

## »» International trade in services – German SMEs are active too

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Across the globe, a structural change towards services is underway that also manifests itself in international trade flows. Compared with other European countries, Germany is still heavily characterised by industrial production but the share of services in total exports has grown noticeably here as well in the past decades – to nearly 18 % in the year 2016.

Business services in particular, such as research and development, legal advice, tax and business consultancy, as well as information and communication services are becoming increasingly important in international trade. Today they account for some 55 % of Germany's service exports and 47 % of service imports.

Firms that export services are larger, more productive, pay higher salaries and are more often foreign-owned than non-exporting enterprises. In Germany, around one quarter of all service exports originate in manufacturing firms.

In the German SME sector, service enterprises make up around three quarters of all businesses. Around one in five of them is an exporter and in wholesale and retail it is nearly one third. Small and medium-sized enterprises are particularly affected by restrictive regulation on trade in services and should therefore benefit greatly from further liberalisation. Digitalisation should also further strengthen service exports by SMEs.

### Services are becoming increasingly important ...

Services are playing a growing role for the global economy. The share of services in global GDP grew from 58 to 66 % between 1996 and 2016. The structural transformation is especially evident in low and medium-income countries but also in highly developed industrialised countries. In the EU, the share of services in GDP rose from 68 to some 74 % between 1996 and 2016. One explanation for this development is that demand for services grows with rising incomes. At the same time, relative prices of manufactured goods have fallen as a result of technological progress, which has reduced the share of manufactured goods in GDP, even though manufactured goods production has grown in absolute terms.<sup>1</sup>

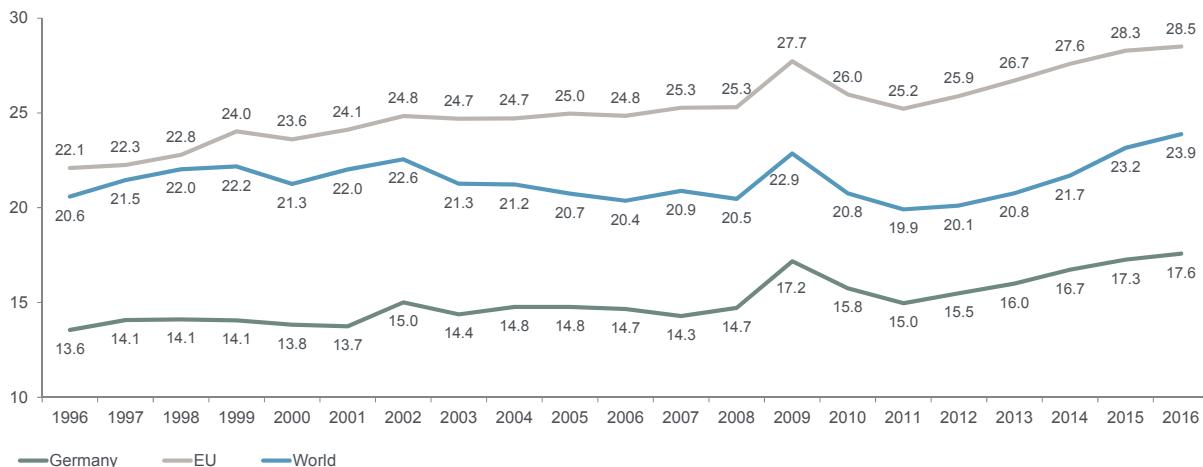
In Germany, services generated some 69 % of GDP in 2016 – only two percentage points more than in 1996 and significantly less than in other European countries such as the United Kingdom (79 %), France (79 %) and Italy (74 %). This reflects the traditionally strong manufacturing focus of the German economy.

### ... including in international trade

Services are playing a growing role in international trade as well. In 2016, services accounted for just under one quarter of global exports, at USD 4.9 trillion – an increase of a good three percentage points on 1996. In the EU, the share of services in total exports in 1996 was around 29 %, in Germany around 18 % – around four percentage points more than in 1996 (Figure 1).

**Figure 1: International trade is increasingly characterised by services**

Share of services in total exports (in per cent)



Source: World Bank

Note: This paper contains the opinion of the authors and does not necessarily represent the position of KfW.

During the financial crisis, service exports proved to be relatively robust, unlike goods exports, which led to a sharp rise in the share of services in exports in 2009. One explanation for this is that the demand for services is less dependent on the business cycle and relies less heavily on external funding than demand for goods. At the same time, services were less affected by protectionist measures as a result of the financial crisis.<sup>2</sup>

### Services are often exported indirectly

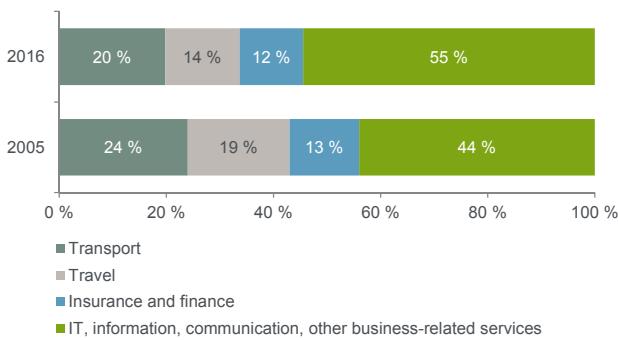
Nevertheless, trade in services is not completely uncoupled from trade in goods. Rather, both are closely linked to each other – the more complex production networks become, the higher the need for support services. Many business services, especially research and development, legal advice, tax and business consultancy, as well as information and communication services, go into the production of goods that are then exported. If we look at the exported value added and not the gross value of Germany's exports, the share of services increases from less than one fifth to about half.<sup>3</sup>

### Germany is the world's third-largest exporter of services

Although services in Germany make up a smaller share of exports than in many other EU countries, Germany is the world's third-largest exporter of services after the US and the UK. Germany's service exports totalled around EUR 258 billion in the year 2016.<sup>4</sup>

**Figure 2: Structure of Germany's services exports**

Share in Germany's total services exports in per cent



Sources: World Bank, Deutsche Bundesbank

### Business services dominate

Trade in business services has recorded particularly strong growth. They accounted for around 55 % of German services exports in the year 2016, around 11 percentage points more than in 2005. One major driver of this trend is advancing digitalisation. Information and communication services are playing an increasingly important role. In 2016 they accounted for EUR 30 billion, which was around 12 % of Germany's total service exports, compared with just under 7 % in 2005. Exports of transport and travel services, on the other hand, have become relatively less important (Figure 2).

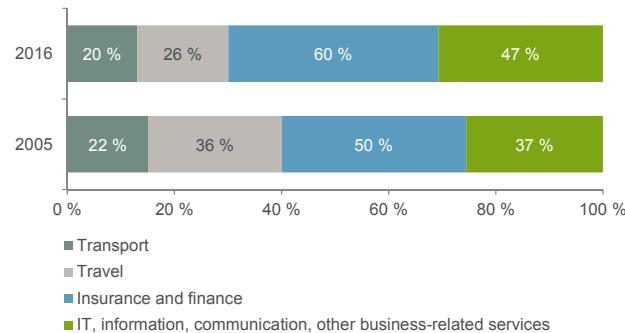
### High level of travel service imports

Germany's service imports totalled around EUR 278 billion in the year 2016. Germany therefore has a deficit of some EUR 20 billion in its trade in services – unlike in its trade in

goods.<sup>5</sup> This can be attributed primarily to the relatively high imports of travel services, which still accounted for more than one quarter of German services imports in 2016 (Figure 3).

**Figure 3: Structure of German services imports**

Share in Germany's total services imports in per cent



Sources: World Bank, Deutsche Bundesbank

### US and UK are Germany's main trading partners

Germany's most important trading partner by far is the US, which in 2016 accounted for nearly EUR 41 billion in service exports from Germany and some EUR 39 billion in services imports into Germany. The UK is the second most important trading partner, followed by Switzerland, France and the Netherlands (Table 1).

**Table: Germany's most important partners in trade in services**

Rank	Services exports		Services imports	
	Country	EUR millions	Country	EUR millions
1	USA	40,740	USA	38,710
2	United Kingdom	24,266	United Kingdom	22,099
3	Switzerland	23,140	France	18,418
4	France	15,283	Austria	16,801
5	The Netherlands	15,063	The Netherlands	16,030

Source: Eurostat

### Service exports are strongly concentrated on a few enterprises

In general, trade in services is heavily concentrated. In Germany, only around 5 % of all services exporters serve more than 25 countries but generate around 70 % of Germany's total services exports. In contrast, 43 % of all service exporters operate in a single foreign market only. Their combined share in total services exports is no more than 3 %.

The pattern is similar for the types of services exported. Fewer than 15 % of services exporters export five or more different services but together account for more than 70 % of Germany's export turnover in trade in services.<sup>6</sup>

## Services exporters – large, productive and often manufacturers

Enterprises that export are larger, more productive, pay higher salaries and are more often foreign-owned than those that do not, and this applies equally to services exporters and goods exporters.<sup>7</sup>

The largest share of service exports from Germany originates in enterprises that can be attributed to the services sector, such as business consultancy firms, engineering firms or software developers. However, manufacturing enterprises also contribute substantially to German services exports, with around one quarter.<sup>8</sup> Examples of service exports from the manufacturing sector are research and development services rendered at the head office of a multinational automaker for subsidiaries abroad, as well as service and advisory services linked to the sale of a machine or software to a customer abroad.

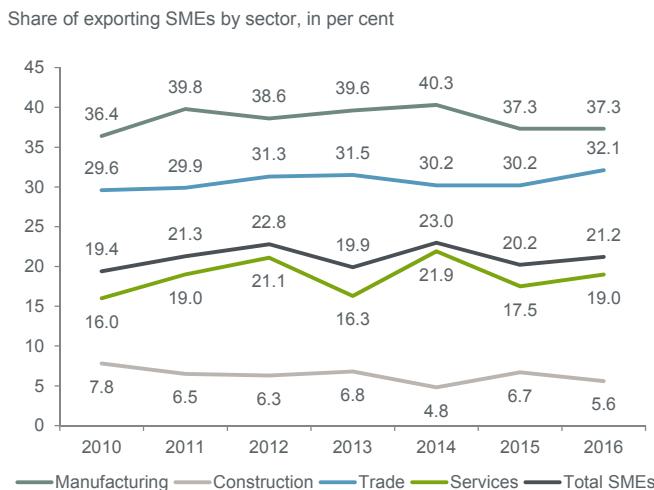
## Multinational corporations drive foreign turnover

German enterprises achieve international turnover not just by exporting services but also by providing services through their foreign branches.<sup>9</sup> Official statistics about the type of services they trade in do not exist. But estimates suggest that EU companies generate more than two thirds of their international turnover in non-EU countries through their local branches and less than one third through exports.<sup>10</sup>

## One in five SMEs in the services sector earn turnover abroad

A look at small and medium-sized enterprises<sup>11</sup> in the service sector shows that around one fifth of them earned cross-border turnover in the year 2016 – either through direct exports or through foreign branches. The latest figures show that nearly one third of SMEs in wholesale and retail trade, which is also part of the service sector, were active abroad. But these figures are not an indication of a continuing increase in service enterprises' propensity to export (Figure 4).

**Figure 4: Share of exporters in German SMEs**

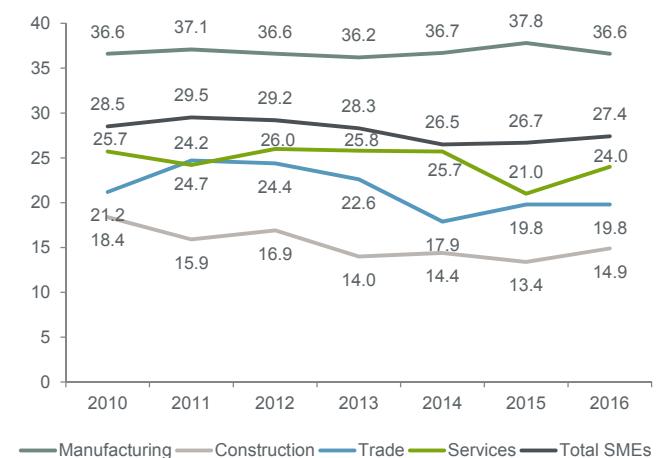


Source: KfW SME Panel

Export intensity also fluctuates slightly. In the years 2010–2016, service enterprises with international business generated around one quarter of their total turnover abroad (Figure 5). In total, international turnover of small and medium-sized service enterprises was around EUR 140 billion in 2016; trade accounted for around EUR 125 billion. Combined, this amounts to around half of all international turnover of SMEs in 2016, which totalled EUR 547 billion.<sup>12</sup>

**Figure 5: Export intensity in the SME sector**

Share of international turnover in total turnover of SMEs doing business abroad by sector, in per cent



Source: KfW SME Panel

This figure does not represent SMEs' services exports.<sup>13</sup> But it can be assumed that the share of services in exports is significantly higher in the SME sector than in the overall economy.

With around three quarters of all small and medium-sized enterprises operating in the service sector, their strong focus on services should thus also be expressed in international trade in services. SMEs are likely to have a significantly higher share here than in international trade in goods.

## SMEs could benefit greatly from the liberalisation of trade in services

At the same time, the restrictive regulation of trade in services for small and medium-sized exporters means that they incur relatively higher costs than large enterprises.<sup>14</sup> SMEs should therefore reap particular benefits from a further liberalisation of trade in services. The EU needs to catch up in this field as well. Furthermore, trade in services with the United Kingdom needs to be redefined, as more restrictive trade rules could deal a severe blow not just to the second largest exporter of services but also to the EU and, in particular, German SMEs. According to estimates, trade in services with the United Kingdom could decline by more than 60% in the long term.<sup>15</sup>

## Digitalisation provides SMEs with opportunities – including in exports

More than 72 % of business service providers in the SME sector expect to benefit from digitalisation. Almost as many expect digitalisation to simplify the integration into their customers' value chains. And nearly 62 % of the surveyed service providers expect digitalisation to make it easier for them to tap into European sales and procurement markets.<sup>16</sup> The KfW SME Panel also shows a significant positive correlation between export propensity and successfully completed digitalisation projects. These figures indicate that

digitalisation will open up new pathways for trade and simplify cross-border trade and services.

The ability of small and medium-sized enterprises to make effective use of e-commerce, B2B platforms and similar mechanisms is likely to crucially depend on the systematic expansion of the broadband network. What will be important here is to create a clear legal framework for cross-border trade in services that is as uniform as possible and comprises the protection of both intellectual property and data. ■

<sup>1</sup> See OECD (2017): Services Trade Policies and the Global Economy. World Bank data on the share of services in GDP and total exports.

<sup>2</sup> See Ariu, A. (2016): Crisis-Proof Services: Why Trade in Services Did Not Suffer during the 2008–2009 Collapse, Journal of International Economics, Vol. 98, p. 138–149 as well as Borchert, I. and Mattoo, A. (2010): The Crisis Resilience of Services Trade, The Services Industry Journal, Vol. 30 (13), p. 2115–2136.

<sup>3</sup> See Miroudot, S. and C. Cadestin (2017): Services in Global Value Chains: From Inputs to Value-Creating Activities, OECD Trade Policy Papers No. 197.

<sup>4</sup> See Deutsche Bundesbank (2018): Außenhandel und Dienstleistungen der Bundesrepublik Deutschland mit dem Ausland, Integrierte Daten für den Berichtszeitraum 2013 bis 2017 (*Cross-border trade in goods and services of the Federal Republic of Germany – Integrated data for the reporting period 2013–2017* – our title translation, in German only).

<sup>5</sup> See *ibidem*.

<sup>6</sup> See OECD (2017): Services Trade Policies and the Global Economy and Rouzet, D., Benz, S. and Spinelli, F. (2017): Trading Firms and Trading Costs in Services: Firm-Level Analysis, OECD Trade Policy Papers No. 210.

<sup>7</sup> See Nordas (2015): Services SMEs in International Trade: Opportunities and Constraints, and the literature cited therein.

<sup>8</sup> The share varies greatly with the type of service exported. Thus, manufacturers account for around two thirds of exported engineering services but less than 10 % of exported financial, information and communication services. See Rouzet, D., Benz, S. and Spinelli, F. (2017): Trading Firms and Trading Costs in Services: Firm-Level Analysis, OECD Trade Policy Papers No. 210, and Kelle, M. and Kleinert, J. (2010): German Firms in Service Trade. Applied Economics Quarterly, Vol. 56(1), p. 51–71.

<sup>9</sup> The General Agreement on Trade in Services (GATS) distinguishes between four types of trade in services: Mode 1 – cross-border supply (e.g. transmission of a design for the construction of an office building to a customer abroad), Mode 2 – consumption abroad (e.g. tourists from abroad booking a hotel in Germany), Mode 3 – commercial presence (e.g. a German national opening a language school abroad) and Mode 4 – movement of natural persons (e.g. a German expert on tax law providing personal advice to a foreign company). The balance of payments recognises the exchange of services between nationals and foreigners as exports of services (Modes 1, 2 and 4). Services sold by branches abroad are not counted as exports of services but as part of a domestic enterprise's foreign turnover and are contained in the statistics on the structure and activity of foreign affiliates (Foreign Affiliates Statistics – FATS).

<sup>10</sup> More specifically, an estimated 69 % of trade in services between the EU and non-EU countries is in the form of sales by foreign branches of EU enterprises to non-EU countries (Mode 3). Cross-border supplies (Mode 1) make up 21 % of the EU's trade in services with non-EU countries, consumption abroad (Mode 2) 6 % and movement of natural persons (Mode 4) 4 %. See [http://ec.europa.eu/eurostat/statistics-explained/index.php/Services\\_trade\\_statistics\\_by\\_modes\\_of\\_supply](http://ec.europa.eu/eurostat/statistics-explained/index.php/Services_trade_statistics_by_modes_of_supply)

<sup>11</sup> Here, small and medium-sized enterprises are defined as businesses with an annual turnover of up to EUR 500 million. See also Schwartz, M. (2017): [KfW SME Panel 2017](#) Germany's domestic economy continues to break records – sectoral transformation poses new challenges, KfW Research.

<sup>12</sup> See also Abel-Koch, J. (2017): [The world is not a village – geographic proximity to export markets is crucial to SMEs](#), Focus on Economics No. 182, KfW Research.

<sup>13</sup> The KfW SME Panel captures the international turnover of each enterprise but does not distinguish between exports and turnovers of their foreign branches nor, in particular, between exports of services and exports of goods. Services exports of small and medium-sized manufacturing enterprises therefore cannot be captured, for example. Official statistics that break down international trade flows by enterprise characteristics thus far exist only for trade in goods but not for trade in services.

<sup>14</sup> See OECD (2017): Services Trade Policies and the Global Economy, and Rouzet, D., Benz, S. and Spinelli, F. (2017): Trading Firms and Trading Costs in Services: Firm-Level Analysis, OECD Trade Policy Papers No. 210.

<sup>15</sup> See House of Lords European Union Committee: Brexit - Trade in Nonfinancial Services, 18th Report of Session 2016–2017.

<sup>16</sup> Cf. Abel-Koch, J. (2016): [SMEs' value chains are becoming more international – Europe remains key](#), Focus No. 137, KfW Research.