



Employment-oriented Industry Studies

A Review of Trade in Services

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A REVIEW OF TRADE IN SERVICES

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1. Introduction

The flow of trade in services is notoriously difficult to measure, and therefore it is difficult to identify what role it is playing in driving growth and competitiveness in the SA economy. This report therefore reviews the official data on trade in services and compares it to other available sources of information to get a sense of the extent to which the official data might be reflecting the reality on the ground.

1.1 How are services traded?

How are services traded?¹ The complexity of services trade poses significant challenges in the measurement of trade flows. Trade in merchandise is very easy to picture: a tanker, container or boxes are filled with goods, and transported by ship, rail, plane or truck. The container's contents will be itemised, and can be weighed or checked at customs. It is not necessary for the buyer and the seller to know or see each other.

In contrast, most services are different: they generally require direct interaction between providers and consumers. In most cases, the production and consumption of services can't be separated. Therefore most international transactions in services require either the consumer to move to the location of the producer (as in tourism, health, education) or that the producer move to the place of consumption (through foreign direct investment and/or the temporary movement of labour).

The WTO distinguishes between four modes of trade:

- **Mode 1 involves cross border trade.** This includes services embodied in goods (such as a software programme embodied in a CD). Services that electronically cross borders through telephone lines (e.g. call centres) or the Internet (e.g. distance education) are also classified as mode 1 trade.
- **Mode 2 involves consumption abroad.** This includes all services where the consumer travels to the country of the service provider, as in health, education and tourism. South Africa exports in Mode 2 when foreigners come to South Africa for a holiday, to study or for plastic surgery. When South Africans go to Zanzibar or the UK for a holiday, or obtain an academic qualification from Harvard or Cambridge Universities, this constitutes an import in mode 2.
- **Mode 3 involves commercial presence.** This takes place primarily through foreign direct investment. In this mode, a foreign company supplies a service to a consumer in the home country via a resident foreign affiliate – a SA example could include MTN in Nigeria or Shoprite in Mauritius. Certain services can

¹ See M. Mayer et al. (2005) *Trade in Services: an overview of research findings*, an HSRC report to the DG's Economic Cluster on the Services Sector, unpublished.

only be traded by commercial presence, specifically those that require the provision or use of physical infrastructure located in the market. These include local and long-distance telephony, domestic transportation and local energy distribution.

- **Mode 4 involves the temporary movement of natural persons.** This occurs when an individual service provider temporarily² moves to the country of the consumer to provide a service. This includes a range of activities, but is largely centred on professional services (medical, accounting, engineering etc.), although there is some evidence of lower-skilled workers exporting their services through this mode, particularly in the construction and care sectors. An example can include SA financial experts working on financial deals in Dubai, or SA resident doctors flying to the UK to perform surgery.

In most countries, Modes 3 and 4 are either not captured by balance of payments statistics at all, or are not adequately captured. Given their importance in trade in services flows, it is likely that services trade is probably vastly underestimated.

There are a great many challenges in measuring trade in services. For example, the way in which data is collected for trade in services implies that foreign receipts and/or payments that have arisen through the operation of subsidiary or associate companies (largely the WTO category “commercial presence”) are not reflected in national accounts as trade in services, but rather as dividends or remitted income. This would particularly be the case for telecommunications and financial services companies, who are providing an “export service” via local subsidiaries. Thus, the blurred lines between “trade” and “foreign income” in an increasingly globalised economy are making it more and more difficult to determine “trade” in terms of the definitions that are much more easily applicable in the world of manufactured goods. Multi-national employment and ownership of income exacerbate the problem.

Exchange control regulations in South Africa have, generally, provided an incentive for South African companies (and individuals) to keep proceeds un-reported. Given that the paperwork and controls (duties, shipping records, etc.) that are required for merchandise trade are practically non-existent in the services market, “adjusting” earnings is that much easier. Sophisticated mechanisms utilising offshore holding companies and subsidiaries can allow companies to either pay export earnings back offshore, or never bring them onshore in the first place. The more that these mechanisms are used, the more difficult it will be for South Africa to accurately calculate trade in services, due to reluctance to disclose on the part of individual companies. This problem is likely to persist until exchange controls are abolished.

² Note that this mode of trade is not to be confused with emigration, which is not temporary and therefore does not constitute a trade in a service. Hence if a SA doctor permanently immigrates to the UK this is not a trade in a service. In contrast, if a SA doctor works in the UK for a year and then returns to SA, this is considered to be a mode 4 export.

1.2 Methodology

This report uses a number of sources of information. The starting point is the official data, made available by the South African Reserve Bank (SARB) balance of payments figures. Nominal figures for trade in services as published in the Quarterly Bulletin tables are deflated by that recommended by the SARB and/or Quantec for imports and exports respectively.³

This data is difficult to compare to anything else, partly because it is only published according to 3 very broad sectors that do not correspond to SIC codes, namely: ‘travel’, ‘transport’ and ‘other’⁴. It is also not decomposed either by country of origin or destination or by mode of trade. In addition, mode 3 trade (commercial presence) is not captured and most mode 4 trade (temporary movement of natural persons) is either not captured or conflated with ‘travel’.⁵

The SARB data is compared to a range of other sources. In the first instance, it is compared to that made available by Quantec, which is a private company providing data to users. This is the data made available through the Trade and Industry Policy Strategies (TIPS) website, and is used by researchers across the country. The different categories of trade in services are not always comparable, because of the basis on which the various sources have done their sector allocations. This is particularly the case when using the SARB data, which is not disaggregated past transport, travel and tourism, while the Quantec data is available by SIC code. The Quantec data is not official⁶ but it does offer one estimate of SIC category breakdowns that are aligned to the balance of payments. The paper then makes use of other sources such as company information and expert opinions.

Obtaining industry-based information in services is a special challenge. Unlike manufacturing, there are no export councils for services, except for the South African Electrotechnical Export Council, which is a public/private partnership between South

³ These deflators are being revised by the SARB. There is a difference between the import and export deflators. The mix of products SA exports consists largely of primary goods (commodities) while imported goods consist largely of semi- and finished secondary goods of which investment goods, oil and consumer goods make up a large portion. Exports are mostly priced in US\$ while imports are priced in a broader basket of currencies. Both these factors can lead to different deflators over the medium term. Longer run comparisons of the deflators should however be more in line as prices tend to converge over the longer run.

⁴ It is also not clear how the “compensation of employees” category in the SARB data is accounted for by the various sub-sectors.

⁵ A resolution was taken to improve this state of affairs at a workshop convened by the dti in 2004 as part of the “Services Project”. A plan is in place to achieve this objective. Please see paper by Greg Lewis, *An Analysis of SA’s Trade in Services Data*, HSRC report submitted to the DG’s Economic Cluster, unpublished. For ease, his paper has been appended to this report.

⁶ The value of comparing the Quantec data to the SARB figures was underlined when, upon calling the SARB for guidance in using its data, an official asked why the researcher was not simply getting the data from the Quantec site!

African companies and the Department of Trade and Industry to support and coordinate export initiatives for the following sectors: Electronics, Electrical Engineering Information Technology, Telecommunications. Export Councils would normally provide very valuable source data about trade.

2. Overview of services trade

Figure 1 and Figure 2 show imports and exports sourced from the SARB, in current Rand and deflated to 2000 prices. Figure 1 shows a trade deficit after 2000, reaching R3.5bn by 2003. This deficit widens to R5.9bn if we include compensation made to employees⁷. Payments and receipts related to compensation to employees is presented in Figure 5, and shows how important this activity is becoming, likely in sectors like finance, medical and construction. Figure 2 shows that imports have been growing faster than exports in real terms⁸.

If the researcher were to directly access the Quantec site for this data, they would find a growing trade surplus, reaching R49bn by 2003. Figure 3 shows that the main divergence is found in their import numbers, where the SARB records dramatic growth in services imports, and Quantec shows relatively slow growth. What explains the difference?

The SARB data records merchandise trade FOB – in other words, the freight and insurance attached to merchandise trade is recorded under services categories. The Quantec merchandise trade is recorded CIF – in other words, including freight and insurance. It is done this way to enable users to directly compare import product prices to domestic prices⁹. In this vein, the Quantec figures offer a more realistic presentation of how services trade is faring, as it isolates trade in services, as opposed to trade that arises merely as a result of merchandise trade. This is shown in Figure 4. It is not clear why there should be such a large deficit in freight and insurance costs associated with merchandise trade, unless importers and exporters are either under-reporting or alternatively primarily engaging foreign firms.

⁷ The Reserve Bank lists exports and imports associated with “compensation for employees” separately from its sector categories. It appears that Quantec builds this into its sector categories. According to the SARB, approximately 5% of exports were accounted for by compensation to employees in 2003, as compared to almost 10% of imports.

⁸ Note that the deflated figures should not confuse the reader into thinking that there is a growing deficit. It merely offers an indication of real growth (see footnote 3).

⁹ Quantec makes estimates of sector categorisations that are closer to SIC codes. According to its owner, Claude van der Merwe, their data adds up to the total as reflected in the balance of payments account for service exports in the SARB Bulletin. On the import side they do a CIF adjustment to show each industry’s goods imports to include the cost of transport and insurance. The CIF adjustment is then subtracted from the service imports as reflected in the SARB data. It should be noted that the SARB service categories do not accord strictly to the SIC and are at purchases prices and not basic prices. Quantec say that they will continue to improve its data, but admit that the data is “softer” than that for merchandise.

Figure 1 – Services imports and exports (current Rand)

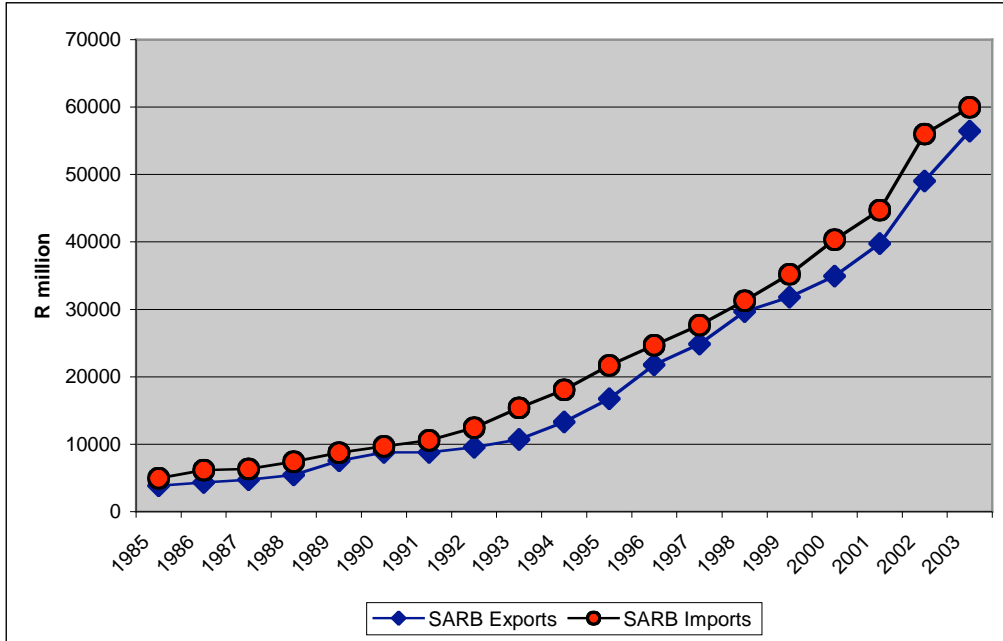


Figure 2 – Services imports and exports (2000 Rand)

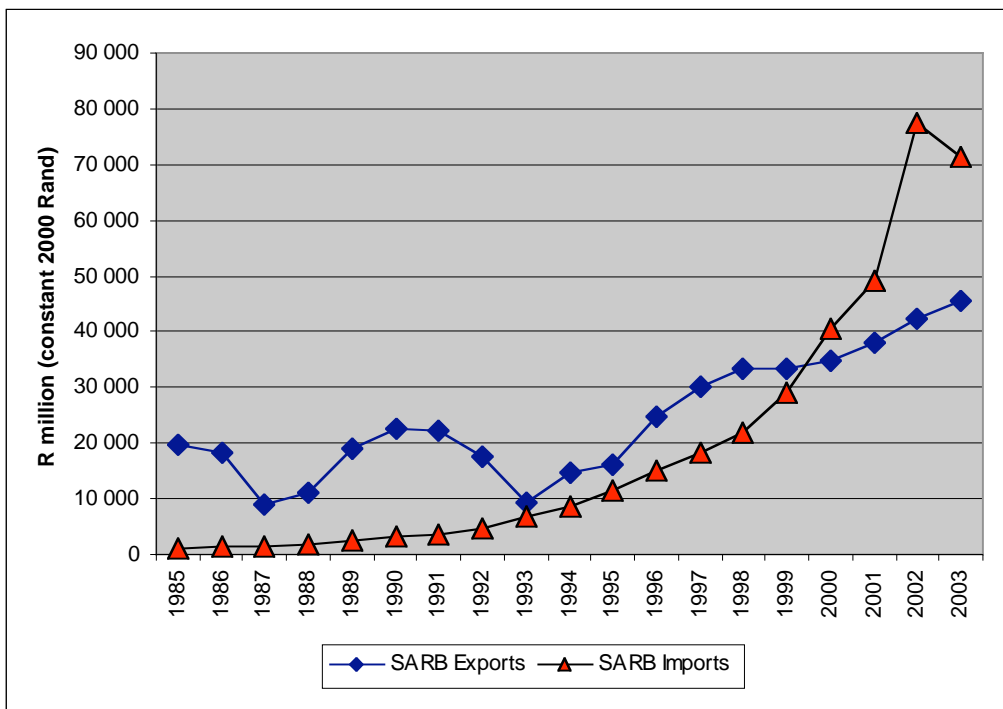


Figure 3 – Services imports and exports: Quantec (current Rand)

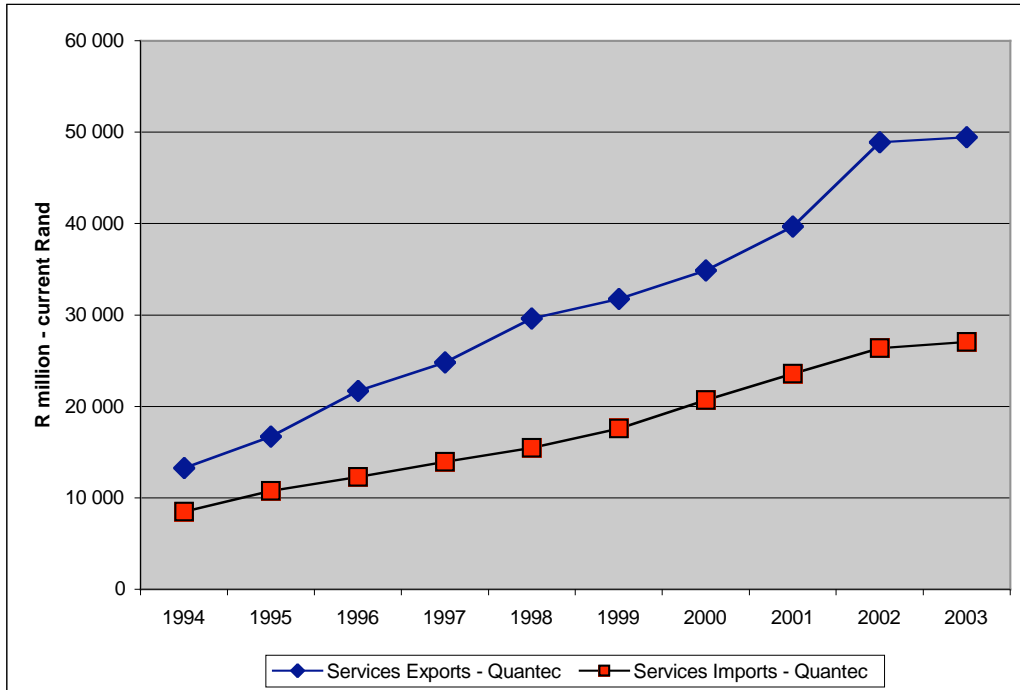


Figure 4 – Net surplus/deficit in services trade (current Rand)

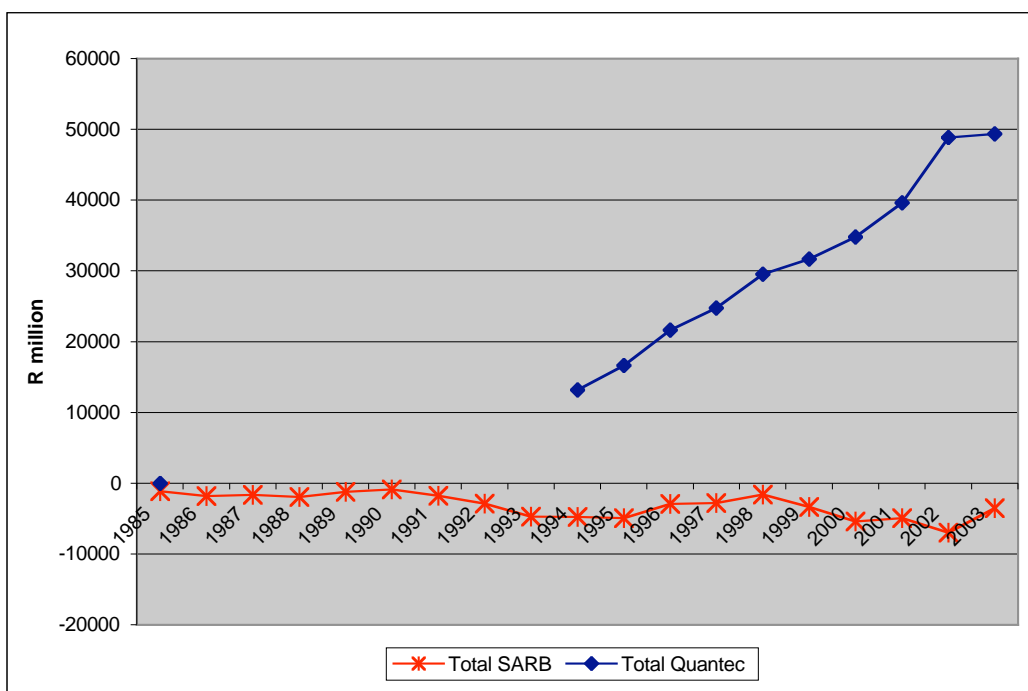
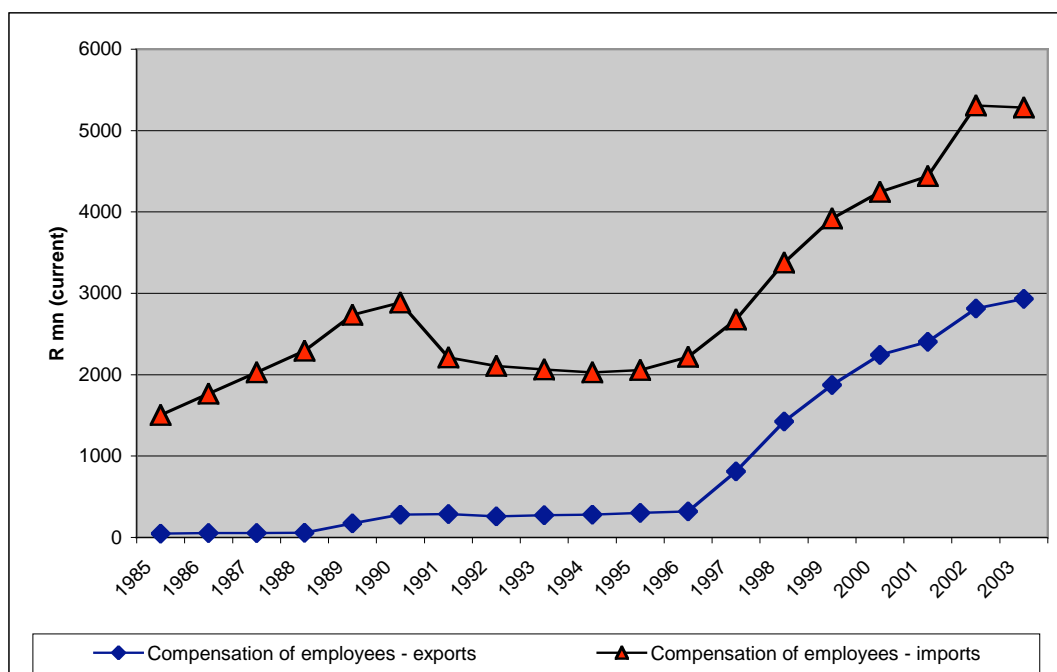


Figure 5 – Compensation of employees: SARB



If we were to look at the Reserve Bank figures for direct investment income (on the assumption that companies very reasonably could include income/expenditure from or to a foreign associate or subsidiary as “trade in services”) the figures for 2003 show an even larger deficit, of an additional R17bn.

As with other sectors, it is possible that South African companies are under-reporting export income from services in order to divert hard currency earnings. Not all of these mechanisms are illegal, and many are quite common among companies who want to hedge against the Rand.

As a matter of interest, the United Kingdom in 2002 indicated the following with regards to trade in services with South Africa. This gave a total value to exports from the UK of £963 million, and imports from South Africa of £610 million.

Table 1 – Trade in services between SA and the UK, 2002 (£ million)

	Trans	Trav	Comm	Constr	Insur	Finan	ICT	Royalties	Other	Pers	Govt	Total
Exports from UK to SA	178	208	20	0	101	98	20	48	252	26	0	963
Imports to UK from SA	145	329	20	0	7	24	3	10	57	6	9	610

3. Assessment of submitted trade data: sector-specific issues

3.1 Tourism and travel

Tourism activities generally fall under Mode 2 – Consumption Abroad

The main source of non-African tourism for South Africa is the UK, followed by the rest of Europe and the US.

Main destinations for tourists from South Africa are Europe, the US and Mauritius.

The Reserve Bank figures for “travel” for 2003 show receipts of R38bn in current Rand. In 2003, there were 6.477 million tourist arrivals. If travel receipts were sourced only from these arrivals, then on average, R4,940 was spent per visitor. This seems very low.

More than 70% of recorded tourists visiting South Africa are from mainland Africa, and by far the majority of these are from Lesotho (nearly 30%), Swaziland, Botswana and Zimbabwe. The main reason for visits is shopping and visiting family. It is possible that many of these visitors do not spend much on catering and accommodation, but rather spend on buying goods to take home with them. If we exclude African visitors from the travel totals, then the average expenditure per visitor is R16,467, which seems closer to the mark for a long haul destination.

Stats SA tourism statistics (those that are available electronically) show the following in respect of arrivals of foreign travellers **not** from Africa:

Table 2 – Tourism arrivals

Year	Number	% change from previous year
2003	1,943,203	+4.3%
2002	1,862,460	+19.5%
2001	1,558,325	-1.2%
2000	1,578,001	

If we look at departure figures for South African residents, it shows 1,254,063 people were part of the tourism import market in 2003 (that is, they travelled outside of SA). As R18.3bn was ‘imported’, this comes to an average R14,593 spent per South African traveller abroad.

Figure 6 – Trade in travel services: SARB

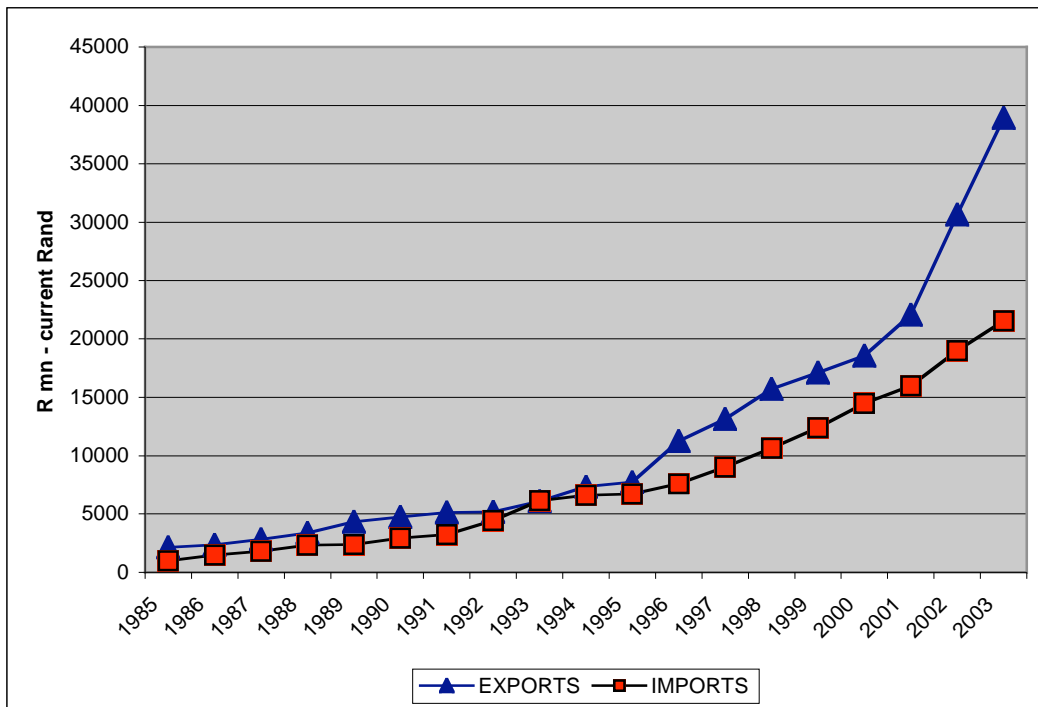


Figure 6 shows that exports have been rising considerably over the 1990s, but particularly after 2002. Exports have also grown albeit less dramatically. This is surprising in the current Rand context.

Researchers should note that the SARB figures cannot be directly compared to the Quantec figures, which use the SIC codes. Tourism isn't a sector, so much as it is an agglomeration of activities. The Quantec figures refer only to catering and accommodation, and do not include transport and car hire, the latter of which is included under "Business Services" (SIC 85).

Not only are these figures a fraction of the SARB travel category, they show the reverse trend: with a trade *deficit* which also comes to naught in 2002. This picture more closely resembles what we know about growing tourist numbers until the Rand appreciated in 2003.

Figure 7 – Trade in catering and accommodation (Quantec): current

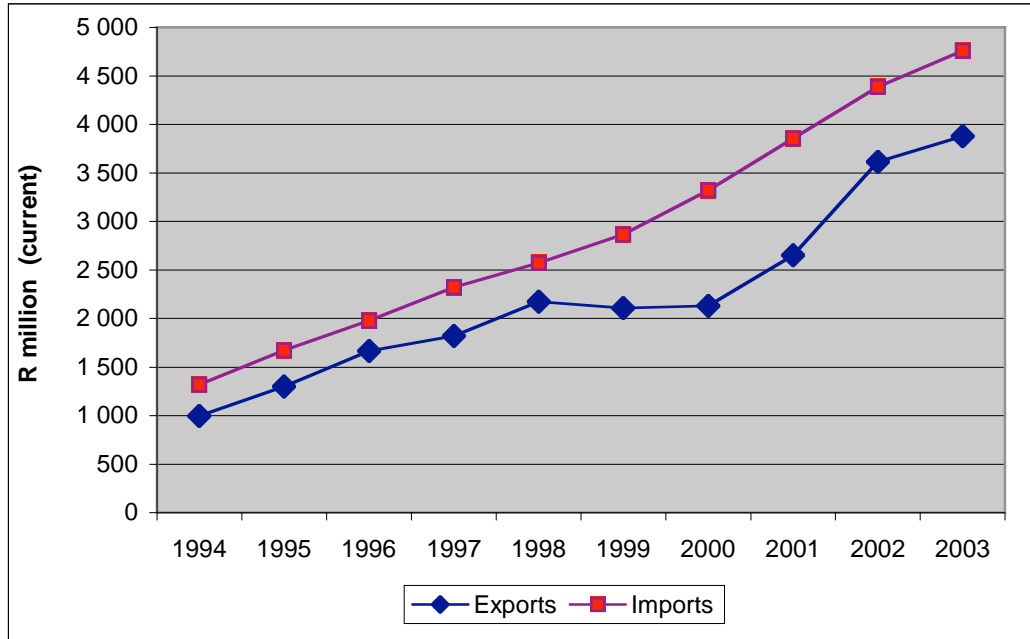
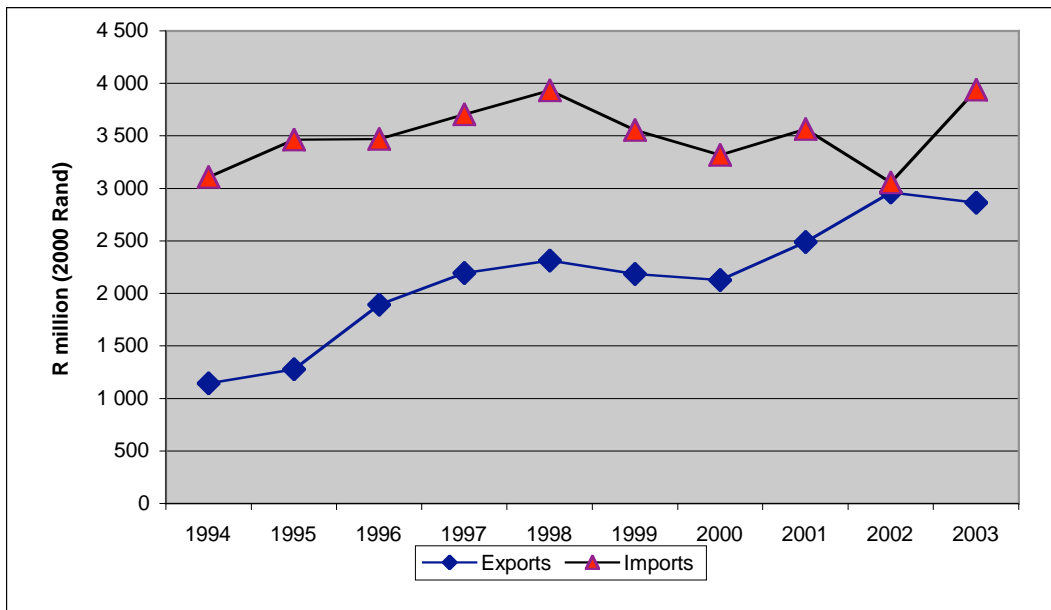


Figure 8 – Trade in catering and accommodation (Quantec), constant 2000 Rand



When deflated, the data show a steady decline in the real value of exports (around 15%) from 1998 to 2001, with a strong rise in 2002 (more than 10%), and then falling back in 2003. This coincides with the exchange rate fluctuations.

The Quantec figures for 2003 show that R3.878bn was ‘exported’ in catering and accommodation. As already noted, it is possible that a large portion of African visitors do not make use of catering and accommodation services. This in itself is probably not a very important issue, since these visitors are generally spending money on goods (retail) rather than services (catering and accommodation).

If only non-African foreign arrivals booked into a hotel, this would mean that each one spent R2,000 on their visit. This seems low for a long-haul destination, but may simply represent some leakage from the SA market to foreign tour operators.

The fall in trade value in 2003, despite the increase in the volume of tourists, can easily be explained by the nearly 25% real increase in the value of the Rand over the same period which would have reduced expenditure in local currency terms.

Quantec shows a deficit in accommodation and catering trade of R880 million (in current Rand) in 2003. If it is accurate, it could be possible despite the fact that arrivals exceed the number of departures. This might be explained by leakages: where SA tourists pay overseas operators and foreign tourists also pay over some of their receipts to foreign operators¹⁰.

3.2 Transport and storage

A significant portion is Mode 1, but South African companies tend to use foreign subsidiaries to provide services, which would then fall under Mode 3.

The Reserve Bank’s balance of payments data has a sub-category “transport” which shows receipts (exports) of R9.5bn and payments (imports) of R25.5bn in 2003. This represents a real average annual growth in exports by 12.7% between 1994 and 2003, (mostly in passenger fares) and a real average annual real growth of 93% in imports, mostly in non-passenger fares.

¹⁰ For example, of the average 5215 Swiss Francs tour package price from Switzerland to SA, and making use of SA Airways, only 42% will flow to SA. One quarter goes directly to the tour operator. The rest goes to other foreign inputs, from fuel for the flight, to imported furniture in the hotel, to the import of food products, to the hire of a care from a foreign multi-national. (see: Tourismus in Entwicklungsländern, Antwort der Bundesregierung auf die Grosse Anfrage der CDU/CSU, Drucksache 15/2027, April 2004. www.igtn.org/pdfs/346_Tourism_and_GATS.pdf)

Quantec presents “transport and storage”, with exports of R14.4bn and imports of R11.45bn. This entails real average annual growth from 1994 to 2003 by 13.8% for exports, and 2.1% for imports.

The Quantec data shows an increase in receipts until 2002, and then a decline in 2003. There is likely a critical difference between Quantec and the SARB, as already noted: the SARB records freight and insurance associated with merchandise trade as a service import or export. The Quantec data includes these items within the merchandise trade statistics. It is perhaps worth noting that, according to the SARB, transport exports that did not involve passenger fares amounted to R2.25bn in 2003, and imports amounted to R19.6bn.

Figure 9 – Trade in transport services: SARB

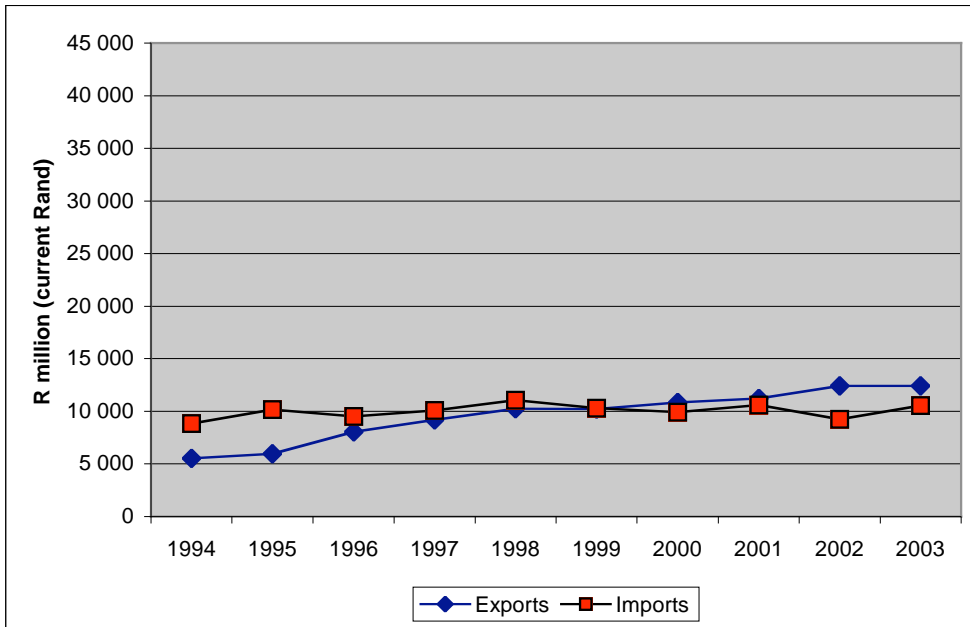
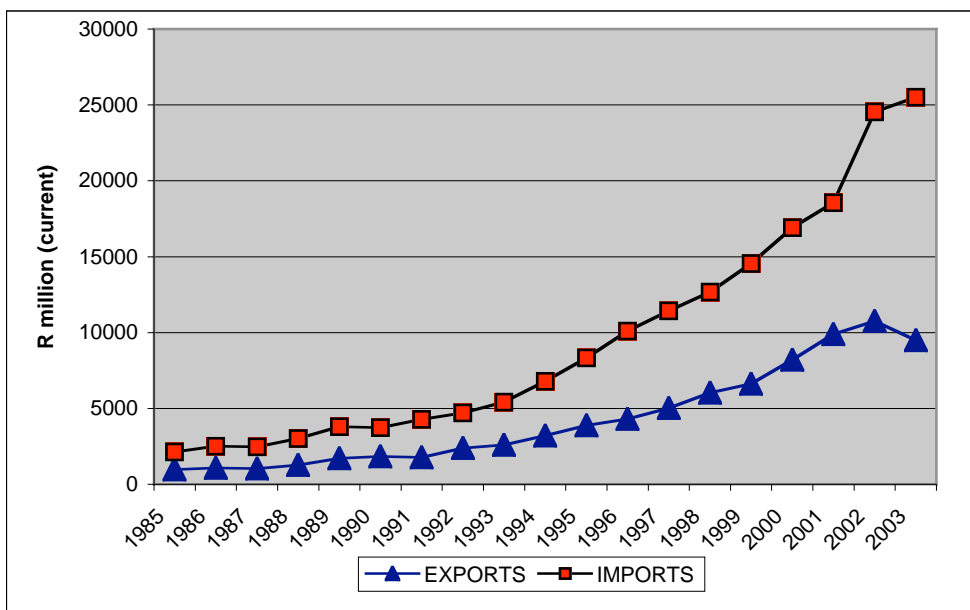


Figure 10 – Trade in transport and storage (Quantec)



Quantec's receipts are some R5bn more than the SARB reported (which may be due to the problems with classifying earnings from foreign subsidiaries and/or associates as discussed above and below) and that service payments (R11.5bn) are less than half of what the SARB has on record.

The SARB data shows (as the tourism figures would suggest) that receipts from passenger fares are higher than payments, the big difference is in the "other" transportation category, where payments are almost 8 times higher than receipts. Why is this significant spend on other transport not captured in the data? It suggests that there are significant outflows on freight and related services that are not being captured. Although earnings data is available from companies such as Bidvest (the largest non-government entity engaged in freight management in sub-Saharan Africa) it is not so easy to separate earnings and payments from or to foreigners from those that are from local businesses. The answer may well lie in the state transport agencies such as the NPA and Spoornet, who are unlikely to be part of a business survey.

3.3 "Other" services

Figure 11 and Figure 12 present trade in "other" services, based on SARB and Quantec estimates respectively. Again, these show very different trends, which are difficult to disentangle given the sparse information available from the SARB. According to the SARB, trade in "other services" has moved into a growing deficit, especially since 2001. Quantec estimates there is a growing surplus. In addition, the SARB figures are considerably lower than those put forward by Quantec.

Figure 13 and Figure 14 show disaggregated trend estimates from Quantec for "other services". Essentially this shows the main export growth in wholesale and retail. Imports are much smaller, and mainly in communications, business services and finance. Given the gaps in measuring Mode 3 (commercial presence), this may understate the activity in both directions.

Figure 11 – Trade in “other services”: SARB

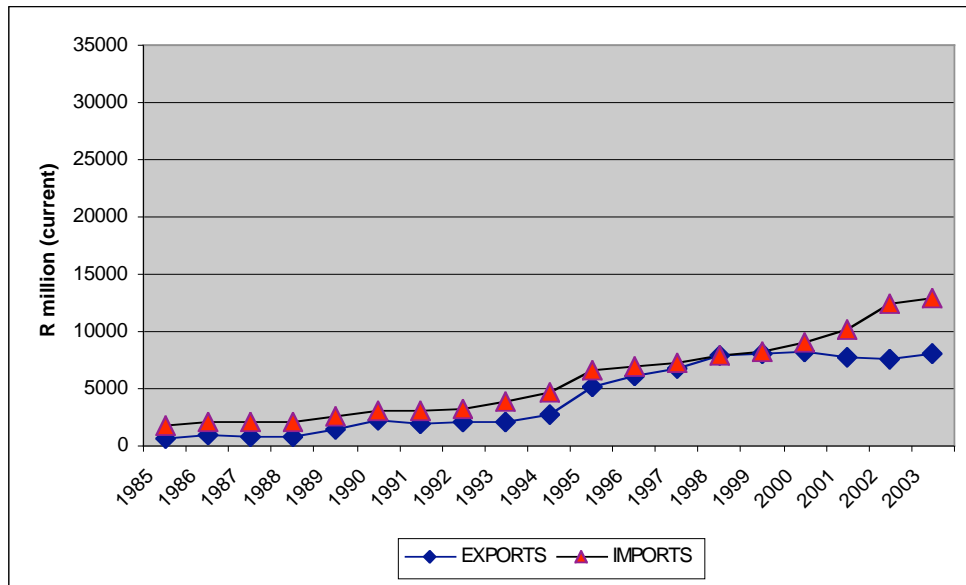
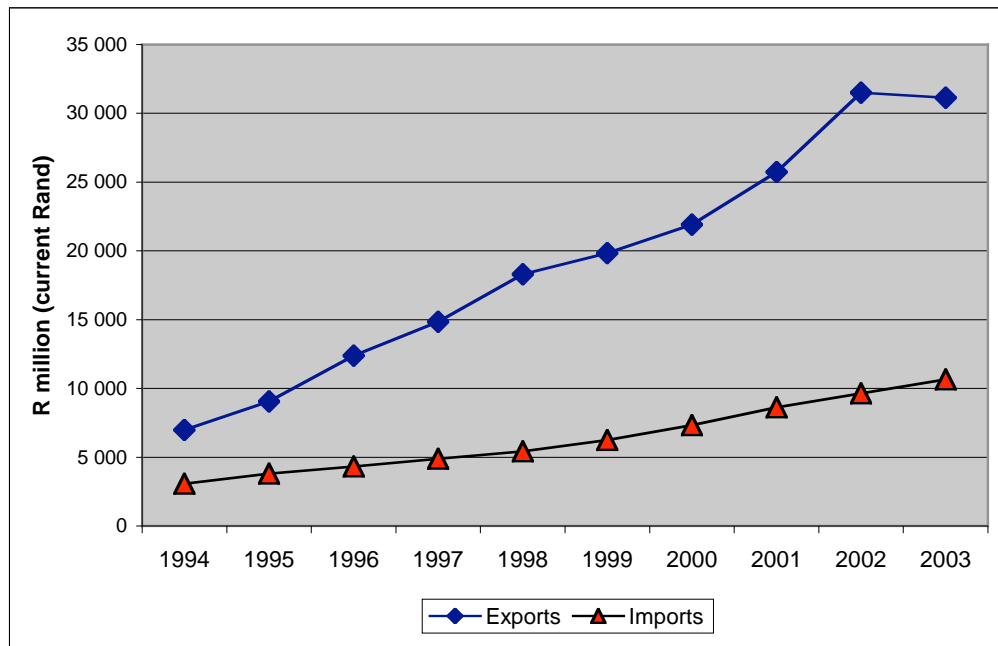


Figure 12 – Trade in "other services": Quantec



Notes: “Other services” include communications, wholesale & retail, finance & insurance, business services, medical & related, and ‘other’.

Figure 13 – Exports of "other services", disaggregated, Quantec

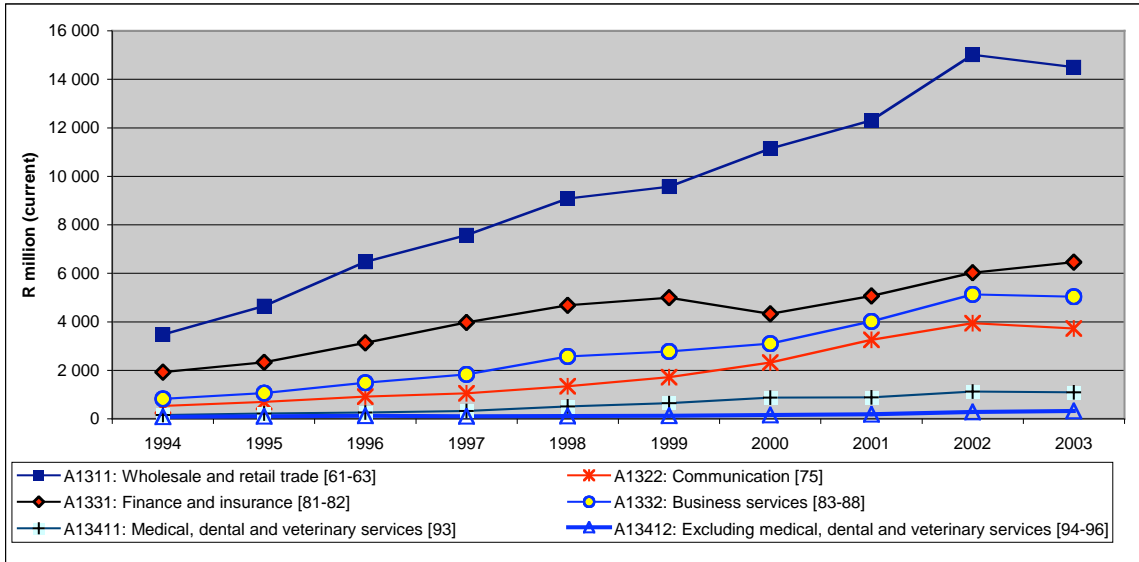
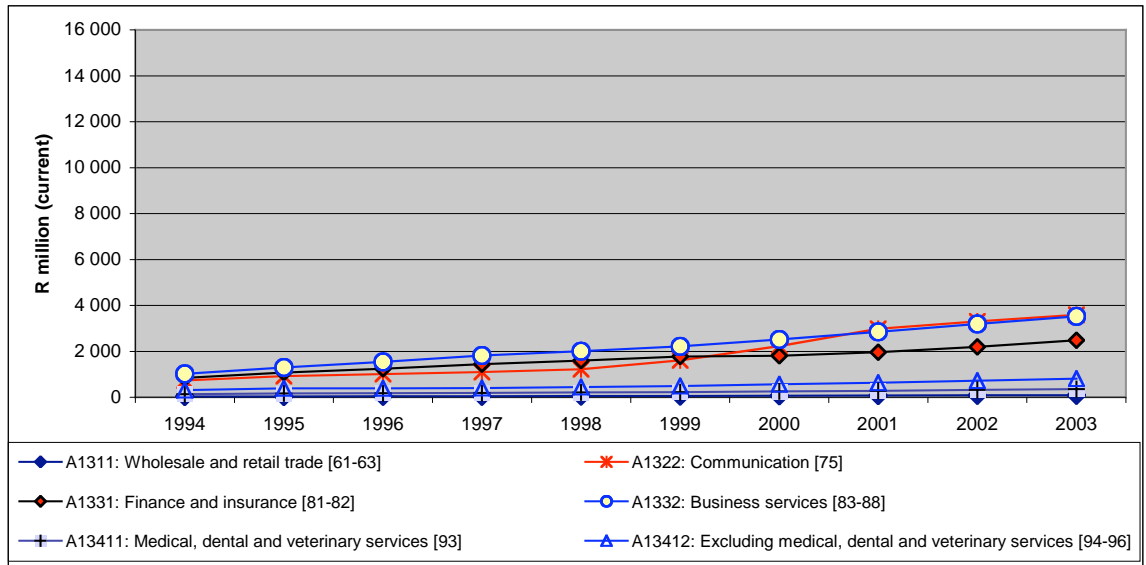


Figure 14 – Imports of "other services", disaggregated, Quantec



3.3.1 Financial services

Financial services trade is overwhelmingly provided via Mode 3.

Key trading partners for financial services are the UK (where Investec and Old Mutual have a significant presence) and the United States. However, there is an increasing focus on Asian markets (including India and China). Australia also features, due in no small part to the high number of ex-South Africans living there.

There are no Reserve Bank figures for financial services. As they are mostly provided via Mode 3, any data would likely dramatically underestimate actual trade. The only available estimates are those made by Quantec, and we discuss these, plus other industry sources.

Quantec estimates that financial services exports in a steady and strong upward trend, albeit off a very small base. From 1994 to 2003, the real value of exports rose by an average annual 11.7%. Over the same period, imports fell by about 0.9% annually. The data show nominal exports of R6.5bn and imports of R2.5bn.

The SARB figure for exports of all “other services” (i.e. excluding transportation and travel) was only R8bn. Quantec estimates that there were R6.5bn worth of exports in the finance sector alone.

The table below sets out the information around foreign earnings by geographic location for the major SA banks for their 2003 year ends (Source: KPMG survey).

Table 3 – SA banks' foreign earnings, by region, 2003

Bank	Region (R-million)				
	Africa	Europe *	N. America	Asia/Pacific	Rest
Absa	0	9	0	101	0
Capitec	2	0	0	0	0
First Rand	322	33	0	0	67
Investec	0	485	-311	0	94
Nedcor	198	268	0	11	0
Standard	489	840	0	0	0
Total	1,011	1,635	-311	112	161

*Notes * Including the UK*

Nedcor recorded a substantial loss for SA operations for that year.

Since these figures indicate headline earnings (as opposed to revenue which is the more correct method of calculating of Mode 3 trade) and that these banks typically would have a cost to income ratio of around 60%, we could roughly estimate that revenues were at least double these figures (i.e. more than R3bn).

There are almost certainly problems with data collection in this sector. The preferred method of offering services to foreigners in this sector has been through the establishment and/or purchase of foreign subsidiaries and/or associate companies. In

certain cases, the South African company has relocated itself offshore, by moving its primary listing (and, therefore, its residence) to a foreign country. “South African” financial services companies that have done this include Investec, Old Mutual, Brait and Liberty International. This results in some inconsistencies and/or problems in the way in which trade in services data is captured for this market. The SARB classifies an enterprise as a resident of South Africa when it has premises in South Africa from where it engages in business activity (in South Africa). However, financial companies with a primary foreign listing are classified as non-residents. This means that Old Mutual the holding company is a foreign entity, but its local operations are classified as a local resident. Clearly this will result in some considerable confusion around data collection. Does Old Mutual’s revenue from countries outside South Africa (which is billion of pounds sterling) constitute trade in services?

According to the SARB’s definition of resident and non-resident suggest that it does not. Since Old Mutual’s pre-tax operating profit is currently around R12bn, how they and similar companies are accounted for is important.

Another “calculation” problem is caused by companies working within a restrictive exchange control environment. This provides the incentive to set up offshore structures in order to increase hard currency revenues, *and to keep as much of these offshore as possible*. Although many companies across several sectors use these structures, the opportunity for leveraging them is much greater in financial services, given the fluid state of international markets. The result is that there are many companies that are registered as “foreign” (and treated as such by regulatory bodies such as the SARB) when in reality they are local companies servicing mostly local clients. A good example of this “foreign” collective investment schemes, set up by local companies in locations such as Guernsey. These are usually staffed by a small contingent of local people and South Africans, support is provided by the South African company almost all clients are South Africans (individual and institutional) investing their foreign exchange allowances. It is difficult to consider this “foreign trade”.

Given these methodology issues and problems (largely caused by a restrictive exchange control framework) it is very difficult to try and determine an accurate figure for foreign trade in financial services.

The trend in imports looks unlikely. Since the late 1990’s there has been a noticeable increase in the number of foreign financial services companies operating in the local market, particularly in merchant banking, asset management and custody services. This might be reflected in an increase in service imports over the period, rather than the slight downward trend. Citibank is the largest foreign banking operation in South Africa, and currently has 450 employees.

3.3.2 Information and communication technologies (ICT)

In the South African context, trade in ICT services tends to take place via Mode 3. This is because local companies are largely offering consulting services, rather than software. Mode 4 probably also plays a part, given the migration of local IT staff to destinations such as the UK.

Key trading partners are the UK, the US and Australia.

Trade in ICT covers consulting services, data services, internet hosting, software download sales and outsourcing. As noted, the Reserve Bank does not publish trade statistics in respect of ICT sectors. We have only estimates made by Quantec and other industry information.

The Quantec data does not strip out the ICT data (SIC 86), but rather has a category for “Business Services” (SIC 83 – 88). That data shows 2003 exports and imports of R5bn and R3.5bn respectively. The trend data indicate a generally strong upward trend in exports, by an average annual 32.4% in real terms (with the omnipresent dip in 2003). Imports grew by an average annual 0.9% in real terms between 1994 and 2003.

Dimension Data is South Africa’s largest IT company, and well internationalised. Around 42% of the company’s business in 2003 (financial year to September) was from services (as opposed to product sales). This equated to approximately R5.3bn in 2003 9at an average US\$/Rand exchange rate of 6). If we make the rough assumption that South Africa’s share of services revenue was the same as its share in total revenue (around 17%), then we can make the rough calculation that the value of Dimension Data’s foreign trade in services was around R4.4bn. This is about the same as the total value of all ICT service exports for that year. Since there are numerous other companies providing ICT services to offshore clients, the conclusion has to be that the figure is under-stated.

(However, once again we should note that Dimension Data’s primary listing is outside South Africa, and so its foreign operations are considered “non-resident” by the SARB.)

The slow increase in imports is more difficult to assess, but it seems to be broadly in line with market observations of a well-developed and competitive local industry that, combined with a weak currency, is largely a deterrent to foreign companies entering the market.

3.3.3 Communications

The bulk of exports is probably made up of Mode 3 – Commercial Presence. The same would apply to imports, but the latter may also include a portion of Mode 1 – Cross-border Trade, where cheap telecoms services are offered by foreign companies through a dial-up facility from South Africa.

The main trading partner for communications services is mainland Africa.

Again, there is no Reserve Bank data for the communications sector. As with finance, establishing commercial presence is an important form of trade, and this is not captured by balance of payments data. Hence, any measure would likely underestimate actual activity. We have only the Quantec data, plus industry sources.

Quantec estimates that trade in communications services experienced a steady increase in exports over the period from 1994 – 2003, at about 50% per annum in real terms – albeit off a very small base. There was a marginal decline in real terms in 2003 (which could easily reflect the much stronger Rand rather than declining volumes). Imports over the same period grew by 12.4% per annum in real terms. In 2003, have exports were valued at R3.7bn and imports at R3.6bn.

We can easily make the assumption that the bulk of “communications” is made up of telecommunications. On that basis, the main exports would be those of the cellular companies, that have expanded aggressively into Africa.

MTN has operations in Nigeria, Cameroon, Uganda, Rwanda and Swaziland. For the year ended 31 March 2004, MTN’s foreign revenue was R8.7bn. Vodacom has foreign operations in Congo, Lesotho, Tanzania and Mozambique. For the year to 31 March 2004, income from foreign operations amounted to R1.5bn. So, for 2003, the trade in telecommunications services from just these two companies was more than double the reported total.

This leads to the fairly obvious conclusion that exports in communications are very likely grossly under-estimated. In addition, given the enormous presence of MTN and Vodacom in the offshore markets (compared to any foreign operators working in the local market), I believe that the trade surplus in communications is probably quite a lot larger than shown (R1.96bn in nominal terms).

In contrast to this, the Quantec data show only a very small surplus for communications (sub-sector 75) of R143 million for 2003. for all the reasons set out above regarding South Africa’s cellular operators, this seems a very unlikely figure, and an enormous understatement of exports (at R3.7bn).

3.3.4 Construction

Where construction services are being offered through a foreign subsidiary or associate, this would be classified as Mode 3. The bulk of construction services is probably offered in this way, but there is probably a portion that arises from Mode 4 – where engineers and other consultants will move to the country where the service is offered, and work directly for the client (not in a subsidiary)

There is also some anecdotal evidence in the sector of limited Mode 1 trade. This is happening when South African consulting engineers and similar are asked to do design work, from South Africa, for an offshore client.

Mainland Africa is a key source of business for South African construction services, although Aveng's wholly owned subsidiary (McConnell Dowell) is headquartered in Australia, and focuses on the Pacific region and South East Asia.

There is no Reserve Bank data on trade in construction. We use estimates from Quantec and industry sources.

The construction data shows a deficit in trade in services, but also that that deficit has been declining since 1997, with only a marginal increase in 2003 (in which year both exports and imports increased). In the larger picture, construction services are negligible, with 2003 nominal values for imports and exports of R147m and R71m, respectively.

Aveng's construction cluster recorded revenue of R9.8bn in 2003, with around 50% of that generated outside South Africa. However, it is not clear how much of that is services rather than actual construction work. However, even if we assume that it is only 10%, then the value of export services could be around R49 million.

Murray and Roberts does not publish data showing geographical source of earnings by division, but does indicate that 44% of earnings are generated outside South Africa. If we apply that to 2003 revenues for construction operations (R8.3bn), engineering contracting and services (R955m) and construction services and material supplies (R3.4bn) we can calculate a **very rough** estimate of foreign revenue across these activities of around R5.5bn. Not all of this can be considered services revenue (since contracting revenue includes materials), but it does suggest that the construction services export figure for 2003 of R71m is probably too low, particularly if we consider some of the mega-projects that South African contractors have been busy with in mainland Africa (which is probably the main destination of exported services).

The main problem with contracting services in this sector is that they are often undertaken by individual professionals, whose earnings are not easily recorded in official mechanisms.

3.3.5 Community, social and personal services

Mode 2 – consumption abroad, although those foreign students receiving education from Unisa are under Mode 1 since they do not physically attend the university.

Other African countries are probably an important source of business for the medical and education sub-sectors.

Community, social and personal services trade mainly involve activities related to education, health and possibly the film production industry (including advertising briefs). The SARB does collect discrete foreign exchange data on “services related to study” and “medical services” but these are lumped with all the other non-transport and non-travel categories under “other services” in the published balance of payments statistics.

Quantec estimates that exports in CS&PS were valued at R1.4bn in 2003, as compared to R1.16bn in imports. Almost 80% of exports were related to medical and dental services, as compared to only 30% of imports of CS&PS. Between 1994 – 2003, exports grew by an average of 42% annually in real terms off a very low base, as compared to imports, which stagnated in real terms.

Starting with education: In 2003 Wits University had 1,300 foreign students and UCT had 3,000 foreign students. At an average tuition fee of roughly R15,000 per annum, that gives us an export value of around R65million. Unisa had around 14,000 foreign students in 2004, paying approximately R4,000 per year (total = R56 million).

There is very little in the way of accurate data on the local film and television production industry, but a 2000 Price Waterhouse report put the total value of the local entertainment industry at R7.7bn, with almost all of it focused on the local market.

4 Appendix: an analysis of South Africa's trade in services data¹¹

4.1 Executive summary

Trade in services is inherently difficult to measure, as there is no physical object (good) that actually crosses borders. For the purposes of the GATS negotiations, the WTO distinguishes between four modes of supply: Mode 1 (cross-border), Mode 2 (consumption abroad), Mode 3 (commercial presence) and Mode 4 (presence of natural persons). Balance of payments data is designed to capture transactions between residents and non-residents, and thus, if sufficiently detailed, may be used to obtain a disaggregated picture of trade in services via Modes 1, 2 and 4. However, companies maintaining a commercial presence in a country, via a foreign affiliate (as many multinational companies do) are treated as legal residents of that country, and thus are not captured by balance of payments data. The WTO has suggested that the compilation of foreign affiliate trade in services data (FATS) data is necessary to measure trade via commercial presence (mode 3). In addition, there are some subtleties relating to trade in the services of natural persons that necessitate the collection of employment data in order to accurately measure this variable. This is of particular importance (and difficulty) in the South African case, due to the large number of migrant workers employed by domestic firms in South Africa.

South Africa, like many other developing countries, is somewhat behind in the implementation of the WTO standards. Our balance of payments data relies partly on the cross-border transactions reporting data system (which is based on foreign exchange data), but until recently this was not aligned with the IMF's balance of payments standards, as described in their 5th edition manual (BPM5). It is expected that this will enable Reserve Bank will release revised and possibly disaggregated data (by sector) in the near future, as currently it reports only the travel and tourism components, with other service sectors aggregated under "other". Even if this becomes the case, we still will not be able to fully implement the extended balance of payments system (EBOPS) recommended by the WTO. More importantly, we do not collect FATS data, and thus can only get a sense of mode 3 trade from foreign direct investment (FDI) data. This is inadequate, and is the area in which we have the greatest need to improve our data reporting. The table below summarizes our current position.

¹¹ This appendix was prepared by Greg Lewis for the "Leveraging Services Project", a joint project of the Employment Growth and Development Initiative at the HSRC and the Government of South Africa. This project seeks to raise awareness of the role of services in South Africa's social and economic development. The research project was supported by the Director-General's Social and Economic & Employment Clusters. The financial assistance of the South African Government is gratefully acknowledged.

Table 4 – Review of data collection by mode of trade

		Mode 1: Cross-Border	Mode 2: Consumption Abroad	Mode 3: Commercial Presence	Mode 4: Presence of natural persons
WTO Standard	Data Type	Balance of Payments (as per BPM5)	Balance of Payments (as per BPM5)	Foreign Affiliate trade in services (FATS)	BOP, FATS and others
	International Standard	EBOPS	EBOPS	Majority ownership; variables as per WTO manual	No clear standard yet
South African Reporting	Data Type	Balance of Payments. Components are tourism and travel only.	Balance of Payments. Components are tourism and travel only.	FDI data, old industry censuses. Clearly inadequate.	Balance of Payments. Clearly inadequate.
	Data Source	Reserve Bank	Reserve Bank	StatsSA, Reserve Bank	Reserve Bank

4.2 Introduction

Accurate data on trade in services is necessary to inform industrial policy in the services sectors, and to shape negotiating strategy at the World Trade Organization. Due to the inherent difficulty of measuring trade in services, however, there had until recently been little effort to provide a coherent conceptual framework for such trade activities. This has changed with the publication of the *Manual on Statistics of International Trade in Services* (2002). This manual has been compiled with the support of the WTO, UN, IMF, OECD and other major international organizations. It builds on the 5th edition of the IMF's balance of payments manual (BPM5), and introduces a number of refinements necessary to capture trade in services in a manner consistent with the general agreement on trade in services (GATS). These include:

- The introduction of a new, more disaggregated standard for balance of payments reporting, namely the Extended Balance of Payments Services Classification (EBOPS);
- The outlining of a system of reporting for foreign affiliate trade in services, which is necessary to capture trade via commercial presence (mode 3);
- A technical appendix dealing with the difficulties of trade in natural persons (mode 4).

This report aims to compare South Africa's data reporting systems with those recommended by the WTO, and thus to suggest what is necessary to move closer to international best practice. Section 2 gives the details of the system recommended in the manual, section 3 examines the current state of South African data reporting, and section 4 provides some policy recommendations.

4.3 International standards

4.3.1 Modes of supply

The Manual takes its lead from the general agreement in trade in services (GATS) in distinguishing between four modes of supply for services. These are:

- Mode 1 - *Cross-border Trade* - where the consumer remains in his home country, and the service is supplied from abroad;
- Mode 2 - *Consumption Abroad* - where the consumer moves outside his home country to consume the service;
- Mode 3 - *Commercial Presence* - where a foreign company supplies a service to a consumer in his home country via a resident foreign affiliate;
- Mode 4 - *Presence of Natural Persons* - where an individual moves temporarily into the home territory of a consumer to provide a service.

4.3.2 Capturing modes 1 and 2 – Balance of Payments data

The Manual recommends using Balance of Payments data to capture services trade via modes 1 and 2. Essentially this should work because in both cases there is a transaction between a resident and a non-resident (resident consumer and non-resident supplier in the case of mode 1, and vice-versa in the case of mode 2). Under the international standards for balance of payments recording set out by the IMF's manual (5th edition, henceforth BPM5), countries should provide partial disaggregation by service sector¹². However, this is not sufficient for the purposes of trade negotiations, so the WTO (in association with other multilateral agencies) has developed the extended balance of payments services classification (EBOPS). This distinguishes between the following services:

- Business Services, including professional and trade-related services;
- Communications Services, including telecommunication and postal services;
- Computer and Information Services;
- Construction Services, including engineering and building services;
- Environmental Services, including sanitation and refuse disposal;
- Financial Services;
- Government Services not included elsewhere;
- Insurance Services, including freight, life and reinsurance;
- Personal, Cultural and Recreational Services, including audiovisual, education and health services;

¹² See paragraphs 158-170 of BPM5

- Royalties and License Fees;
- Travel, including health and education related expenditure;
- Transportation, including road, rail, air, maritime and electricity transmission.

There are few countries that are currently in a position to comply with EBOPS, although some developed countries are able to implement the full disaggregation recommended by BPM5. EBOPS allows for a gradual progression towards full implementation. For example, a country may implement a version in which it measures travel at an aggregate level (which most countries currently do) and then move towards a disaggregation that identifies education or health related travel. These categories are not just a disaggregation of the BPM5 categories, and the correspondence between them is not so clear (it is outlined in appendix II of the Manual).

4.3.3 Capturing mode 3 – foreign affiliate trade in services (FATS) data

As noted above, mode 3 trade in services occurs when a foreign company buys or establishes a *majority-owned*¹³ affiliate in the consumer's home territory, thereby establishing a commercial presence. In this case, the transaction is between a resident company (the branch, subsidiary or affiliate of the foreign company) and a resident consumer. Critically, this means that the transaction will not be reflected in the balance of payments. This necessitates the use of a parallel measure of economic activity, which should be the *sales* of the foreign affiliate (just as balance of payments data records the value of the transaction between the two parties). Yet this data is not typically available, and hence the Manual recommends the compilation of FATS data. This data should consist not only of the sales of the foreign affiliates, but also value-added and employment, as this will enable the compiling authority to make a good assessment of the effects of trade via commercial presence¹⁴.

Data collection can be accomplished in three ways. The first is the traditional method of conducting surveys on the operations of resident affiliates of foreign firms and foreign affiliates of domestic firms. The second is appropriate only for "inward" FATS (service imports), and involves identifying the subset of existing data on resident enterprises that is accounted for by foreign-owned firms. Obviously, this requires good data on resident enterprises, by sector. Finally, one may obtain data on "outward" FATS by getting the "inward" FATS data of major trading partners and aggregating them. Clearly, this implementation strategy works only if countries employ similar standards, which is precisely the problem that the manual tries to address.

The manual suggests that for countries without the capacity to compile FATS data, one may use foreign direct investment (FDI) data as a proxy for trade in services via

¹³ This is one case where the Manual does not follow GATS. GATS talks of foreign affiliates as resident companies that are controlled by a foreign company; whereas the manual speaks of majority ownership.

¹⁴ Other suggested statistics are to be found in paragraphs 4.47 and 4.68 of the Manual.

commercial presence. Clearly, the two measures are not equivalent, as FDI has as its flow variable direct investment income, including income from equity and interest from debt. Yet this will only be recorded when money is actually repatriated by the foreign affiliate back to its majority owner (e.g. dividends), whereas sales will be recorded regardless of the repatriation (which is the correct measure). It therefore follows that FDI will be an inaccurate proxy for FATS, and will typically underestimate the extent of trade in services.

4.3.4 Capturing mode 4 – Balance of Payments, FATS and others

Services trade via the presence of natural persons is the most difficult of the modes to accurately capture. Part of this is because there are so many ways in which natural persons can supply a service to residents of the home country; and part of this is because it is so easy for the value of this service to become conflated with other modes, as when a top executive is flown in from the parent company to consult to the foreign affiliate. The Manual identifies a number of ways in which natural persons can typically supply a service:

- Independent service provision – in which a foreign natural person provides a service in the home country (as with many professionals). In such a case, the data will be recorded in the balance of payments, although it will be difficult to get the disaggregation by sector that one requires (one is unlikely to survey individuals, for example). forex data may provide a partial solution. Moreover, unless one takes the time to separate individuals from companies, this data will be “indistinguishably included with resident/non-resident transactions that take place through other modes.”¹⁵
- Employed by a foreign affiliate – in which case their services should be picked up under mode 3. Again, conflation cannot be avoided.
- Employed by a domestically owned firm – in which case, the recording method depends on the length of the employment. Under BPM5, if the worker is employed for less than a year, data is available through the term *compensation of employees*. However, if they are employed for more than a year, they are automatically viewed as residents of the host country, under BPM5. Yet GATS would still view it as a trade in a service if their stay is intended to be “temporary.” This is particularly problematic in the case of migrant workers, who are often employed for many years in their host country, and yet always intend to return to their family in their home country. Data on such workers can be inferred from the BPM term *workers remittances*, although this is clearly just a proxy measure.

The bottom line is that mode 4 trade is difficult to measure and separate out from other measures of trade. Yet the WTO negotiations over mode 4 access tend to be some of the most contentious, and thus it is worth some effort to get some measure of the trade in this mode.

¹⁵ Paragraph 7, Annex I, WTO Manual on Statistics of International Trade in Services

4.4 South African data reporting

4.4.1 *The Balance of Payments system*

South Africa currently follows BPM5, reporting only the most aggregated components of trade in services. These are travel, transport, and “other”, a category that incorporates all the other components described above. These statistics are published in the quarterly bulletin. The current system is founded on two different data sources. Firstly, the Reserve Bank conducts sample surveys of different firms in the service industry to assess their transactions between residents and non-residents. Secondly, the bank employs foreign exchange (forex) data acquired via the cross border transactions reporting system (which is part of the exchange controls system). Until recently the forms used did not align with BPM5 components, making use of this data difficult. This changed in April 2001, with the introduction of new forms. Recently the Reserve Bank has gained access to the forex data¹⁶ and is in the process of merging this data to get revised figures for the service sector. The appeal of this secondary data source is that it is “same source”, in the sense that a transaction is captured as it is processed. The same is not true of the survey-based system. With the improved data, the Reserve Bank may be able to provide greater disaggregation of the balance of payments statistics, in line with the finer categories of BPM5. This will be very desirable. One of the potential problems is that the exchange controls act forbids the publication of statistics that would allow one to identify the individual transactions of domestic firms. Thus it may be possible to publish sectoral data, but only in cases where one or two big firms do not dominate the sector. Once we move towards greater disaggregation, and make extensive use of the forex data, our balance of payments system should be comparable to that of the developed countries.

4.4.2 *Problems with the BPM5 system*

From reports commissioned by Trade and Industrial Policy Strategies (TIPS), as well as the recent scoping exercise, we are aware that certain South African sectors are significant exporters or importers of trade in services. These include the construction, health and tourism sectors. In each of these cases, there are problems with capturing the true value of trade in services, and these are *endemic* to the BPM5 system. The two main problems (which impact on measurement in these sectors) are summarized below:

- *1 year Residency Rule:* Under BPM5, a company or individual that stays in a country for more than one year is considered to have located his centre of economic activity in that country, and is thus treated as a resident. This has two major impacts. Firstly, as noted above, it becomes very important to collect FATS data, because a foreign affiliate simply “disappears” from your balance of payments data after a year. Secondly, the same applies to *migrant workers*. During their first year of employment, their data is captured under workers

¹⁶ Until some time ago, neither the Reserve Bank nor any other organization could gain access to forex data, under the legislation that establishes exchange controls.

compensation; but thereafter the value of their work simply disappears from your data set, and thus you get an inaccurate picture of mode 4 trades. This is particularly important for the construction sector, both because it is a sector in which long term trade is important, and because there is the potential for many migrant workers to be employed in this sector.

- *Consolidation under Travel:* Under BPM5, when an individual from a foreign country travels abroad in the home country, all his consumption of goods and services are recorded under “travel”. This is obviously a simplification, and it is particularly problematic for South Africa, where we have some trade in health services via health safaris. This expenditure will be misclassified under travel, and thus exaggerate the importance of trade in tourism at the expense of trade in health. Again, migrant workers create complications, because their goods purchases, which are often for resale in their home countries, will be classified under travel.

These problems can be ameliorated by taking care to identify the travel data pertaining to consumption of health and educational services, as is required under EBOPS; and by compiling FATS data that includes employment statistics to capture resident foreign affiliates and migrant workers.

4.4.3 Analysis of the current South African data reporting system

The key tools in compiling extensive and accurate data on trade in services are a good balance of payments reporting system, and the compilation (at least annually) of FATS data. Our current balance of payments system is not sufficiently disaggregated to give us a reliable picture of trade in important sectors such as financial services. Moreover, until we make consistent use of the forex data, it may not be possible to provide such disaggregation with sufficient accuracy. This is something that is high on the Reserve Bank agenda, and will hopefully change soon.

More worrying is the absence of any South African institution that attempts to compile FATS statistics. Part of the problem is the absence of a business register that would allow us to identify firms that are majority owned by foreign companies. Another problem is that no institutions seem to have the mandate and/or capacity to systematically survey these firms, and obtain the FATS statistics. Statistics South Africa used to undertake irregular censuses of sectors that could capture some measures of inward FATS (data on the sales of companies in which a foreign company has a controlling interest)¹⁷. This is no longer the case (the last such census was in 1996). Yet without this data, we have little means of capturing mode 3 trades. We may look to the data on foreign direct investment provided by the Reserve bank as a proxy. But this is not very disaggregated, and does not allow for a breakdown by service sector. There is a very real need to collect FATS data if we wish to assess the trends, threats and opportunities presented by trade in services.

¹⁷ Since the purpose of the censuses was not to obtain FATS data, only some of the useful statistical measures are captured. Often these are related to employment rather than output, which is unfortunate, since output is the key (primary) measure needed.

4.5 Policy recommendations

4.5.1 Core elements

The WTO identifies in the Manual a number of core elements that it suggests countries move swiftly to implement. These are as follows:

BPM5 – Countries should implement the BPM5 recommendations, to capture service transactions between residents and non-residents. *South Africa currently complies with these standards¹⁸.*

EBOPS (first part - disaggregation) – Countries should compile their balance of payments data according to EBOPS, thus allowing disaggregation into EBOPS subcomponents. *South Africa does not comply with these standards.*

Foreign Direct Investment Statistics – Countries should collect complete statistics on FDI flows, income and period-end positions as classified by ISIC, Rev. 3 to be complementary to the FATS statistics. *South Africa partially complies with these standards.¹⁹*

FATS: Basic Variables – Countries should record basic FATS statistics, such as sales, employment and value-added. *South Africa does not comply with these standards.*

Trade in Services by Partner Country – Countries should compile trade in services data for their major trading partners, at the level of major industry categories. *South Africa does not comply with these standards.*

Thus overall, South Africa still needs to make a lot of progress in order to implement the core elements recommended by the WTO. Indeed, the Reserve Bank has stated that this is not a priority for the Bank, and thus it is perhaps not surprising that we have not made greater progress in this regard.

4.6 Recommendations

Of the core elements mentioned above, we need to focus on the implementation of EBOPS and FATS. With the recent access to forex data, it should become possible to compile accurate balance of payments data at the level of individual sectors, which will go a long way towards providing extended balance of payments data. The Reserve Bank should be strongly encouraged to do this, and should obtain additional capacity if it is necessary to implement this.

It will be much more difficult to collect FATS statistics. An incremental approach is perhaps advisable, where surveys are undertaken, at first, only in sectors that are of

¹⁸ Although we provide only the coarsest possible disaggregation: travel, tourism and “other”.

¹⁹ The Reserve Bank reports FDI, but not by industry, and hence not “as classified by ISIC.”

major importance for trade negotiations and policy. An institution needs to be tasked with this data collection process, and that institution should have the potential to fulfil this task in the long term, as we move towards full compliance with the Manual.