

International Trade Committee

Oral evidence: Trade in services, HC 1776

Wednesday 13 March 2019

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Members present: Angus Brendan MacNeil (Chair); Mr Nigel Evans; Mr Marcus Fysh; Sir Mark Hendrick; Mr Ranil Jayawardena; Emma Little Pengelly; Julia Lopez; Catherine West; Matt Western.

Questions 1 - 77

Witnesses

I: Professor Catherine Barnard, Professor of EU Law, Cambridge University, Sam Lowe, Senior Research Fellow, Centre for European Research, Professor Lucia Quaglia, Professor of Political and Social Science, University of Bologna, and Professor L. Alan Winters, Director of UK Trade Policy Observatory, University of Sussex.

II: Jonathan Athow, Deputy National Statistician, Office for National Statistics, Anjalika Bardalai, Chief Economist and Head of Research, TheCityUK, and Dr Ingo Borchert, Senior Lecturer in Economics, UK Trade Policy Observatory.

Written evidence from witnesses:

– Professor L. Alan Winters and Dr Ingo Borchert, UK Trade Policy Observatory, Written evidence TiS0012
<http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/international-trade-committee/trade-in-services/written/96103.pdf>

Examination of witnesses

Witnesses: Professor Catherine Barnard, Sam Lowe, Professor Lucia Quaglia and Professor L. Alan Winters.

Q1 Chair: Good morning, panel. Welcome to the International Trade Committee's first evidence session on the UK's trade in services. You arrive obviously at a very calm and relaxed time in Westminster politics, as is evident, probably, by our Committee membership this morning. Before I say much more than that, can I ask the panel to give their name, rank and serial number and introduce themselves, from my left?

Professor Quaglia: I am Lucia Quaglia, University of Bologna.

Professor Barnard: Catherine Barnard from the University of Cambridge.

Professor Winters: I am Alan Winters, Director of the UK Trade Policy Observatory at Sussex.

Sam Lowe: Sam Lowe. I am a senior research fellow at the Centre for European Reform.

Q2 Chair: Thank you. Just before I kick off on our trade in services this morning, something that will be very interesting to followers of the International Trade Committee is the UK tariffs being published. Would anybody like to express a view or two, as experts in this area? Alan Winters?

Professor Winters: My initial reaction was that this is probably a reasonable sort of compromise between protecting some producers and important political groups, and the right of consumers to lower prices. But I have to say the devil is always in the detail with these things and we need to work through the numbers before we are confident that we can say very much, both in terms of the average amount of protection but also in the little gritty details at the very precise product level.

Q3 Chair: It also means, for the agricultural sector, presumably the European Union is going to have the full tariff schedule up as well. So for those hill farmers and crofters like my good self who are exporting lambs in the autumn—

Professor Winters: In the event of a no deal—this is the UK tariff, not the EU tariff—the EU would levy its most-favoured-nation (MFN) tariff on imports from Britain in the event of no deal; yes, high tariffs.

Q4 Chair: Do you think there will be shocks in the market?

Sam Lowe: I agree entirely with Alan's assessment. I looked at it briefly because we were coming here, but it looks like a pragmatic approach. One thing I would say is I do not think that the additional language on Northern Ireland and what is intended there is sustainable at all in the long term. In fairness to the proposal, it does admit that it is not



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sustainable. It says that this would be a temporary measure until you move on to find something else.

In terms of how the UK sells into the EU, Alan is right—yes, we would be faced with the EU MFN tariff—but from an agricultural perspective that is, in a way, the least of the concerns because we are still not sure if the UK would be authorised as a country and able to sell products of animal origin into the EU because that has not been determined yet and has not been published on the EU side.

Q5 Chair: You are saying that it is not just a tariff wall; it may be a sanitary and phytosanitary wall as well.

Sam Lowe: As ever—and we are about to get into this with services—tariffs are really the tip of the iceberg when it comes to trade.

Q6 Chair: An uncertain term. We will go on to services then. May I ask the panel in what ways services are tradeable internationally and how this is reflected in the various modes of supply under the WTO General Agreement on Trade in Services—GATS as it is more commonly known?

Professor Barnard: Do you want to hear about the different modes?

Q7 Chair: Yes.

Professor Barnard: We will start with the modes. There are four modes. Some people say five but there are four modes that are officially recognised. Mode 1 is “cross-border supply”. That would be, for example, where an architect sends plans from the UK to Japan for a building there. Mode 2 is “consumption abroad”. That would be where a consumer travels to receive a service, whether it be plastic surgery or whether it be tourism services in another state.

Mode 3 is called “commercial presence” and that is essentially about establishment, where you have a bank that wants to set up a subsidiary or a branch in another state. Mode 4 is the most controversial and the most difficult one, which is essentially about the “movement of natural persons”. Essentially what you get there would be, for example, foreign construction workers working in another country to do a building and then returning back. It is not full migration at all. It is much a temporary provision of services.

Then mode 5, if it were to exist, is sometimes talked about as “services in a box”. That is where I am selling you a lift, but in addition to selling you the lift and all the component parts—that is the good bit—I am also selling you the maintenance contract that goes with it. Those are called “services in a box”. They are not covered at all in the existing agreement but there is much talk about the fact they should be.

Q8 Chair: Thank you. Anything to add?

Professor Winters: I would add a tiny bit to that. Mode 5 also covers service inputs into manufactured exports, such as the design services.



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Not just the maintenance contract but all the services that enter into the production of a manufactured good enter into what we measure in terms of mode 5.

Q9 Mr Ranil Jayawardena: To what extent does GATS liberalise international trade in services, particularly in terms of the market access schedules and other regulatory provisions?

Sam Lowe: It is interesting, as a precursor to that question, to think about how services are actually traded cross-border. If you look at it by mode, generally speaking, if you want to sell a service into a country you do it via mode 3. You establish there. If you look at the EU's services supplied to the rest of the world, about 69% are supplied via mode 3, by setting up a commercial presence, and that makes sense. If you think about how services are done, still a lot of it is face-to-face. If you want to access a market, you establish there so you know it. Then about 21% is done via mode 1. That would be done remotely.

In terms of how GATS goes about liberalising services, I suppose you can look at it as having horizontal provision. That would be, for example, Most Favoured Nations. This would apply to everything. It says, "If we allow a country to sell into our market and we offer them these provisions, we have to apply it universally in the absence of a free trade agreement."

Then you also have the sector-specific provisions, where you are looking at market access and national treatment. Market access is, for example, saying, if you do it by mode, "We will allow an accountancy firm to sell remotely into the UK from, let us say, South Africa—let us just pick one—and we will not put any restrictions on the amount of transactions they are allowed to carry out; or, if we are going mode 3, we will not require them to enter the European market as a joint venture."

We are not talking about the regulatory front because when we get to the regulations and the licensing issues, which is the barrier to trade in services, GATS is actually quite quiet. The exact language is, "WTO members have the right to retain measures relating to qualification and licensing requirements and technical standards so long as they are not an unnecessary barrier to trade". We do not really know what "unnecessary" means and it has not really been tested. Largely, I would say that if you are a service provider looking to enter a new market, the way you go about it is you employ a lawyer in that market to tell you exactly how to do it. Just looking at the schedules, looking at GATS or looking at the trade agreement probably is not going to be enough.

Q10 Mr Ranil Jayawardena: Did anyone want to add anything about that?

Professor Winters: Could I add a little bit? The GATS itself uses what we refer to as a positive list, which means that only sectors that countries volunteer to be liberalised under the GATS fall under its auspices at all. That is a limited set. De facto, most countries—or most developed



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countries, anyway—have considerably more liberal de facto regimes than they have bound in the GATS. In a sense, if one is looking at potential service transactions between the UK and the EU, there is one step of restrictions as we go from inside the single market to the EU's de facto policies for third countries and, if we ever were forced to fall back on the GATS, that would be yet another step towards restrictions. In fact, although the GATS was a giant leap forward conceptually it probably did not deliver very much liberalisation.

Professor Quaglia: Perhaps if I could add something with reference to financial services, there is a specific provision concerned called prudential carve-out, whereby countries and jurisdictions can limit market access and/or impose additional requirements if that is seen as necessary to protect financial stability, market integrity or consumer protection. Those measures have to be reasonable.

Professor Barnard: Can I just add to that? Of course we will be going from a position of being EU members to not being EU members and as far as the provision of services under EU law is concerned, it is of a different order of magnitude to what you find under the GATS. The starting point under EU law is that there is complete liberalisation of services, unlike the positive listing system where states have to choose in which sectors they will allow liberalisation.

Q11 **Mr Ranil Jayawardena:** Although we have not actually seen that entirely, have we? It has not been fully implemented.

Professor Barnard: Absolutely. I would agree with that. I would just say that if we start conceptually, then we can look at how it is working in practice. Conceptually, it is, at the moment, liberalisation. That is the default position. It is not even just equal treatment, it is what is called "market access" under EU law, which is different to market access under GATS law. It means that any restriction that gets in the way is presumptively unlawful unless it can be justified.

Your point is right. The fact is that states take a lot of advantage of the justifications. That is absolutely true. But the biggest difference between what you have currently under EU law and what you have under the GATS is that if a member state is persistently putting barriers in the way, the Commission can come and start enforcement proceedings. Secondly, if I find I want to work in another member state to provide a service and France is causing me trouble, I can either complain to the Commission, who can act on my behalf, or I can go to the French court. The enforcement mechanisms under EU law are far, far more robust than anything you see under GATS or GATT. The WTO enforcement mechanisms are so weak as to be almost useless for very small traders.

Q12 **Mr Ranil Jayawardena:** The UK, if I am not mistaken, is the second-largest exporter of services in the world. There are, of course, smaller traders, but there are also a lot of big traders. In respect of growing that in the years ahead, you have outlined some of the challenges but where



can you see some of the opportunities? What are the opportunities that the UK can exploit? One country we have not touched on—we had an example about South Africa and we have discussed the EU—is of course the United States, which this Committee has visited. We considered the opportunities potentially for financial services. Lloyds of London does a lot of insurance already. What is your assessment of services arrangements and a liberalised service deal with the United States? There are a lot of different questions posed but I thought I would just get them out there, Chairman.

Chair: Indeed.

Sam Lowe: The US is difficult. One of the reasons for this is that the US is not, in and of itself, an integrated services market. In some ways, just to use the EU as a comparator, when it comes to, say, professional services and recognition of qualifications, the EU is better and more liberal than the US. It is easier to have your qualification recognised across the EU than it is between different states. The reason this is a problem for the UK going in is that there is only so much that can be done at the federal level on the US side. This has nothing to do with the UK and how good it is or is not, it is just what the US is able to offer.

This problem occurs with services and also when it comes to financial services specifically. In the past we have a history of the US Treasury essentially asking for financial services to be carved out of negotiations, at least on the regulatory front. That happened with TTIP (Transatlantic Trade and Investment Partnership). Then when we get into other areas that are quasi-services—it could be goods, it could be services—such as procurement, you have this issue again that yes, while the US can talk about it in trade agreements on the federal level, it becomes difficult to talk about it on the state level and that is actually where the big barriers exist.

Q13 **Mr Ranil Jayawardena:** How do we exploit that the opportunity that is there, with a big market that we could do a deal with? That was the question.

Sam Lowe: How do you go about it? There is a question of what the UK has to offer. If you want something in return, you have to give something. With the UK being quite an open market on services as it stands, we do not have so much to offer on that front. One of the areas where we do—I am not sure how much this would help with the US but if we apply this to other countries—is on temporary movement of people. One thing we can do is make it easier for, say, Indian—if we just pull out India—IT engineers to come over here temporarily to deliver a contract. That might open up some opportunities there.

On the other side with the US, we know what they want from the UK when it comes to a trade agreement. They published their objectives two weeks ago. Lots of those objectives move over into other areas. We are talking agriculture, we are talking standards, we are talking approaches



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to conformity assessment. If you were able to give all of that, could the US potentially give a bit more when it comes to services? Yes, but as per my earlier point, it is difficult on the US side because of the distinction between what they can do at a federal level and what can be done at a state level.

Mr Ranil Jayawardena: We do not have to do the deal that they want us to do, do we? That is the point.

Chair: Thank you.

Q14 **Mr Ranil Jayawardena:** It is the same question. If they are not able to honour what we want on services then we do not have to do what they want on goods, do we?

Sam Lowe: No one can ever force the UK to sign a trade agreement with them but if we want to have a trade agreement and we are negotiating with a bigger party in the case of the US, and as we are slightly experiencing with the EU now, then we will find that it is the UK that probably ends up having to make more concessions than the other party. This is not a UK-specific issue, this is to do when South Korea negotiates with the EU. You see it all over.

Professor Winters: Could I add one conceptual comment, in a sense? Remember services are just much more complicated to liberalise, bilaterally or multilaterally, than goods. Essentially, services are governed by regulations. Regulations have regulators. These regulations have grown up through a historical process. They are also supported, remember, usually by very articulate groups of producers. You take on the doctors, you know about it. In fact, one has lots of things that are not really very carefully controlled by the federal Government, each with a strong lobby, each with a big historical justification for where it is. It is not an easy job.

One of the things that one can do is just encourage sectors to talk to each other, so that UK professional associations talk to US professional associations, at that sort of level, and then eventually turn up to the Governments and say, "We think we can agree this. Why don't you sign it?"

Professor Quaglia: Sorry, I just wanted to add a couple of points. First of all, I endorse what Alan said with reference to the role of domestic regulators. That is particularly important in the case of financial services, where the national competent authorities in the US have a lot of regulatory power as compared, for example, to regulators in other countries.

Second point. I think it would be useful, from a strategic point of view, to look at the failed negotiations between the European Union and the US, the so-called TTIP, the Transatlantic Trade and Investment Partnership negotiation, because in those negotiations there was a very controversial point concerning financial services. In those negotiations the US wanted



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to treat financial services as they had been treated in other trade agreements in terms of market access, whereas the European Union wanted to go further.

There were, in European Union documents—at least the documents that were made publicly available—references to regulatory co-operation, mutual recognition, mutual reliance, equivalence and substituted compliance, which is the US version of equivalence. My suggestion to you would be to look for perhaps more fully-fledged documents, which I am sure have been produced in the past by the Commission and distributed to the member states, and see what the European Union proposed during those negotiations with reference to financial services.

Q15 Matt Western: In what ways are the trade in services agreement negotiations seeking to build on the GATS? I put that to anyone.

Professor Winters: They are seeking to extend GATS but they are not particularly constrained to only work in terms of the GATS architecture. The hope of the trade in services negotiation is that they will be able to take a really very serious step towards liberalising and codifying regulations across a broad number of serious players. The people who are negotiating in principle account for something like 70% or 80% of services trade. There is quite a bold ambition, but of course it is all in stasis at the moment so in a sense it is quite difficult to know where it would end up.

Q16 Matt Western: You are saying it is in stasis. In terms of the state of play with the negotiations, nothing is happening but what are the likely next steps?

Professor Winters: The process stopped because the Americans essentially poured cold water on it; President Trump. I guess more or less the first step would be either that the Americans relent a little or, like with the Trans-Pacific Partnership, everybody else decides that they will go together without the States. That is a difficult political position to take but it is not impossible. I do not have, I am afraid, any political insights into how that is going to turn up. Let me add just one rider. It is not going to be changed dramatically by the arrival of the United Kingdom as an independent player.

Sam Lowe: I think the exact phrase that has been used was, "Negotiations are now on hold and are expected to resume when the political context allows."

Q17 Chair: That is very enigmatic. When might the political context allow? When Mr Trump shifts?

Sam Lowe: Yes. It is not just the Americans; it is also on hold because the EU had lots of concerns as well. It is essentially when both big players decide that they want to do this again. Then potentially it will move, or, as Alan said, even if a smaller group try to take it further, as happened with the TPP (Trans-Pacific Partnership).



Q18 Catherine West: I guess they are a bit busy with China. Seventy-six WTO members recently launched a framework for negotiating on e-commerce regulations. What are such negotiations likely to achieve?

Professor Winters: E-commerce is difficult. The way that different major trading countries treat e-commerce is very different. It is not just meeting with equivalences and bickering about, "Are you a bit higher than we are?" There are really quite different conceptual issues. I think everybody recognises that e-commerce is important and everybody, I think, would like to try to make permanent the moratorium on any tariffs on e-commerce, therefore there is some incentive, but one has to recognise that it is not an easy win. Remember that a lot of the US interest in e-commerce derives from the FANGs, a group of companies that are not terribly popular around the world, and certainly some commentators are worried that discussions under e-commerce are in danger of being led essentially into a validation of the behaviour of those companies. I am pessimistic about most things, I am afraid, but I would not be holding my breath. I very much hope it will work, it is constructive for the WTO and it is something that is making some process, but we do have to focus very hard to get it there.

Sam Lowe: I would add to that that it is constructive that it has happened, that this announcement is beginning, because the WTO is seen as having been in stasis for a while. It is nice to have a new initiative to move forward on, but it is quite a complex topic because it is so expansive. If you think of e-commerce you could be talking about—de minimis levels—parcels. How much does it have to cost before you levy a tariff on it? That has an effect. But then you could also be talking about mutual recognition of qualifications. We have these apps now that allow you to see a GP on your phone. What if that GP was based in, for example, New Zealand? The time difference obviously causes a problem here but just theoretically—

Q19 Catherine West: Literally moonlighting.

Sam Lowe: Yes, exactly. What do you do about assessing their qualification? That becomes quite a tricky question, and how you answer it. The answer is probably that if you were to go along this route—and I am not necessarily advocating it—you would have to put a lot more focus on consumer information and them making the decision as to whether they are okay with it.

Then you also have issues such as: if I were to buy something from Amazon using their website and they sell it, theoretically, from outside the UK, is that a mode 1 service that I have taken advantage of or a mode 2? Have they sold it remotely from that country to me or have I gone to them to take advantage of it? Some of the e-commerce is just trying to define things in order to then fit it into existing frameworks. There is a lot to do and it is very expansive. Hopefully progress can be made but as Alan also said, there are some bigger issues that need to be



taken into account along the lines of the monopoly power of certain industries as well.

Catherine West: The Committee has looked briefly at small parcels when we were doing some of the customs work and it is very complicated. You can see the pros and cons of the free model, because it helps small businesses, but you can also see how problematic it is in other ways.

Q20 **Julia Lopez:** Just to build on that, when countries do get together to sign a free trade agreement, how do they generally try to liberalise trade in services between the partners?

Professor Barnard: If you look at something like the CETA (EU-Canada comprehensive Economic and Trade Agreement), which is the Canadian free trade agreement, obviously the starting point would be the GATS as the baseline. That is likely to be the case in any negotiations between the UK and the EU going forward, you start with GATS rather than starting with what there is at the moment. Then you try to work out how far beyond the GATS you go. As we have said already, the GATS is pretty minimal. What you see in the CETA agreement is a mix of not just positive listing, which is the approach under GATS, but negative listing as well.

What you also find is this huge amount of negotiation over what are going to be in the schedules, which sectors are going to be opened up. You may well find that they will be more generous because there are greater levels of trust than you would have across GATS trading nations but nevertheless there will be considerable restrictions put in.

Perhaps the most interesting area, which I think you are going to look at a bit later on, is the movement of people and to what extent that would be more liberalised than you would get under the GATS provisions. Under GATS it is almost non-existent. Then you work on particulars.

Q21 **Julia Lopez:** On that point, taking a country like Canada where you have the Commonwealth link and a strong historical connection between the two countries, do you see that there might be potential to be more ambitious between Canada and the UK rather than Canada and the EU?

Professor Barnard: Possibly, but even still, if you look at the Canada agreement you see it is highly technical. Just to give you one small example, key personnel are allowed to move, which would include ICT people, investors and business visitors, but for each of those groups there are separate periods of time that they are allowed to stay in the host state and of course it is worth bearing in mind that it is still national immigration law that will apply. You may well need some sort of visa or other form that might be waived. National immigration law applies, unlike the situation at the moment under free movement of services where if you hold the nationality you can just go.



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Of course, it is not terribly transparent. Those documents are very difficult to read your way through. You can read the text of the main part but the devil is in the detail and the weeds at the back. That is what makes it much more difficult.

Sam Lowe: Just to add to that slightly, if we take EU–Japan as an example, which focuses more on negative listing, I would like to emphasise Catherine’s point that it makes it very difficult to find out what is allowed or not. It has a bias towards liberalisation, which is positive, but if you are trying to work out what is allowed or not you have to fill in the gaps. Because it just lists the things you are not allowed to do, you then have to fill in the blanks in your head as to everything you are allowed to do. I spent the entirety of last Sunday going through this and I still found it quite difficult.

In terms of what FTAs do on services, I would say, crudely speaking, free trade agreements do little more than lock in existing GATS provisions or if countries have gone beyond their GATS obligations in terms of what they actually apply, it tends to lock that in. Does this have benefits? Yes, absolutely, because it prevents rolling back and it locks it in as a baseline, but it is not significantly more expansive.

In terms of what else they do when it comes to mutual recognition of qualifications, as we have already discussed, it is quite difficult to do because the body that recognises qualifications is often not the Government, it is an associated body or the like. What they do usually is they create a framework through which both Governments commit to encouraging their respective bodies to talk to each other and come up with a proposal that can then be made into law. It does not liberalise it in and of itself but it tries to create a platform for it to happen.

Also, if you then look through newer trade agreements, they stop talking in the language of mode 1, 2, 3 and 4. If you look at EU–Japan they talk about it in terms of investment, which is mode 3 but beyond that because we are not just talking about services. Mode 3 is services investment but you can also invest for goods. Then you talk about it in terms of cross-border, which is mode 1, and then mode 4 is its own distinct category. Mode 2 often does not get referenced because people do not have that many controls on me going somewhere to go on holiday or the like, but it could be.

The other bit is regulatory discipline. While they very rarely to not at all do anything to bring down regulatory barriers, what they do usually is commit both parties to be transparent in their licensing regime. They make it easy to find the information you would need in order to access the country and not to unfairly discriminate. Again you have this question of what is unfair, what is legitimate and what is not.

Then on procurement, which is an area that straddles services, FTAs do probably go further than existing provisions in that they can lock in



commitments to allow companies to bid on contracts at levels that they were otherwise unable to do.

Professor Quaglia: I also wanted to add something about CETA and particularly financial services. In CETA there is a specific entire chapter devoted to financial services and I think it would be fair to say that CETA is seen as one of the most advanced trade agreements concerning financial services, but even so, the provisions concerning financial services very much build upon—and do not often develop much further—the provisions that are already in GATS.

The other point is that in the negotiation of CETA the chapter on financial services was particularly controversial to negotiate, in particular on the Canadian side because there was concern about the domestic regulatory authority of the Canadian authority. That is perhaps an indication that in further negotiation between the UK and Canada, this might be an issue.

Q22 **Sir Mark Hendrick:** May I ask the panel, Chairman, how successful they feel that the EU single market has been for trade in services between member states of the European Union? Twenty years ago I was a member of the European Parliament and we talked about completing the single market, and it is as if they have been talking about it ever since. Obviously the big problem has been services and the regulatory environments that you spoke about earlier are obviously part of that problem. Having said that, I was surprised to hear what you were saying, Mr Lowe, about the difficulty the United States finds, despite the fact that they all speak the same language, because of the political constitution there. How successful do you feel that the European Union has been in terms of services between member states?

Professor Winters: I would say it has been very successful relative to what realistic expectations might have been. Remember even within the United Kingdom, where we have been working on it for 300 years, there are differences that make internal trade sometimes just slightly complicated. We have been talking about it in Europe for some time.

Some recent work that I would commend to the Committee by OECD, done a while ago but published just in January, compared on the same scale the degree of restrictiveness of European Economic Area countries, EU plus Norway and Iceland, towards imports of services from third countries relative to their restrictiveness to imports from within the Area. There is a lot of detail in this but very roughly speaking, on the scale they used, imports from third countries were restricted four times more fiercely than imports from within the bloc. In other words, clearly one recognises there are still difficulties. There are clearly chunks where the single market needs to be completed, but when you do it sector by sector, it has clearly gone quite a long way.

Let me also say—I expect Catherine will want to add more to this—that the EU brings a whole architecture to services that helps liberalisation. They are all subject to the same court. It is subject to the freedom of



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movement of labour, which is very important for delivering services. That is why we are here, not doing it electronically. Meeting face-to-face matters. The single market has had a number of quite detectable, measurable improvements in the liberality of the market by sector and it has embedded that in a structure that allows enforcement and liberalisation.

Q23 Sir Mark Hendrick: What about financial services? How would you see it on that?

Professor Winters: As I understand it—I am sure Lucia will correct me—financial services is pretty liberal in the EU. That is the passport.

Professor Quaglia: In terms of financial services the single market has been very successful, in particular for wholesale markets rather than retail markets. For the UK economy, thinking about the business structure of the City of London and the companies in the City of London, it is the wholesale market that is more important. In that respect, the passporting system has been successful.

Professor Barnard: May I just follow up on the points that Alan has been making? Yes, you are absolutely right, services has been the deep frustration because of the nature of regulation.

To give you a very simple example, in the UK you or I could set ourselves up as a hairdresser tomorrow. In Germany, you have to produce lots of qualifications before you can be a hairdresser. In the UK, the fact that you and I are not trained to be hairdressers means that we will be not very successful very quickly, but we have an open market for hairdressing. In Germany, you have to be qualified before you can set up as a hairdresser and therefore there will be a demand to see your hairdressing qualifications. It is not the market that operates; it is the regulatory body for hairdressing. You have a very different approach to regulating even something as simple and as un-life-threatening as hairdressing.

What does work in the EU is the mutual recognition of qualifications directive. It is a pretty rebarbative piece of legislation, over 130-odd pages, but the fact is there is a system that works. Why does it work? It is not just because you have a directive. It is backed up not just by the architecture of the Court and the Commission but also by the internal market IMI database. If I am concerned about your qualifications, the competent authority in the UK can put in a request in English into the IMI database and it will come back with an answer from the relevant competent authority. They might answer in Bulgarian but it gets translated. This IMI system has proved to be extremely effective in trying to allow the different countries to communicate to overcome some of these regulatory burdens.

Sam Lowe: Just to add a couple more references to reports that I think could be very helpful for this investigation on services, there is a report



that was just published by the Northern Irish Economy Department that looks at barriers to trade in services. It is in the context of Brexit but it is informative beyond that. It uses the OECD methods and then converts the restrictiveness in different sectors into a tariff equivalent. It says, "If you were to treat services barriers as a tariff, how restrictive would we find it?" It looks at that within the single market and without, and in every sector you find that yes, while tariffs for services—obviously tariffs do not exist for services but in this context—do exist within the single market, they are much bigger if you are out. Could the single market for services go further? Absolutely. But does it exist? Yes. This is something that I think has been lost in the British debate slightly because a meme has taken hold that the single market for services does not exist. That is not true.

The other report I would recommend—and I am obviously going to recommend it because I wrote it—is a recent one looking at the composition of existing UK trade with the EU versus the composition of its services trade with the rest of the world, and its composition by mode, modes 1, 2, 3 and 4. How do we actually sell into these markets? The interesting thing is that if you look at UK–rest of world it conforms with what we know, most services are supplied via mode 3. Companies that want to access those markets go and set up there.

For the EU, it is different. For financial services, mode 1 dominates. We supply most of the services we sell to the rest of the EU from the UK. For other sectors, it is a bit more varied. For business services we do a bit more from the UK than we do for the rest of the world, but it looks quite similar. For insurance, we do more from the UK to the EU than you would see from the UK to the rest of the world. It is quite a crude method but I think it shows that the EU has certainly helped when it comes to the UK's sales of services to the rest of the single market, when it comes to selling them remotely, from the UK.

Q24 Sir Mark Hendrick: Coming back to the question of mutual recognition of qualifications, obviously the directive that you mentioned, Ms Barnard, is very useful and a neat way of dealing with that particular problem but the thing that always puzzled me—I am an electrical engineer by background—is whether you compared like with like. Would an engineer in Germany study exactly the same or very similar syllabus material to what I studied here in the UK? Does a doctor in Bulgaria study exactly the same type of thing to the same standard that a doctor would in France or a doctor would here in the UK? It seems like a neat solution but is it a level playing field in terms of the quality of the service and the standard of that service going forward?

Professor Barnard: You of course raise a very valuable point and it depends from profession to profession but the working presumption under the directive is mutual recognition that a Bulgarian electrical engineer is equally qualified as a British electrical engineer. Then you look to see the reality of their qualifications and you look to see whether



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there needs to be some sort of top-up. What happened in the past, prior to the mutual recognition of qualifications directive, was that the UK would have said, "You are a Bulgarian electrical engineer. You are allowed to come to the UK to work but you have to re-qualify from scratch. We ignore the fact that you have Bulgarian qualifications. You have to start all over again." That is what the mutual recognition of diplomas directive overcomes.

The other interesting feature is—

Q25 Sir Mark Hendrick: Does it solve the problem in terms of being able to guarantee a certain quality or level of standard?

Professor Barnard: There is some concern, for example, in the medical sector, particularly over the language requirement. We know that. One point I want to add, and I think Sam wants to say something too, is that the way the directive is structured it is basically aimed at higher-level qualifications. What about people who have lower-level qualifications? How does that work? There the Treaty has stepped in, the basic provisions under Article 49 and Article 56 of the Treaty on the Functioning of the European Union, and it replicates what is in the directive in treaty form.

Sam Lowe: What you have particularly identified is exactly the difficulty with liberalising recognition of professional qualifications globally. If you go into a negotiation everyone says, "We can do some stuff on mutual recognition of qualifications", but what you have just stated is the reaction from nearly every industry group and industry body within the country you are negotiating with and domestically. There is a reason services are difficult to do and what you have laid out is a great example of why that is the case.

Professor Winters: If I may add one thing, as I understand it, it is open even within the single market for national authorities to withdraw recognition or essentially say, "We will not treat this as equivalent", but the presumption is that they have to defend that. Where there are a series of issues of this sort, often the Commission then seeks to broker a compromise, perhaps through instituting common standards.

Q26 Matt Western: Professor Barnard, sorry, "IMI database". What does the IMI stand for?

Professor Barnard: Internal Market Information system. It is not very exciting but it is really quite an extraordinary database. It is now used not just for professional qualifications, it is also used for public procurement, for exchange of information on that. It is also used for exchange of information about posted workers, those workers who are temporarily sent to another country to do a job and then to come back.

Chair: It seems like a really good idea, does it not?

Q27 Matt Western: A very sensible idea, anyway. Mr Lowe, you were



referring to this in one of your earlier answers but I just want to explore very briefly how the UK's departure from the EU will impact on the UK's trade in services around the world. You were talking about the different modes and so on. Can you just briefly elaborate on that?

Sam Lowe: What I have looked at specifically is the impact on trade in services with the EU. I am not able to say necessarily, off the research I have done to date, what impact the UK's exit from the EU would have on our trade in services with the rest of the world.

In regards to with the EU, my working assumption at the beginning of the project was that we would see fewer services provided remotely from the UK into the EU. If those service providers wanted to continue providing those services, they would establish within the EU in order to do so. The EU makes it quite easy to establish, for the most part. What I then actually found was it does differ by sector. In banking services you would expect to see the transition from mode 1 to 3, and that is exactly what you have seen with companies setting up subsidiaries in Frankfurt, Dublin and the like. The reason is that they still want to service those customers but they are not going to do so from the UK any more. In banking services, I expect to see that in quite a pronounced way.

In terms of other business services, it is a bit more varied. "Other business services" is a balance of payments category that covers a wide range of activities. It could be legal services and it could be PR services, quite different things, and in terms of how UK companies provide them across the EU already, mode 3 already plays a large part. Most of the professional consultancies already have offices in the different member states they service because people like to talk to people. They need someone to speak the language and the like.

In terms of what I would expect to see post-Brexit, I would think that you would see a shift still. In my paper I said it would be about a 10% drop in mode 1 exports, direct exports from the UK in terms of business services, but it is not so pronounced as the upper end of financial services, in which—absent an expansive equivalence regime—I think you could see drops in exports of about 60%. It varies sector to sector and this speaks to the complexity of services.

Q28 **Sir Mark Hendrick:** Any other comments?

Professor Quaglia: With reference to financial services there is also equivalence provision in European Union legislation, which is a way to facilitate market access. I would expect that for the financial sector, services for which there are equivalence provisions, UK policy-makers would apply for equivalence provision whereby financial service providers based in the UK can provide those services in the European Union to customers in the European Union, being subject to home regulation or the minimal host state regulation.



Professor Winters: Can I add one reservation of ignorance? One might think that if the European market became more difficult for service providers they would try harder to sell elsewhere and that is not an implausible position, but remember that quite a lot of services rely on agglomeration or economies of scale. In particular, there is not room for that many international lawyer firms who are the top experts in a particular thing. If you lose a large part of your core market you might find that you are no longer as competitive or as attractive elsewhere. This is clearly going to vary from sector to sector. I cannot think of careful studies that have allowed us to quantify this effect. One really has to rely on information from the sectors about, "What is the technology? What is it that makes them competitive?" and how that is going to be affected if part of the market falls away.

Q29 **Chair:** If the UK falls out with no deal the mutual recognition arrangements for qualifications, professional and academic, would need to be re-validated in each member state. What difficulty would no deal provide to those UK nationals currently working in EU member states? What is the situation?

Professor Barnard: It does not look good for them because it is not one of the EU's no-deal clauses, as my recollection is, and so it will not say, "You have nine months or so to carry on practising under your UK qualification".

Q30 **Chair:** There are people at the moment from the UK who are working in 27 EU member states who, in 16 days' time, could see their right just guillotined? How many people are we talking about?

Professor Barnard: I do not know. I am not sure anyone would know the answer. Do you know?

Sam Lowe: No, but you have seen a reaction to this already. It is the reason there are quite a few lawyers in the City who are redoing a couple of exams in Dublin, so that they are still able to take advantage of mutual recognition of professional qualifications in terms of legal services across the UK but also so that they can continue to represent clients in front of the European courts.

There is an issue with mutual recognition of professional qualifications and how the EU does it. Within the EU, if you are an EU national and recognised within one of the member states or even if you are not an EU national and recognised by one of the member states, then that qualification is recognised across the EU. But if, for example, a national body, say the UK, recognises a qualification from the US, which it does now and it can do, that qualification is not recognised by every other member state. Once you are a third country, unless you qualify within one of the EU member states, which is possible as a non-EU national—France, at the moment, recognises a UK qualification. That is fine for you working in France but it does not necessarily mean you are able to then work across the EU.



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Q31 **Chair:** So if you have an Irish passport or another EU passport, if you have a UK qualification, that other passport will not save you? You still have to go and sit the exams?

Sam Lowe: Within the EU framework you have to do whatever is necessary to top it up. There is also a positive side to this in no-deal because insofar as it is national competence, it is possible even in the event of no deal to have your qualification recognised in the country that you are working in because the national body might just decide to do so. There is obviously a big risk and a big negative but it does mean the UK could, if it wanted to, largely just work country by country in the event of no deal in order to ensure that qualifications were still recognised.

Q32 **Chair:** Country by country. We would have to do it for the UK as well?

Sam Lowe: Yes.

Q33 **Chair:** It could be reciprocal. It might not be reciprocal.

Sam Lowe: Yes. You would want it to be reciprocal.

Professor Winters: Typically a negotiation would be reciprocal. It is important to remember—

Q34 **Chair:** In 16 days' time if there is no deal, those negotiations will not be completed in time.

Professor Winters: Exactly so, and 27 of them is very demanding. These things are not particularly straightforward. It is just not a simple matter. You are negotiating 27 times over rather than once.

Chair: We know more about Brexit as each passing day goes on.

Q35 **Catherine West:** Would the panel's assessment be that that would be quite problematic for research and the NHS? I am thinking about science qualifications and the fact that at the moment there is a very free flow of researchers across the 28 member states. We are exposed to that because in the UK, life sciences do account for a big chunk of our economy. Obviously, on the services/NHS side as well you have nursing and medical qualifications, radiography, physiotherapy, dental work, etc, etc.

Professor Barnard: The answer is yes. The mutual recognition of qualifications applies at different levels. It applies in particular to those who are employed in the way that you suggested but it also applies to those who are providing services on a temporary basis and if their qualifications are not recognised after 29 March, this puts both the individual and the employer in a very difficult situation because they cannot have non-compliant, non-recognised individuals.

Sam Lowe: I would say it is in the UK's gift to recognise these qualifications.

Q36 **Catherine West:** May I just come in on that, Chair? What we know is



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that when it is not a member state, for example, in certain health research with African countries, they have terrible troubles getting visas to do even six months' work in the UK. I can see what is a large sector of our economy being very slowed down by this.

Professor Winters: Yes, that is correct but in a sense that is a visa issue, it is not necessarily a qualification issue. I think the point is that for the professions that are regulated, and that is a very large part of the health service, clearly these regulatory issues around mutual recognition arise. In the university sector with research, we are not, in a sense, particularly recognised. It is open to universities to recognise degrees from elsewhere. I cannot speak for other European countries recognising British degrees but regarding skilled researchers coming into the UK, my understanding is that there will not be regulatory barriers. There might be all sorts of other reasons why they do not feel that they want to come but that is a different story.

Chair: There are two problems there: the problem of the recognition and then the normal problem that we have with the UK Home Office letting people into the UK, which, as we know, is a nightmare.

Q37 **Julia Lopez:** As you know, the Government has now acknowledged that it is unlikely to be able to roll over all of its free trade agreements that it has a member of the EU in time for Brexit if we leave on 29 March. I just wonder how significant this is likely to be for UK service exporters and consumers.

Professor Winters: It is of some significance but a lot of these trade agreements do not include a huge amount of liberalisation of services so in a sense it is not as if they are dropping out of the European Union, where we do have the single market.

Q38 **Julia Lopez:** I would assume that some agreements are more important than others and so something like the Swiss agreement would be much more relevant.

Professor Winters: Yes. In simple terms, there are big ones. The Swiss is the one that we have but Japan, Turkey, Korea, Mexico, these are also big ones. One would just have to pick through case by case to ask to what extent they have liberalised service trade that British firms can take advantage of. I have looked at the Korean agreement. There are certainly parts of the Korean agreement that do liberalise service trade and in the absence of a rollover, which seems likely, in principle these things would evaporate.

Sam Lowe: Although, to be clear, the Koreans could still allow it to happen. This sets a floor.

In terms of the existing agreements and replication when it comes to services, I suppose the big one you would have some concern about is the EEA agreement. They are in the single market or they at least have the single market extended to them. They do in respect of financial



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services. What happens then? That is one of the agreements that is, I would say, entirely dependent on our future relationship with the EU, along with Turkey, and until we know what that looks like we do not know what our relationship with Norway, Iceland and Liechtenstein looks like.

In terms of impact on services, it depends how broad you want to go. If we do start talking about mode 5 services, the services value-added incorporated into goods, any disruption to goods trade does have a knock-on implication for British-based—maybe they just provide domestically— domestic service providers, if their business is dependent ultimately on the export of a good. If you want to discuss that more fully, I suppose you are in luck because you have Ingo, who is the expert on this, on your next panel.

Q39 Matt Western: Just a question to Professor Quaglia. What domestic regulatory requirements typically apply to financial services and how do these affect international trade in those services?

Professor Quaglia: The main regulatory barriers to trade in financial services are non-tariff barriers. They mostly have to do with different domestic regulatory frameworks across jurisdictions, including different licensing requirements. On top of this, there are restrictions often to market access, non-national treatment, which is discrimination between domestic and third country financial services providers, and the prudential carve-out, which is an international part of the GATS. On the top of this in terms of additional barriers to trade in services, financial services, also different accounting standards are important.

Really it is often difficult to liberalise trade in services, in particular in financial services, because those barriers have to do with different domestic regulatory frameworks across jurisdictions and those different regulatory frameworks actually set the purpose or should set the purpose of safeguarding financial stability, market integrity and consumer protection. They are rather difficult to remove or harmonise.

Q40 Matt Western: Could you just be specific in what way you think these issues have been addressed through the WTO and the preferential trade agreements?

Professor Quaglia: The WTO or, to be precise, the GATS, the General Agreement on Trade in Services, contains a limited number of provisions concerning financial services and they mostly have to do with enhancing market access, national treatment, non-discrimination, and the Most Favoured Nation clause as well as prudential carve-out. Basically, GATS does not say much about regulatory harmonisation, regulatory alignment approximation, mutual recognition, substituted compliance or equivalence.

Sam Lowe: Can I add to that? GATS has its annexe on financial services where it lists all of the different types of financial services and says that



the countries make commitments in these areas when it comes to market access, but there is a supplementary treaty, the Understanding on Financial Services, which significantly limits the scope. If I was to put it crudely, it largely limits the scope in insurance to issues related to the transport of goods—when you are transporting goods you need insurance—and when it comes to broader financial services, it is largely advisory and auxiliary services. The GATS commitments are very narrow and you see this replicated in the EU's free trade agreements.

Q41 Chair: What are the options for financial services trade arrangements between the UK and the EU after Brexit and how might such arrangements impact the future of financial services trade between the UK and non-EU countries?

Professor Quaglia: Financial services will be part of the broader negotiation of the trade relations between the European Union and the UK. There is a range of possibilities. I will start with what is called the minimalist option, which would be to continue to trade under WTO GATS terms. That would mean the complete loss of the passporting system and accessing the European euro market, making use—

Q42 Chair: That is the no-deal scenario.

Professor Quaglia: Yes. Then the second option would be a Canada-style agreement, a trade agreement that has a chapter on financial services but not a very substantial one. Then I think for UK policy-makers perhaps the most favoured option would be a Canada plus plus with a substantial chapter or substantial part, or even a special deal if we want to call it in this way, for financial services. Then there is one option, the maximalist option, which would be to remain part of the single market and therefore to join the European Economic Area. I am ignoring the customs union option because it would not have implications for financial services or services in general.

Q43 Chair: If you had to numbers on this—no deal, Canada, Canada plus plus and maximalist—maximalist, I presume, is 100% of what there currently is, or is there a dip from 100%?

Professor Quaglia: It is more or less what is there. In terms of market access and passporting, it will remain the same. Politically, the difference is that UK regulators and policy-makers would become policy-takers rather than policy-makers and would no longer have at least a direct say in the making of European Union financial regulation. I think it is something to signal because in the past UK policy-makers have been very influential in shaping European Union financial legislation in different sectors. That is something, in terms of domestic regulatory economy, to bear in mind.

Q44 Chair: On Canada plus plus, Canada, no deal—where do you see the percentages, approximately? I know it is very difficult.



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Professor Quaglia: The second-best option for the UK would be a Canada plus plus, in economic terms and also in political terms. Since I am a political scientist, perhaps I should also bring a political perspective to this. I think from the European Union side it is a bit unlikely that politically the European Union would agree to a Canada plus plus, precisely because it would be seen as granting a special deal for the City or this famous expression of cherry picking. Perhaps the most likely outcome would be a Canada or a Canada plus.

Sam Lowe: I think when it comes to financial services and the UK trade with the EU post-Brexit, unless the UK stays in the single market we will not have the access we do now and if we are not in the single market we will be treated by the EU as every other third country. That means that we will be dealt with on the basis of the GATS commitments but then the equivalence regime. There is a question about the equivalence regime, which is one of the most expansive worldwide, theoretically. If the UK is able to take full advantage of it then it will mitigate some of the issues, but then you still have the issue with equivalence, which is that it is unilaterally applied and it could be unilaterally withdrawn. You have that issue there.

There is a second thing that may offset some of the immediate impact, which is that it is also in the gift of the EU-wide regulators but also the domestic regulators to smooth the transition and that is what you are seeing at the moment, when it comes to, say, banks relocating in part to Frankfurt, so the German regulator says, "Okay, you can move here initially. We will allow you subsidiary rights and to begin with you just have to bring over some sales capacity to deal with the domestic clients but over the course of the next two years we want to see a plan of how you are going to bring over some of your trading capacity".

Q45 **Chair:** If in 16 days' time there is no deal and we are talking about professionals and everybody else, that would be a shock for Frankfurt to have to deal with.

Sam Lowe: It would be, but they are trying to mitigate in that in the long run, for EU-based consumers to continue to be served by British banks, absent being able to use equivalent provisions, they will need to be done by an entity located within the EU. However because there are financial stability considerations as well it is not in the regulator's interest to force banks to do that overly quickly, so for a while they can allow certain activity to continue to be done in London and just try to make the process a bit more gradual. That is what you are seeing. Even if there is no deal, they can do that. It is within their gift and they will do that, because while they want the activity to come over and EU law does require it ultimately they do not want it to create a financial incident so it will be gradual.

Professor Quaglia: If I could add to this, in the case of clearing houses, of CCPs and central security depositories and also the novation of derivatives contracts over the counter, the European Union has



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temporarily granted equivalence to UK-based CSDs, CCPs and for the novation of these contracts, and as well as for the access of UK-based payment institutions to the single euro payment area.

Professor Winters: With regard to equivalence, we need to keep realistic about what we will get from equivalence. Even the political declaration that after all is the aspirations of the parties says that equivalence decisions will be taken in each party's own interests. There is absolutely no requirement to consider what you are doing to the other party. There is no comity in this. That is in this agreement and if we do not get that far, even worse, I suspect.

Chair: Absolutely fascinating. Panel, thank you very much. It has been illuminating. We have learnt a lot and could continue the conversation for quite a lot longer but, as ever on Wednesday mornings, time is our great enemy, so we will take a two-minute break before we have the next panel, but may I thank the first panel very much for their time and their expertise? It is greatly appreciated.

Examination of witnesses

Witnesses: Jonathan Athow, Anjalika Bardalai and Dr Ingo Borchert.

Q46 **Chair:** Welcome to our second panel of the morning and again can I ask our panellists to help us along to introduce themselves as they wish with their name, rank and serial number, starting on my left?

Jonathan Athow: I am Jonathan Athow. I am Deputy National Statistician for Economic Statistics at the Office for National Statistics.

Anjalika Bardalai: Good morning. My name is Anjalika Bardalai and I am the Chief Economist and Head of Research for TheCityUK, which is the industry body that represents UK-based financial and related professional services.

Dr Borchert: Good morning, Chairman. I am Ingo Borchert. I am an economist at the University of Sussex and a Fellow of the UK Trade Policy Observatory.

Q47 **Chair:** The famous Sussex University is absolutely ubiquitous, is it not? Thank you, panellists, for coming. To you all, nearly 80% of the UK's economic output comes from services and the UK is the second largest service exporter in the world. Obviously the UK is leading the financial service sector but what other types of services does the UK export and the value of such exports over and above the financial sector exports?

Jonathan Athow: Maybe I should start there. For 2017, which is the latest full year of data that we have, the UK exported around £280 billion worth of services. The largest item is not the financial sector; that is the



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second largest. The financial sector is about £60 billion. The largest is what we call rather inelegantly “other business services”, so this covers a wide range of services. Unfortunately, “other” is a term statisticians probably use a bit too much. It covers a wide range of business services. That can be things like consultancy services, accountancy, head office services, those sorts of things, but it reflects the wider makeup of the UK economy, that business services are a very important element of that. Many businesses are headquartered here and therefore you get the services that support those activities here and many of those services can then be exported. Business service is around £80 billion, £60 billion are financial services, so that takes you to about half of all exports.

You then get into things like travel and transportation. Travel, a lot of that is really tourism, so about £40 billion. Many people are visiting the beautiful parts of the country such as the Highlands of Scotland and also—

Q48 **Chair:** Well said.

Jonathan Athow: —many other very interesting tourist hotspots, but then we also sell a lot of transportation services, so that can be airline services, passenger services, but also freight and other services. By the time you have gone through those services they are the main areas that the UK exports. That will cover about two-thirds of all exports of services.

Chair: Does anyone want to add to that?

Q49 **Sir Mark Hendrick:** Which countries do we mainly export services to, both financial and non-financial services?

Jonathan Athow: Some of our big services exports tend to mirror broadly our wider trading pattern, so around 40% of service exports go to the rest of the EU, which is a little bit less than it is for—

Q50 **Sir Mark Hendrick:** Can I ask specifically what countries they would be?

Jonathan Athow: Yes, again it tends to follow our normal pattern, so Germany and France of the European countries tend to be the largest. Outside that, the US is the single largest nation state with whom we export, so we export around £60 billion of our £280 billion to the US so it is a very substantial export market for services. In many ways the patterns are not that dissimilar to what you would find for goods.

Q51 **Sir Mark Hendrick:** Can you give us some examples so we can get a feel for the types of services we are talking about?

Anjalika Bardalai: I can address the point about financial services specifically. Building on that, the patterns for financial services are again very similar to the broader services patterns. For financial services exports again the US is the single largest destination for the UK’s industry exports, so the value of financial services exports in 2017 was £16.3 billion and that was equivalent to 21% of the total financial services exports from the UK.



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More broadly I think the thing that is really striking is the geographical concentration of financial services exports. The top five country destinations for industry exports, which are the UK, Germany, France, the Netherlands and Japan, combined those five countries accounted for around 50% of industry exports and then what you see after that is basically a long tail where you have six or seven other countries that each account for, let us say, 2% to 3% of financial services exports and then after that this very long tail. All the other countries would each have less than 1% share of industry exports.

Dr Borchert: To add to what Jonathan was saying, within the EU countries it is very much about economic geographies, geographically proximate countries including the Republic of Ireland and the Netherlands that are smaller economies but just by virtue of their being proximate to the UK among the top five destinations, next to the larger ones, France, Germany, Italy and Spain up to a point. I think imports from Spain are much larger than exports to Spain but they are in the ballpark.

Coming on to your second point, Jonathan is right that the comparative strength of the UK services economy in focusing on professional business services and financial, there are interesting variations. Japan, for instance, UK exports to Japan are 60% in financial services and 30% in intellectual property rights, which is by far the largest chunk of these kinds of services to any country we would be exporting to, presumably related to the presence of Japanese multinational enterprises here in the UK.

To give a counter example, in Ireland, for instance, 60% of the exports are professional business services and the same is true for Switzerland, so naively, perhaps, one might have thought that a lot of financial services are going back and forth between the UK and Switzerland. That is not true. A lot of that is largely dominated by professional business services or what Jonathan rightly called the "other" commercial services, which is a well-defined technical term.

Q52 **Chair:** To clarify, if somebody goes on holiday to Spain are they importing a service from Spain or are they exporting a service to Spain? They are importing a service from Spain, is that right?

Jonathan Athow: It would be a UK import.

Q53 **Chair:** Even though you personally, physically, go to Spain?

Jonathan Athow: Yes.

Chair: My head was in a bit of a swirl over that clarification.

Dr Borchert: May I add on to that one point, because I do not want that travel item, which figures very prominently in terms of the numbers, to just be construed as tourism? It is a big chunk of tourism but medical services and educational services that are really important for the UK happen to be accounted for as part of travel, so if the travel is for



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purposes of acquiring education or the travel—and I think that was mentioned in the previous panel—was to have your dental implants fixed in Bulgaria then that would be medical services. It really is a discharge of medical services abroad, consumption abroad, but it would pop up in travel services, so there is more to it and obviously tourism is largely unregulated but more interesting regulatory issues might appear once we think about trading educational or medical services.

Q54 **Chair:** That would still be seen as an import?

Dr Borchert: Yes. It is almost the converse of a payment flow. So if a British person goes abroad then that would be an export.

Jonathan Athow: It would be a UK import, so if you are studying in, say, Paris as a student, you are a British student overseas that would be a UK import. On the flip side, overseas students studying in the UK is a UK export.

Q55 **Matt Western:** To confirm, Mr Athow, about the exports, you said that the US was £60 billion of the £280 billion and Europe is £120 billion. Looking at the chart here, would it be right to say that Germany is about £30 billion or something?

Jonathan Athow: The latest figures we have are Germany is about £20 billion. France is around £17 billion but when you add up the long tail of the EU 27, yes.

Q56 **Matt Western:** It is to get a scale of it really. We have talked about exports. Will you give some idea about the types of services that we import and from where? Overall figures.

Jonathan Athow: The patterns of imports geographically are very similar to our exports. The single biggest source tends to be countries like the US. It is very similar. The pattern of what we import is slightly different. For example, travel services is higher and becomes more prominent. That will be certain things around education, but it is probably the net flow of tourists is overseas rather than to the UK. You see broadly very similar financial and business services remain very prominent. It does not really change the picture very much. We can give you the full details; I do not have them immediately in front of me, but while the levels are lower, we run a surplus on trade and services of around £110 billion, the numbers are much lower but the shares are pretty similar to what you would find on our exports as well.

Q57 **Matt Western:** What is the figure for financial services from the US that we import?

Jonathan Athow: Let me have a look. I only have exports in front of me, I think.

Anjalika Bardalai: While you have a look, the total figure for the UK's financial services imports is £17 billion, so as Jonathan said in absolute terms the figures are much lower. The other business services, including



professional services, are higher, but when you look at the numbers, where it says £17 billion of financial services exports, that is finance plus insurance. Again, £17 billion of finance plus insurance imports, and that is how you end up with, for financial services, a £61 billion surplus that accounts for around 55% of the overall services surplus, which is a pretty significant contribution.

Jonathan Athow: I do not have the figures to hand, but I can certainly provide those.

Dr Borchert: The 2018 Pink Book figures have it down at slightly over £15 billion of imports of financial services globally, one-third of which, £5.2 billion, come from the EU 27.

Q58 **Catherine West:** Further to that point of insurance as a professional service—I think it is within professional services—if it is a multinational that is based in London, how much of that can the UK claim as an import or an export, whichever way it goes. Let us say it is insurance for shipping—one of the big money spinners—but the shipping company is based in Cyprus although it comes through London. How does the analysis work statistically?

Jonathan Athow: We look at the concept of where the entity, where the insurer in this case, is broadly legally resident. If it is a very large insurer based in the UK selling insurance policies to overseas that would accrue to the UK as an export of services and we identify insurance services separately from other financial services, so you can see it slightly differently in the figures, but essentially we use the term “economic ownership”. Is it owned in the UK? That is the key determinant of whether it counts towards UK exports or not.

Q59 **Catherine West:** The reason I ask is that sometimes these figures look very impressive but in the case, for example, of insurance, it is likely to go up in a Brexit scenario because of uncertainty, and we might have to rethink the legislation around a lot of the agreements that we have with Europe. That figure will probably go up and you can say, “Look at the import-export” but that is a bad thing. So how do you get around that?

Jonathan Athow: Sometimes particularly with financial services it is very difficult to measure, because you are not always particularly interested in just the raw value but it is what is the margin—added value. For some services that is very difficult to get to. For some financial services we do take a way of looking at that, so we will look at what the interest rate you may have charged relative to a UK interest rate is, so if a UK interest rate goes up and the world interest rate does not then that would narrow the exports. We do try to take account of some of those things, but it is very difficult to do because you are not always aware of what the underlying risks are in an insurance policy, so sometimes you have to use proxies that may not be particularly accurate in that respect.



Dr Borchert: If I may pick up on that example of yours because you mention multinational enterprises, straying a little bit from the specific example of insurance, there is a services trade item that is called "services trade between affiliated enterprises", and that is buried deep into other business services and within other business services there is another sub-item that is called exactly the same, "other business services". On the other business services there is another sub-item that is called "services between affiliated enterprises not elsewhere specified" so the balance of payments guidelines would have this kind of services trade between affiliated enterprises if possible put where it belongs in terms of substance—under insurance services or under transport services—but I notice that quantitatively residual services between affiliated enterprises is very large. So a lot of that, which might be insurance services but cannot be put under insurance services because we just do not know, might end up in that.

Q60 **Catherine West:** For us as MPs what is interesting is, we are the fifth biggest economy and so on, but then you can see why, in a regional sense, there is no impact of that necessarily in certain of our regions, which is how you end up with inequalities and so on. I am trying to unpick that a bit.

Jonathan Athow: Indeed and in financial services, there are key cities, London being one, Edinburgh being the other, where they are highly concentrated. For the nature of some of those services, they sometimes get bound up with large amounts of employment or the services come with manufacturing. In other cases, those services are more intangible, so those are challenges.

Q61 **Catherine West:** I do not want to downplay the tax that you get back from them, if you can get them, but I think from a political point of view that is interesting.

Jonathan Athow: This is part of the challenge with services. It covers things that are very tangible: a student coming to the UK and getting an education here, very tangible; through to how you measure the value of the insurance trade. It is very difficult.

Q62 **Catherine West:** I have to move on to my proper question now. My Chair will get very frustrated. In terms of the trends, and you have touched on this, what do you think the main trends in services export and import have been in recent years and can we expect those trends to continue?

Jonathan Athow: One of the interesting things certainly for the UK is the services trade is much more important relative to our goods and in particular exports. As the Chair said, we have the second largest value of service exports, even though we are not the second largest economy. Certainly within our more recent trends we see things like business services and intellectual property growing as important sectors. Other things being equal, services will become an increasingly important part of



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our trade. That would look to be what recent trends have been and probably will continue to be in the future, reflecting, again, that 80% of the economy is services.

Anjalika Bardalai: To add to that, I would emphasise this point about the overall importance of services. If you look at the fact that the surplus in services is equivalent to around 80% of the deficit on the trade in goods, I have a macro-economics background and when you step back and look at the big picture essentially what that means is that the overall services trade position provides a pretty significant source of support when you look at the overall balance of payments position. I think that really reinforces the importance.

The other thing that I would say on this issue is that broadly speaking services trade tends to be conducted among advanced economies. That is a very broad and general statement. This has a lot to do with structural economic issues, but for these reasons I agree that the broad trends that we have seen to date would be likely to continue, certainly in the near and medium term.

Chair: Thank you. I am going to pull in Julia Lopez. I am conscious of time. Can we tighten our time?

Q63 **Julia Lopez:** What are the main challenges that you face in measuring services trade flows, particularly in respect of the different modes of service provision?

Jonathan Athow: Maybe I should start by saying trade in services is much harder to measure. Often there is nothing physically moving across a border, obviously if there is a student there is something to measure but in many cases there is nothing to measure.

We put together a number of different data sources. We ask businesses what trade they do in services, so we have a survey. We have doubled the size of that survey to increase the amount of data we can give people.

Q64 **Julia Lopez:** What sort of information do you get from those?

Jonathan Athow: We get very good participation. Businesses in general are very supportive of our work. Many of them realise that having good data on trade helps them to build a case for support from Government or other changes.

Q65 **Julia Lopez:** Do you have any sense of the percentage of businesses in any particular service that participate in those surveys?

Jonathan Athow: I could probably give you a bit more detail later, but in general, services exporting tends to be concentrated in larger businesses, so our survey does not have to be that large and we know we capture most service exports.



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We have trade in services. That covers I think around 50% or 60% of our exports. Then we can look at other sources. The financial sector is regulated so we can look to regulators to help us understand what is going on there.

In other areas, for example the travel and transportation, we can look to the Civil Aviation Authority or people like that to help us understand what UK airlines are doing and what overseas airlines are doing in the UK.

We can bring that all together, but there are some real challenges here. As you say, modes of supply have changed. The internet does pose a particular challenge, if you buy something off the internet and it is a UK subsidiary of a multinational firm we can measure that, but it becomes much more challenging if you are to buy a service from a company overseas that has no presence in the UK. They are relatively few and far between because many of the big providers do have UK offices, but those are much harder to measure because our survey tends to be on businesses and not what individuals are spending. It is unlikely to knock the really big numbers, because it is relatively small but again the way in which trade is changing means these things become harder to measure.

Related to that is also the fact that business models are changing a lot. Where businesses choose to locate their intellectual property, how they then charge that across multinational structures, this is a very fast moving area and one where some things are relatively easy to measure but many things are becoming increasingly hard to measure.

Q66 Chair: Both the USA and the UK are quite happy, I have to ask the Office for National Statistics, because they both have a surplus in services with one another, and it seems a great way of adding to the sum total of human happiness, to tell them and pat them both on the head. What is happening and why is there this discrepancy?

Jonathan Athow: The asymmetries, as they are known, have been a longstanding feature. Some of these issues become harder for trade and services because it is much harder to measure. It is not measuring things crossing borders. We have done quite a lot of work with the US. In some cases it is that the US does not necessarily report on the same basis we do. We have moved into line with the IMF's latest manual, manual version 6. The US is not always reporting on that basis, so there are some transactions we count that the Americans do not count.

Q67 Chair: We both claim the surplus.

Jonathan Athow: Yes. There are then challenges in measurement, so some of our services we measure by value, for example what interest rate do you charge on a loan relative to LIBOR in the UK? That would give us a margin and we will say, "That is the profit we are making by lending money to the Americans". The Americans might not use LIBOR to work out how much of a margin they are paying for imports, so again both countries are using possibly an interest rate that is more relevant for



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them but may not be internationally comparable. There are also some challenges with some countries who measure their trade with the UK including the Crown Dependencies and for financial services the Crown Dependencies are a big part of that global trade.

Q68 **Chair:** So this is skewing the UK data?

Jonathan Athow: Yes; we do not collect data on the Crown Dependencies because they are not part of the UK economic territory, but some countries include the Crown Dependencies in their measure of their trade with us. If they do that it obviously distorts the picture. There are lots of things we are trying to do. We are trying to work through with all the countries we can to understand where there are differences and how we might resolve them.

Q69 **Chair:** But everybody is happy with the statistics at the moment.

Jonathan Athow: I think we are not but we always want to try to get to the best reconciliation we can.

Q70 **Matt Western:** I think it is best not to rattle the cage. Keep certain people happy. Very good. May I pick up on this trend of asymmetry, because it is an issue worldwide? How do you think it can be addressed beyond the US?

Jonathan Athow: In general there is a role for bodies like the OECD and IMF in making certain we have very clear standards and that is probably there. A lot of it comes down to bilateral conversations with the countries to understand their methods. As I said, this issue of what interest rate do you measure against, we need to understand that and how it works.

There is also a challenge because of how multinationals operate. If there is a multinational operating in, say, the UK and Ireland, what is it telling one statistics office and what is it telling the other? Are those consistent? A lot of this comes down to working through item-by-item how we produce our financial services statistics and how do other countries do it, and making certain we have that on a very clear basis. There is no magic wand here. It is very much a case-by-case basis and that is how we are proceeding. We have identified the countries with the largest asymmetries and then have dialogue with those countries to work through the issues.

Q71 **Matt Western:** Okay. It sounds like a job for the people in Geneva, I would say. Ms Bardalai, in an article back in 2017 you said, "Perhaps it is overoptimistic to imagine that the asymmetry issue is going to be addressed comprehensively in the near future". However you suggest that international collaboration and sharing of information is necessary to address trade asymmetries. Will you explain more about what this would involve?

Anjalika Bardalai: On the part about it being difficult to address the issue comprehensively in the near future most of the work that I have



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done in this space has been built on and based on the work that the ONS has undertaken. You have just heard from Jonathan that addressing these issues is no magic wand. It is a question of very detailed, very granular, case-by-case bilateral discussions. When I referenced international collaboration fundamentally what we are talking about here is information sharing looking specifically at financial services. In general I understand that when you look at the bilateral asymmetries services feature very prominently. In many cases financial services feature especially prominently. Some of this again relates to the fundamental difficulties of financial services measurement.

If I am not mistaken, indeed it was the bilateral work that Jonathan did with the US that showed the Crown Dependencies issue. The US includes the Crown Dependencies in their definition of the UK whereas the UK or ONS does not, and given the importance of financial services to the Crown Dependencies' economies you can see how that would have a real impact.

Q72 Julia Lopez: This is a question for Dr Borchert. Can you explain to us the main ways in which goods and services exports interlink and how might international trade agreements better respond to that interplay between goods and services when it comes to global trade flows?

Dr Borchert: Thank you. Obviously perhaps worth noting, first of all there is this derived demand for services from transportation, insurance and this kind of thing, but also new ones, telecommunication services, e-commerce and this kind of thing so this notion that services are really greasing the wheels of international commerce, really, and that has always been there.

The main new developments, what has been alluded to in the earlier panel about mode 5 or services in a box, are the services inputs into manufacturing production generally, but a lot of them go on to be exported, obviously, and the notion that manufacturers consist of manufacturers is just wrong. The manufacturing input into manufacturers on a value added basis is about 50%. That struck me admittedly initially as low when I heard it. Close to 40% are services and about 21% or 22% are domestic services and then there is a big chunk, nearly as much—15% in the case of the UK—of imported foreign services inputs that would then go on to be embodied into British manufacturing exports. That is about 40%. Clearly as has been mentioned, any change in the market access conditions for British manufacturers abroad, especially in the EU, would then have this knock-on effect to the derived demand for these services inputs, which would often, in my understanding, be high-skilled. It will be legal advice, finance, software. One example is modern cars—about 100 million lines of software code is a service that goes into them and often gives these manufactured products the competitive edge. So it is not surprising in a sense that services account for an ever larger share on a value added basis.



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Then there is a third way they interlink, on the sale side. Very often there would be a package of goods and services and I think Sam Lowe was using that example of an elevator that comes with a maintenance contract, or aircraft—one of the best known examples in Britain is Rolls-Royce with its jet engines and so on, where contrary to the embodied input parts the services would still be discernible and traded separately and hopefully will then make its way into the balance of payments, ideally, but the proposition is that the packet of a good and a service is much more than the constituent parts, and so again that is where it links together.

If you listen to industry representatives, that often has a connection to mode 4 because these services will often be maintenance, maybe insurance, and that has to be supplied in a very timely manner on a fly-in, fly-out basis.

Q73 Sir Mark Hendrick: Again a question for Dr Borchert. How open is the UK services market currently including its financial services market?

Dr Borchert: Again I go back to the OECD's work and their Services Trade Restrictiveness Index because for the group of advanced economies that is the best factual base that we have at the moment. They have a group of comparator countries, 44 countries, the UK one of those, in 22 sectors all the way from air transportation down to legal, accounting, and professional business services. Among that group, the UK is among the most open economies when it comes to the UK's regime for importing services across the modes of supply. That is true for both the UK's MFN regime, which is a potential US service supplier coming into the UK as well as the intra-EEA regime. Within the intra-EEA regime group, the UK is the most open economy.

Q74 Sir Mark Hendrick: How is it measured?

Dr Borchert: It is measured by what is called the Services Trade Restrictiveness Index. It would basically involve going through a very large list of individual non-tariff policy measures, regulatory measures. Is there an equity limitation in mode 3? What are the licensing conditions? Do professionals need a visa? What are the qualification requirements for lawyers, for accountants, for auditors? A very long list that would obviously be sector-specific and would also be mode-specific. Then there would be an inventory whether any such requirements are in post and then that would be tallied up into an index.

Q75 Emma Little Pengelly: On 4 March 2018 the Northern Ireland Department for the Economy published a report on the potential impact of NI's tradeable services sector as a result of the UK's exit from the EU. I understand that they used the OECD's STRI methodology. What is your view of the use of that methodology and also could you explain a little bit about why that methodology indicated higher costs for particular sectors, particularly the courier services and some others? What is accounting for that additional burden to businesses through using that methodology?



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Dr Borchert: I had a look at that, and I think it is a very useful study, largely because, as I was just mentioning, this very granular work at the individual policy measure level that the OECD has been doing and the template for which they are providing is the best factual base that we currently have. The heavy lifting in that kind of study was to code what these individual policy measures would mean in different scenarios.

To bring everyone on to the same page, the purpose of that report was to look at Northern Ireland and to see what would be the change in services trade regimes post-Brexit in four different scenarios. Northern Ireland staying under the single market, for an intermediate scenario, a CETA type of scenario, all the way to a no deal. The way to do this really is to code at the individual measure level what these scenarios would involve. In the single market then there is obviously no change. In CETA a little bit might change because CETA sits in the middle very much, as the previous panel said, of largely binding what is applied policy anyway but not giving so much incremental access and being a far cry from the single market and services from the European single market and then what all of these barriers would pop up if the UK were to leave without a deal. That framework is very useful.

The results strike me as largely plausible really and the results I think are that some of these sectors where the hit would be largest, for instance air transportation, courier services and motion pictures, I believe that sits very well because it is largely these sectors where there is a single market and that goes back to a question earlier, the single market really has made big inroads and it is not a surprise that there it would go up.

These results strike me as plausible and the methodology is useful. It could potentially be fairly easily applied to other nations and regions in the UK, largely because I would have presumed that a lot of the services trade policies that apply in Ireland are the same as would apply in Sussex, Cornwall and Scotland. That report has really looked at every single measure and made adjustments appropriately if something different applied in Northern Ireland, but my hunch would be that there might be individual instances but largely there is a UK services trade policy and so that kind of approach can easily be, in a sense, translated to other nations and regions.

I am mindful of the time. There is a second step to that kind of study that converts these impacts, which are in units of STRI, into an ad valorem equivalent. I guess I would have some slight reservations about that. The positive side of that is it is not really needed as far as I can tell, but I am not so sure about that second step of the study as far as the ad valorem equivalents are concerned.

Anjalika Bardalai: In terms of the methodology, I completely agree. I found it robust and credible, essentially because it is quite a detailed and granular application of the STRI framework. In terms of the overall conclusions, I think very broadly speaking one of the key messages from



the report was that when you look at the different scenarios that were outlined essentially the conclusion is that the higher the level of market access, scenario-to-scenario, the less potential disruption and the lower the impact would be.

As a conclusion, yes, I find that very credible. That is very much in line with a lot of other impact assessment research that has been done by think tanks, academia, private sector organisations, but also to link to some of the discussion that we heard earlier, we really heard it emphasised in the first session that one of the main barriers to trade and services is fundamental market access and so following on from that I think the conclusions here make perfect sense.

Q76 Emma Little Pengelly: A follow-up on that: one of the things presumably being looked at by the Government is those sectors that are potentially hit disproportionately in the range of scenarios and that could be supported more by a package coming out through whatever Department. Do you feel this type of methodology could be used to identify those sectors in advance? Would you be confident enough about the methodology to say this gives us a solid basis to say which sectors are likely to be impacted under various scenarios, and to target additional support packages towards them on that basis?

Dr Borchert: I think so. I guess I would like to disentangle the calls for what kind of support packages they would be, but I think it would certainly be useful for identifying those sectors that are most likely affected in terms of deducing a policy response, because we might then learn more about why it is that these sectors are affected. That goes back to the initial question from Ms Lopez about the modes and what kind of restrictions apply across the modes. There are some professional business services sectors that rely a lot on mode 4, and that might be exactly the reason. We will see it in this kind of methodology because it is so granular. Why is it that these sectors are hit and where? Then I think support, whatever form and shape that might take, could be much more targeted.

The methodology itself is really useful and the ad valorem equivalents perhaps might not be, because the one sector that comes out as being hit hardest presumably is air transportation. What does a no deal scenario really mean? An airline in Northern Ireland, if there was one, would just cease to be a community carrier and so the Ninth Freedom of the Air, which is a right even if you are a Northern Ireland airline to go over to France, pick passengers up in Toulouse and set them down in Rennes or Paris, which is a standalone cabotage, will be lost. That has huge ramifications for these business models and it is easily explained with airlines.

Q77 Emma Little Pengelly: We do not have an airline in Northern Ireland yet.



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Dr Borchert: No, but the exact same thing applies to easyJet. It is not a secret that easyJet has already applied for an Air Operator Certificate in another member state. These are the kinds of serious ramifications of losing single market access that we might pre-emptively think of addressing, but whether that is equivalent to a 20% ad valorem tariff I would not know.

Chair: Thank you very much and, panel, thank you for your time this morning. Thank you for your expertise, your knowledge and the patience to explain many of these points to us. It is greatly appreciated.