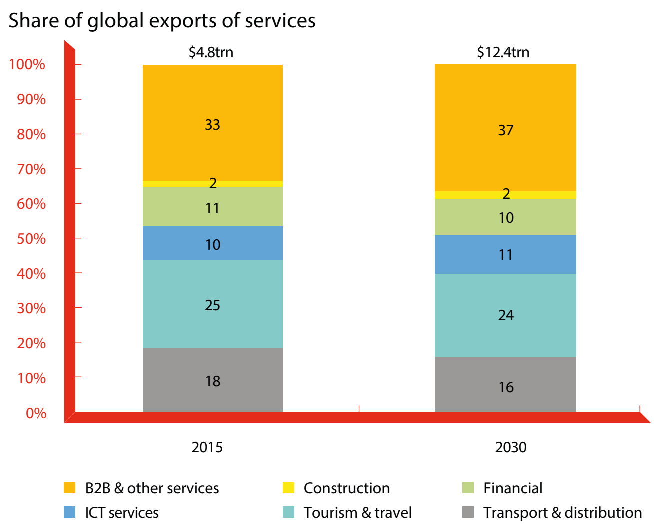
Although service outsourcing has raised concerns about job displacement in developed economies and the quality of services received (e.g. overseas call centres), offshoring of services does not necessarily imply a reduction of domestic employment in these sectors. In fact, offshoring often allows existing service sectors to expand, with developed economies better able to exploit their comparative advantage in knowledge-intensive industries.

Offshoring of intermediate services can also help to increase the productivity and competitiveness of domestic companies, which eventually stimulates output and employment.

While the enhanced regulatory environment will continue to dampen global trade in **financial services** in the short term, the medium-term outlook is more positive. Asia's growing middle class will be particularly important here.

As Asian consumers become richer, they will demand financial services ranging from credit cards to mortgages and investment products. Likewise, the region's maturing corporate sector will require more sophisticated wholesale and investment banking products. Banks, insurers, and brokers across Asia will compete for this business, driving increased cross-border flows in financial services.

Figure 8: Structure of world services exports*



*value of global services exports shown in nominal US Dollar terms

Source: Oxford Economics/WTO

Meanwhile, developing economies will undertake massive infrastructure investments in the next two decades, presenting an opportunity for exporters of engineering, technical, and other business services.[7] At the same time, their aging populations will create labour shortages and an increasing demand for expatriate workers, which will also boost trade in **construction** services. Still, the construction industry's local nature means exports in this sector are unlikely to rank amongst the strongest performing sectors.

Transportation and distribution services are expected to recover in coming years as growth in merchandise trade picks up in response to improving economic conditions. But transport companies will need to adapt to the changing nature of trade in goods, such as the trend toward 'near-shoring' of production as manufacturers seek to shrink supply chains that have become too geographically fragmented and/or costly to maintain. For example, air cargo volumes are likely to face increasing competition from ocean shipping as manufacturers locate closer to their markets and take advantage of ocean shipping's relatively lower freight rates. Distribution centres are also reconfiguring transport routes, as supply chains shorten to serve regional production centres and accommodate tighter timeframes.

The outlook for global tourism and travel exports remains bright, with growth predicted to continue its healthy pace of around 6% a year. The rising global travelling class, especially from emerging markets, will continue to fuel international travel growth. And although older people are less likely to travel, the sheer growth of the over-65 population will mean a large increase in its trips abroad, including for the already growing purpose of medical tourism. Connectivity is expected to continue improving, with hundreds of new airports due for construction. Real air fares should continue to fall, thanks to lower-for-longer oil prices plus ongoing technological improvements and increased competition. Finally, more widespread internet access is making people everywhere aware of multiple tourism options.

7 Jensen (2011), "Global Trade in Services", Peterson Institute for International Economics

3.3
Services trade gets a bigger geographic footprint

Today, with the notable exception of tourism and travel, the developed economies lead most global trade in services. However, this picture is gradually changing. Future growth will be more broad-based; as the skilled workforce expands in developing countries, their digital infrastructure improves, and they're able to offer specialised business and professional services as a result. This is illustrated in Table 5, which shows that China and India will account for a bigger share of global exports of services in 2030, while the share of many developed economies gets smaller.

Service exports from developing economies will also be increasingly directed toward other emerging markets, as illustrated by Table 6. In particular, China's efforts to rebalance its economy away from investment and toward consumer spending imply strong growth in demand for services. Although new and expanding domestic services firms will satisfy some of this demand, Chinese consumers will import services when the foreign producer offers a more sophisticated product or the foreign brand is more trusted than local alternatives. Sectors likely to benefit from China's growing middle class include financial and ITC services. Demand for business services is also expected to grow as China's economy matures.

Table 5: Leading exporters of services (2030)*

Rank (change from 2015)	Exporters	Share of world services exports (%)
1 (-)	USA	13.2
2 (-)	UK	7.2
3 (-)	China	6.6
4 (-)	Germany	4.8
5 (-)	France	4.6
6 (+1)	India	4.2
7 (-1)	Japan	3.5
8 (-)	Singapore	2.9
9 (-)	Ireland	2.7
10 (+1)	UAE	2.7

Source: Oxford Economics

* Ranking of the 24 countries analysed in this report.

Table 6: Average annual growth in services exports between regions, 2016-30

Total	Europe	N America	LatAm	MENA	Developed APAC	Developing Asia
Europe	6.1%	4.9%	6.5%	7.5%	6.9%	9.1%
N America	5.2%	5.6%	5.7%	6.2%	5.9%	8.3%
LatAm	7.0%	6.1%	7.0%	6.1%	7.4%	9.5%
MENA	7.2%	5.1%	6.1%	6.4%	6.9%	9.7%
Developed APAC	5.8%	4.4%	6.3%	7.3%	6.3%	8.1%
Developing Asia	6.8%	5.3%	7.0%	8.0%	7.1%	9.8%

Source: Oxford Economics. Regional definitions based on IMF classification.

Temporary labour movements add further scope for expansion of so-called 'south-south' trade in services (i.e. trade between emerging markets). For example, as the working-age population shrinks in countries like China and Singapore, their construction companies will need young, expatriate workers from places like India, Bangladesh, and Vietnam.

And companies in emerging markets may use intra-regional trade as a stepping stone toward international operations. This has already occurred for a number of telecommunication companies in Asia, and similar expansion of services trade is probable in regions like Latin America, where the recent fall in commodity prices is driving renewed efforts at economic diversification.

Destinations including India and Mexico are forecast to ascend in the global league tables for tourism export earnings, enjoying the fastest rates of growth in this sub-sector. However, the US will remain the largest destination tourism market in 2030, with the US and China accounting for half of the growth in tourism exports across the 24 countries covered by this study. China will also account for two-fifths of the growth in outbound tourism spending across the 24 countries, with the fastest growth of any emerging market.

As medical treatment costs in the developed world increase, more patients from these countries will find the prospect of international travel for medical care appealing, making medical tourism an important driver of future travel exports. Developing countries like India are attractive medical destinations, combining affordable medical treatment with an exciting (but not too costly) vacation.

Table 7: Leading importers of services (2030)*

Rank (change from 2015)	Importers	Share of world services imports (%)
1 (+1)	China	13.4
2 (-1)	USA	7.7
3 (-)	Germany	5.8
4 (+5)	India	5.1
5 (-)	UK	4.6
6 (-1)	France	4.4
7 (-1)	Japan	3.4
8 (+2)	Korea	3.0
9 (-1)	Singapore	3.0
10 (-3)	Ireland	2.7

Source: Oxford Economics
* Ranking of the 24 countries analysed in this report.

3.4
Improving the policy environment to promote services trade

Service firms generally export less than manufacturing firms, even in developed economies with a comparative advantage in service activities. In part, this is because service providers face barriers to trade that are often more costly than those faced by manufacturers. They include not only education, language, culture and institutional differences between countries, but also policy and regulatory constraints.

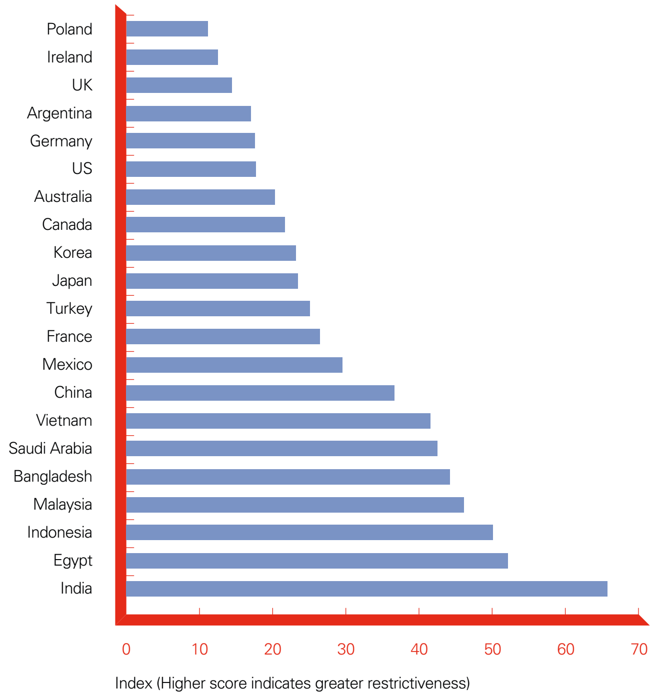
Reducing barriers to trade helps improve allocative efficiency and productivity in the economy. Moreover, there is evidence that increased trade in services supports trade in goods, enhancing competitiveness in shipping, logistics, and distribution while reducing information barriers to international merchandise trade[8]. Foreign service suppliers can also bring new technologies and management techniques, which may have spill-over benefits for domestic firms.

The World Bank produces a summary index rating the restrictions on foreign service providers, ranging from 0 (minimum restrictions) to 100 (maximum), by aggregating relevant legal and regulatory measures. Its analysis shows that the principal barriers to services trade are restrictions on the establishment of foreign operations and the movement of people. At a sector level, accounting, legal services, and air transport have the most restrictions on average, although they vary by country.

As illustrated by Figure 9, emerging markets tend to impose the highest barriers to trade in services, which is consistent with findings in trade literature that developing economies have higher barriers to merchandise trade. With demand for services expected to grow faster in emerging markets than in developed economies over the next 15 years, coordinated trade liberalisation in these countries would clearly yield gains.

Unfortunately, liberalising trade in services is more complex than liberalising trade in goods. Impediments tend to be more covert. Typical examples include licensing requirements, restricted access to distribution channels, quotas governing the number of providers in a market, and lack of recognition of professional qualifications gained overseas.

Figure 9: Services Trade Restrictiveness



Source: World Bank STRI Regulatory Database

However, a number of international negotiations currently under way attempt to overcome these obstacles. These include:

- **Trade in Services Agreement (TISA).** The EU and 23 WTO members[9] are negotiating to progress beyond the stalled efforts to update the General Agreement on Trade in Services (GATS).
- **Trans-Pacific Partnership (TPP).** Negotiations covering goods and services have been concluded between 12 countries around the Pacific Basin. But the agreement still needs to be ratified by all participants. With the US President-elect Donald Trump having promised to abandon the deal as soon as he takes office, the future of the accord remains in doubt.
- **Transatlantic Trade and Investment Partnership (TTIP).** Currently under negotiation between the US and EU, this agreement aims to overcome a variety of regulatory barriers to services trade, although talks appear to have stalled in recent months.
- **Regional Comprehensive Economic Partnership.** Under negotiation between 16 Asian countries, the accord has the potential to liberalise trade in services across much of the region.

If services are to become as globalised as goods, the world needs greater regulatory harmonisation and trade liberalisation. With the correct policies in place, more robust trade in services could jump-start global economic growth, with both developed and developing economies benefitting from the resulting increase in overall productivity.

8 For example, C. Lennon (2009), "Trade in Services and Trade in Goods: Differences and Complementarities", The Vienna Institute for International Economic Studies, Working Papers 53

9 The parties involved in the TISA negotiations are: Australia, Canada, Chile, Colombia, Costa Rica, European Union, Hong Kong, Iceland, Israel, Japan, South Korea, Lichtenstein, Mauritius, Mexico, New Zealand, Norway, Pakistan, Panama, Paraguay, Peru, Switzerland, Taiwan, Turkey and the United States.

10 Countries covered under the TPP are: Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, United States and Vietnam.

Conclusion

Global trade in services is becoming increasingly important. Our projections indicate that technological developments will help services to expand their share of global trade over the next 15 years, with particularly strong gains in business-related services. The geographic footprint of services trade will also expand as emerging markets, leveraging an increasingly skilled workforce and improving digital infrastructure, erode the developed economies' dominant position.

But service firms still generally export significantly less than manufacturing firms, in part because of institutional and regulatory trade barriers. With few remaining restrictions on international merchandise trade, efforts at liberalisation are therefore likely to yield the greatest gains for services trade. Policy-makers have become increasingly aware of these opportunities, with a number of potential trade agreements on the horizon.

The difficulty of untangling the mass of regulations and other internal barriers hampering the tradability of services should not be underestimated. And these challenges are compounded by the current political backlash in many developed countries against global integration. It is therefore crucial that policy-makers and business leaders provide their vocal support for trade liberalisation efforts and emphasise how increased trade stimulates output and employment for all participants.

At a time when the global economy is struggling to gain traction, trade liberalisation's potential to catalyse new sources of growth makes this a goal worth pursuing.

Annex 1: Country data tables

	Value of services exports (US$bn)		Annual growth rate
	2015	2030	2016–30
USA	751	1641	5.3%
UK	345	895	6.6%
China	287	818	7.2%
Germany	254	598	5.9%
France	241	567	5.9%
Japan	163	433	6.8%
India	156	523	8.4%
Singapore	140	359	6.5%
Ireland	135	337	6.3%
Hong Kong	104	216	5.0%
UAE	101	336	8.3%
Korea	98	296	7.7%
Canada	78	209	6.8%
Australia	50	144	7.4%
Turkey	47	139	7.5%
Poland	44	124	7.3%
Malaysia	35	116	8.4%
Mexico	23	63	7.1%
Indonesia	22	91	9.9%
Egypt	19	62	8.3%
Saudi Arabia	16	33	4.8%
Argentina	13	28	5.3%
Vietnam	11	34	7.7%
Bangladesh	3	9	8.5%

Source: Oxford Economics, WTO, OECD, Eurostat

Annex 2: Methodology

Constructing a ground-breaking database

Data on international trade in services remain much scarcer and less detailed than data on merchandise trade. A variety of factors contribute to the difficulty in compiling data on services, including collection methods (company surveys rather than customs records for goods), definition of service categories, and the complexity of multinational operations. Moreover, available cross-country data are dispersed amongst a variety of national and supra-national statistical agencies.

To overcome these difficulties and provide evidence on emerging trends in services trade, Oxford Economics has constructed a unique, proprietary database for HSBC, detailing bilateral export and import flows between 24 key trading nations. We used a variety of sources, exploiting the strengths of each and unifying them into a consistent and reliable database. Where data were not available, we created estimates by comparing an economy's export structure with a similar economic footprint, overlaid with the country and sector-specific knowledge of our team of economists. The result is a comprehensive database that, for the first time anywhere, describes bilateral trade in services globally, allowing us unprecedented insight into its evolution.

Forecasting trade in services

Using this unique e historic database as a starting point, we constructed forecasts of bilateral trade in services were constructed based on HSBC's own analysis and predictions forecasts of the world economy. These macro projections indicate that world GDP growth over the next 2-3 years will be subdued, picking up to around 2.8% a year on average (in real terms) in the decade to 2030. This pace of expansion over the long term implies a significant slowdown from the 3.4% average annual growth rate in output during the pre-crisis period of 1998-2007.

We assume that the responsiveness of global trade to GDP gradually recovers over the medium term, but remains subdued compared with pre-crisis levels. Over the medium term, exchange rates are expected to converge toward their estimated equilibrium rates. This implies a gradual depreciation of the US dollar from current levels against a basket of currencies.

Oxford Economics took a top-down approach, using our suite of economic models to ensure consistency between HSBC's forecasts for economic growth and exchange rates in key countries and the more granular projections for bilateral trade flows presented here. We constructed headline bilateral trade forecasts as a function of demand in the destination market and the exporter's competitiveness (as measured by relative unit labour costs adjusted for the exchange rate). These headline bilateral export forecasts were also disaggregated by sector, using Oxford Economics' industry forecasts to inform future production trends and taking into account the historic relationship between output and exports in each country/sector.

All trade flows data are reported in nominal US-dollar value terms (using market exchange rates) unless otherwise specified. The data therefore reflect fluctuations in a country's terms of trade due to relative price and exchange rate effects.

The projections assume unchanged national policies and do not take account of potential new reforms, whose implementation remains uncertain. Thus, any effects from regional or sectoral trade agreements would be in addition to the results shown here.

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