Spotlight on services

Richard Barfield, August 2023

Services trade is key to the economy but does not get the attention it deserves. Services exports are growing as a share of total trade and, at first glance, they look like the bright spot in the UK's post-Brexit trade performance. However, the Trade and Cooperation Agreement (TCA) is having major impacts on services exports to the EU which are masked by the effects of inflation and growth in non-EU exports, especially to the US.

This article looks behind the mask to assess the impacts on different categories of services exports. We compare 2022, the first post-TCA year of global trade patterns as Covid

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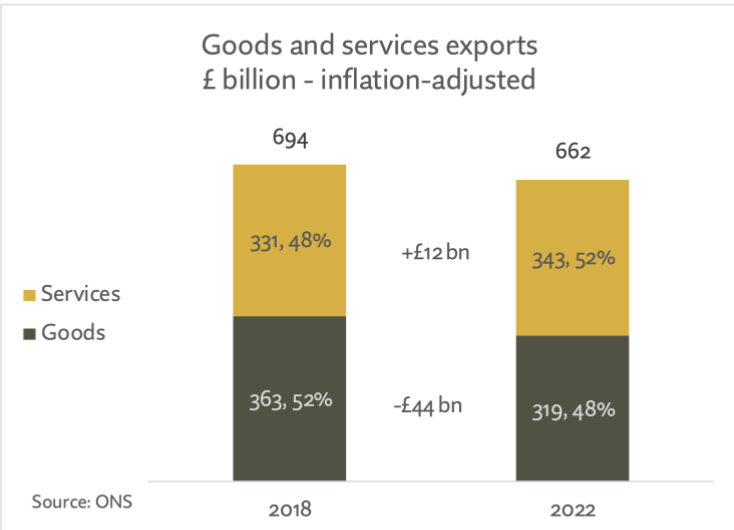
https://rbas.co.uk/pdfs/SpotlightOnServices_RBAS_September2023.pdf

is under threat. The 2022 league table from the World Trade Organisation has China close behind, followed by Germany, Ireland, France and India. In the key area of digitally delivered exports, China, India and Ireland are all growing much faster than the UK.[2]

In 2018, services accounted for 48% of all UK exports (Figure 1), with the EU being the main trading partner (39% of services exports), followed by the US (24% of services exports).

Figure 1 – UK goods and services exports[3]



By 2022, services exports had grown by £12 billion, and goods exports had reduced by £44 billion to make services 52% of total UK exports. These inflation-adjusted figures are at constant 2019 prices from Office for National statistics (ONS).

[1] International trade in UK nations, regions and cities: 2021, June 2023. ONS recommends 2018.

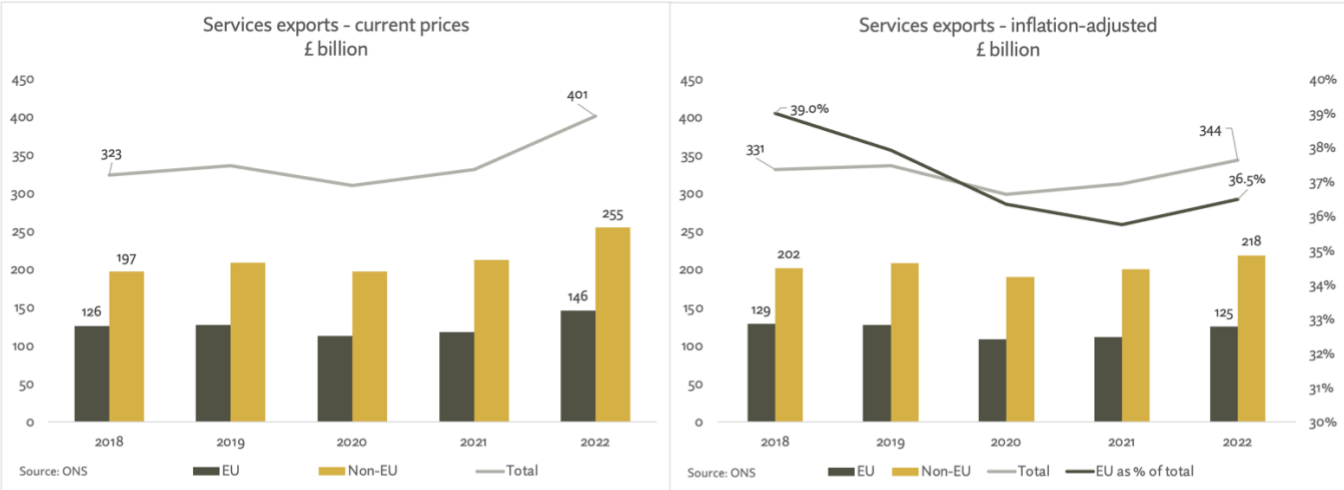
[2] WTO Trade Outlook, April 2023. Growth is for 2022 relative to 2019.

[3] ONS trade statistics. Goods exports exclude precious metals. 2018 goods exports to EU are adjusted to be comparable with 2022, due to the ONS methodology change after UK exit from EU (see Impact of trade in goods data collection changes on UK trade statistics: 2020 to 2022, 3 October 2022.)

Politicians prefer current price statistics because inflation flatters results. Measured in current prices, the trend in total services exports looks particularly strong (Figure 2[4]). After the Covid dip in 2020 and 2021, UK exports to both EU and non-EU markets grew strongly, but non-EU exports grew faster[5].

Economists prefer inflation-adjusted or 'real' prices, which this analysis uses. Even when adjusted for inflation, the overall trend seems healthy (right-hand panel). However, an 8% rise in non-EU services exports of £16 billion (mainly to the US) masked a 3% *fall* of £4 billion in exports to the EU. As a result, the EU share of total UK services exports fell from 39% to 36.5%.

Figure 2 – UK services export trends 2018-2022



In the period 2018 to 2022, the US had higher GDP growth than the EU at 7.5% compared to 4.9%[6], partly due to the economic effects of the Ukraine war on Europe. The difference partly explains why non-EU exports grew faster than EU exports. Nevertheless, without Brexit we would still have expected growth in UK services exports to the EU, not a real fall of 3%. By contrast, EU27 imports of services grew by 17% from 2018 to 2022 in real terms.

Main service types

To understand the drop in UK exports to the EU better, we need to dig into the main service types[7]. In 2018, the top six service types produced £239 billion (72%) of total services exports of £331 billion (Figure 3). Note that the non-EU share of exports was greater for all service types, apart from transportation. This helps protect the UK against reductions in its EU exports and provides growth opportunities.

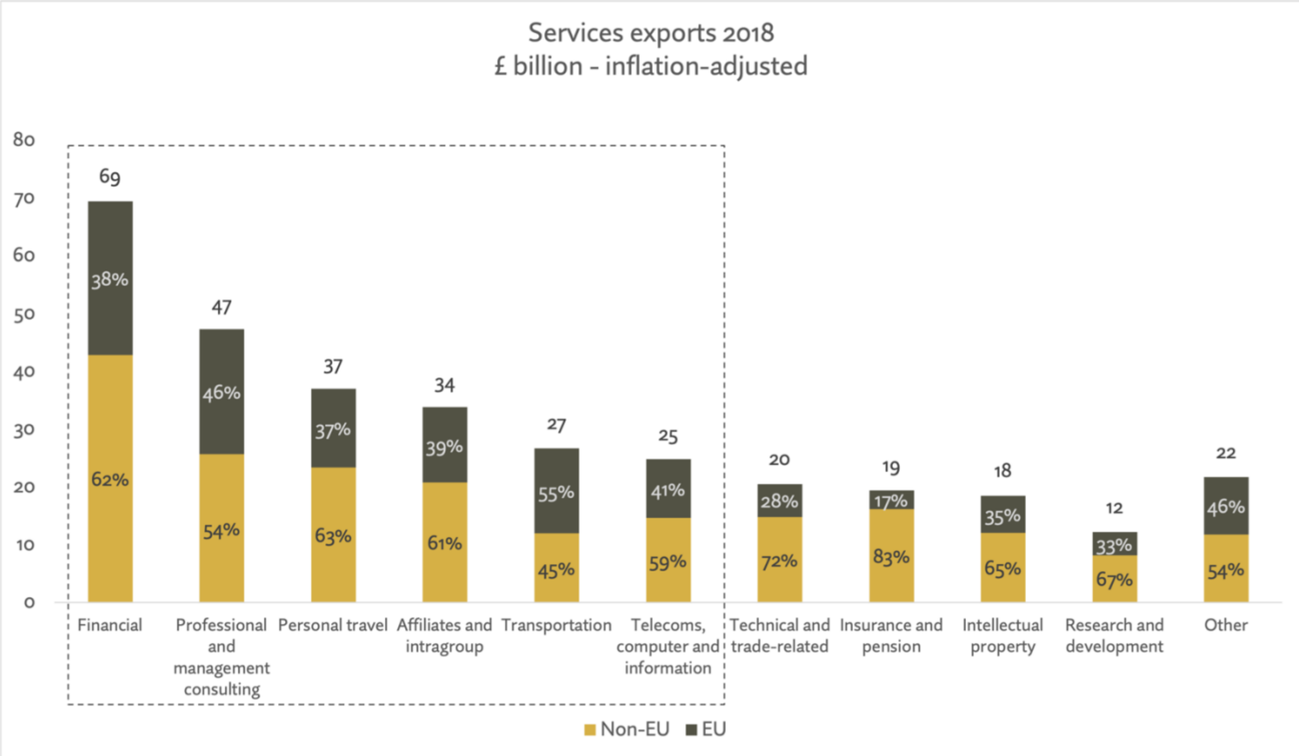
[4] ONS, UK trade: goods and services publication tables

[5] ONS, UK trade in services: service type by partner country, non-seasonally adjusted

[6] OECD, Quarterly National Accounts, chained volume measures. EU import growth includes intra-EU.

[7] ONS uses standard international categories for services trade. Table 1 details the ONS categories and their allocation to the service types.

Figure 3 – UK services exports 2018 (EU/non-EU)



Effects of the TCA

Firstly, the effect of the TCA on goods exports matters for services exports. A third of UK goods exporters also directly export services, often by packaging them together. A well-known example is Rolls Royce where services are more than half of sales. Goods exports to the EU in 2022 were down 13% on 2018, inevitably harming the direct services sold alongside, such as finance and distribution.

There is also a subtler effect of reduced goods exports on services. Over 20% of the value of UK manufacturing exports comes from embedded domestic services, for example the engineering and software services in a car. However, the value of embedded services is included in the value of goods exports – it does not appear as services exports. This means a drop in manufacturing exports reduces services exports by more than the visible effect on direct exports.

Secondly, the TCA sets up a range of barriers for services exports, which include:

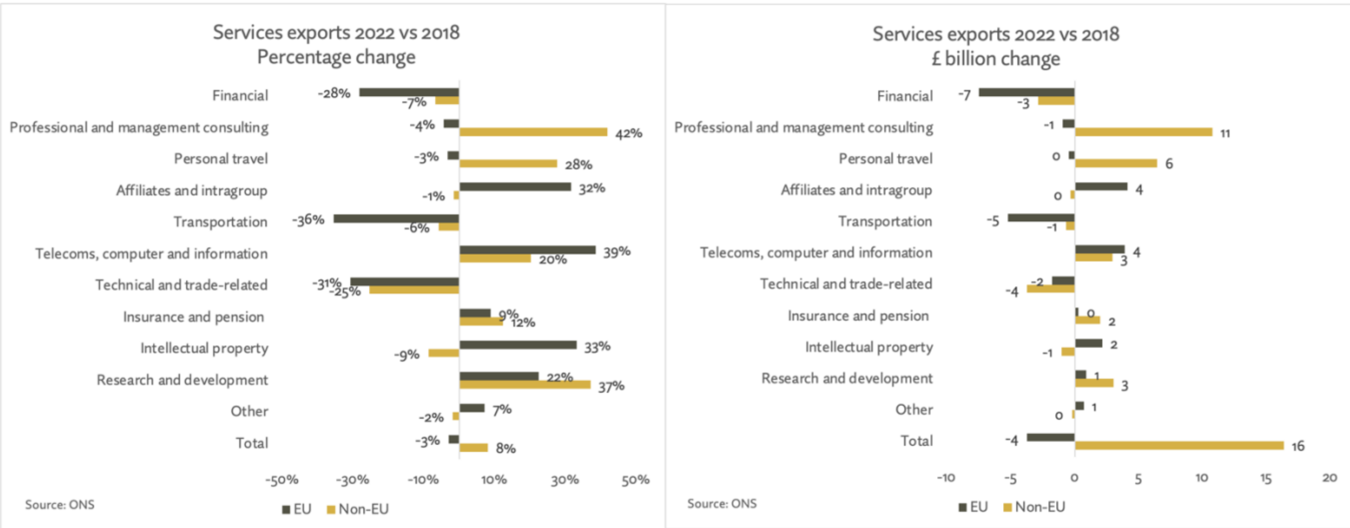
- restricted mobility of people (through limited duration of visits, work permits and visas etc.);
- lack of mutual recognition of professional qualifications;
- loss of passporting rights (notably for financial services firms); and
- loss of road and air transportation rights.

Although we cannot tie individual TCA barriers to the value of export changes, we can highlight those most important for different service types and take a view on the likely consequences. A more detailed study could isolate and quantify Brexit effects more precisely.

Changes to EU exports

For the top six service types, there were markedly different changes in exports to the EU compared to non-EU exports (Figure 4)[8]. The comparisons vary but two broad messages stand out for the top six – firstly, lower growth in EU exports in services where total exports grew and, secondly, where total exports shrank, greater losses for EU exports. There are, however, also two categories where EU exports have grown more than non-EU exports.

Figure 4 – Changes in UK services exports between 2018 and 2022



Assessing the changes

Professional services EU exports shrank by 4% (£1 billion) in contrast to the 21% (£11 billion) non-EU increase, mainly in the US. UK exporters now face a patchwork of member state rules on qualifications and visa requirements, which makes exporting complicated and encourages EU customers to choose EU-based suppliers. The results are stunted growth in professional services exports to the EU and a shot in the arm for EU competitors. Simultaneously, some UK exporters have pivoted from the EU to the US.

Financial services saw a 28% fall (£7 billion) in exports to the EU and a smaller non-EU fall of 7% (£3 billion). Loss of passporting means that UK-regulated services firms can no longer export freely to the EU. In response, several international banks now use EU-regulated firms based in, say, Paris or Frankfurt instead of London, to serve EU customers.

[8] Based on splitting top-level, inflation-adjusted data in proportion to each category's detailed service types and EU/non-EU shares in current prices.

As the delighted governor of the French central bank said recently, 'Paris's post-Brexit success has been spectacular'.

Personal travel EU exports were flat (-1%) but non-EU exports rose by 33% (£6 billion). Travel exports represent expenditure in the UK from foreign visitors and students coming to the UK. However, TCA mobility restrictions make it harder for EU citizens to visit or study in the UK. In addition, a big jump in university fees for EU students, starting in the 2021/22 academic year, makes the UK less appealing. EU exports saw a 41% (£2 billion) fall in education-related travel offset by a 17% rise in other personal travel, bouncing back from Covid. Non-EU exports in education-related travel grew by 20% (£2 billion) and other personal travel grew by 33% (£4 billion).

Exports to EU-based affiliates (related companies in the same company group) rose by 32% (£4 billion) whereas non-EU exports fell slightly (-1%). Some of the rise is related to the falls in other service types, as UK exporters restructure their operations to cope with being a third country. Rather than export directly to EU customers, some now supply services to an EU-regulated entity. For example, easyJet's new Austrian subsidiary operates flights between EU member states but buys its seat capacity from easyJet UK.

Transportation exports to the EU fell by 35% (£5 billion) whereas non-EU exports fell by only 6% (£1 billion). Fewer goods exports to the EU were a factor. In addition, British airlines and road hauliers now have no right to provide services within the EU, and limited rights for drop-offs and collections on trips from the UK. The majority, £4 billion, of the fall in EU exports related to air transport.

There was good news for exports of telecoms, computer, and information services to the EU which rose by 39% (£4 billion), exceeding the non-EU rise of 20% (£3 billion). Exports to the EU are supported by the TCA's digital-trade provisions, which were welcomed as digital services are increasingly important. Despite that, the UK is hostage to the EU renewing its temporary grant of data adequacy in 2025. Failure to renew would introduce hefty compliance costs and decrease competitiveness.

Digitally delivered services can be hampered by other aspects of being outside the single market. For example, in FinTech, where the UK is a recognised leader, a UK digital challenger bank cannot simply provide digital services from the UK to EU customers. It must now have a physical presence in the EU, which involves additional investment, extra operating costs, and an extensive authorisation process with an EU banking regulator.

Conclusion

This high-level analysis shows that loosening the EU shackles on both goods and services exports would lead to a significant increase in the UK's exports of services to the EU. Greater freedom in trade with the EU would also reinforce the UK's global services position, which will otherwise weaken as the TCA's harms accumulate. However, without major changes to the EU trade relationship, the UK seems destined to slip down the services league table.

Table 1 – Allocation of ONS categories to service types[9]

7: Financial	
	7.1: Explicitly charged and other financial services
	7.2: Financial intermediation services indirectly measured (FISIM)
10.2: Professional and management consulting services	
	10.2.1.1: Legal services
	10.2.1.2: Accounting, Auditing, Book-Keeping and Tax Consulting
	10.2.1.3: Business and management consulting and public relations services
	10.2.2: Advertising, market research and public opinion polling
4.2: Personal travel	
	4.2.1: Health-related personal travel
	4.2.2: Education-related personal travel
	4.2.3: Other personal travel
10.3: Affiliates and intragroup	
	10.3.N59: Services between affiliated enterprises not included elsewhere (n.i.e).
	10.3.N510: Intragroup fees and cost recharge
3: Transportation	
	3.1: Sea transportation
	3.2: Air transportation
	3.3: Other modes of transportation
	3.4: Postal and courier services
9: Telecommunications, computer and information services	
	9.1: Telecommunications services
	9.2: Computer services
	9.3: Information services
10.3: Technical, trade-related and other business services	
	10.3.1: Architectural, engineering, scientific and other technical services
	10.3.2: Operating leasing services
	10.3.3: Operating leasing services

[9] Reference numbers relate to ONS categories for trade statistics. Other Business Services is 10.

	10.3.4: Trade-related services
	10.3: Other business services n.i.e. (balancing figure)
6: Insurance and Pension	
8: Intellectual property	
10.1: Research and development services	
Other	
	1: Manufacturing
	2: Maintenance and Repair
	4.1: Business travel
	5: Construction
	11: Personal, Cultural and Recreational
	12: Government

Author's note

I have written this article for the non-expert reader – someone who would simply like to know more about services trade and the impact of leaving the EU.

In discussions with friends, I often find they are unsure about what services trade covers, or how it is being affected by the trade agreement with the EU. It's challenging for casual observers, even the well-informed, because commentators tend to focus on goods instead of services, and frequently quote differing statistics.

However, now that the disruptions from Covid have largely subsided, the data is starting to reveal important trends for services exports. I trust you will find the article's analysis both interesting and informative.

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About the author

Richard Barfield is a management consultant and specialises in risk and regulation in financial services. He also writes occasionally on Brexit issues.

After a career with PwC, he advises Hogan Lovells clients as part of the financial services regulatory consulting team. He has a wide range of business experience and has been finance director at Hertz UK and Barclaycard. He also created BrexitFactBase.

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