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For further information, please contact:
william.cave@oecd.org

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HOW ARE SERVICES BEING INTERNATIONALISED? AND WHICH ONES?

William Cave OECD Statistics Directorate

Summary

How are services being internationalised? And which ones?

A number of strands of analytical work at OECD shed some light on the internationalisation of services. The main ones are the work on:

- i) Foreign Direct Investment
- ii) International Trade in Services; and
- iii) Economic Globalisation Indicators and role of multinational enterprises;

This note outlines the methodological achievements in these areas – The OECD Benchmark Definition, The Manual on Statistics of International Trade in Services (MSITS), and The OECD Handbook on Economic Globalisation Indicators (HEGI), and some of the data arising.

It also looks in a general way at which services are being internationalised relatively more and which ones relatively less; and in which ways; e.g. for financial services, insurance, telecommunications, consultancy, IT services, information services, R&D, hotels, transport, legal services, and retail.

Finally suggestions are made on where further methodological work needs to be done – such as conceptual issues related to economic control, linking international trade in services data with those on production, foreign affiliates and investment, selective use of private sector sources on multinationals; and measuring movement of people and the economic impacts..

HOW ARE SERVICES BEING INTERNATIONALISED? AND WHICH ONES?

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Introduction

1. What does it mean “the internationalisation of services”? I will not offer a precise definition, but the title obliges some explanation of how this term is interpreted here. The “internationalisation of services” is taken to mean something akin to “globalisation” i.e. the internationalisation of services markets including an increased mobility of capital, people, know-how and other resources which have the effect of increasing the interdependency of economies.
2. A number of strands of statistical and analytical work at OECD shed some light on the situation regarding internationalisation of services. The main ones are the work on:
 - i) Foreign Direct Investment
 - ii) International Trade in Services; and
 - iii) Economic Globalisation Indicators and role of multinational enterprises;
3. Other OECD work including that on measuring information and communication technology and “offshoring” also continues to yield interesting insights into some of the mechanics of the internationalisation of services.
4. This note outlines the main methodological developments – The OECD Benchmark Definition of Foreign Direct Investment - 3rd edition (BD3), the Manual on Statistics of International Trade in Services (MSITS), and the OECD Handbook on Economic Globalisation Indicators (HEGI), and some of the data arising.
5. It also looks in a general way at available evidence on which services are being internationalised relatively more and which ones relatively less; and in which ways; e.g. for financial services, insurance, telecommunications, consultancy, IT services, information services, R&D, hotels, transport, legal services, and retail. But the term “services” itself presents difficulties in terms of definitions and of analysis, as the match between service products, and service activities appears increasingly problematic.
6. Finally suggestions are made on where further methodological work needs to be done – such as further development of accounts based on economic control by residents; linking international trade in services data with those on production, foreign affiliates and investment; use of international, including private sector sources, on multinationals; and measuring movement of people and the economic impacts.

The Conceptual Pillars

7. Analytical work on internationalisation of services has been developed at OECD mainly around three pillars - movement of capital and in particular foreign direct investment, international trade in services, and “globalisation” and the activity and role of multinational enterprises, as well as the analysis of the importance of economic control in the production process. The work on the three pillars is centred in three different Directorates of OECD.

8. These pillars are all firmly founded in the basic frameworks of economic statistics, namely the System of National Accounts 1993 (SNA 1993) and the IMF Balance of Payments Manual 5th Edition (BPM5), which in themselves have greatly clarified conceptually the measurement of services production and trade.

Foreign Direct Investment

9. Some of the earlier OECD work relevant to understanding the internationalisation of services was related to the measurement of movement of capital and foreign direct investment in the Directorate of Financial and Enterprise Affairs. The BD3 was published in 1996. The Benchmark Definition is based in the SNA and BPM5, but it sets out a more detailed set of information needs than is required in the balance of payments – in particular related to the economic activity of foreign direct investment enterprises, which provides information on services enterprises investing abroad and of the service subsidiaries; and to the partner countries of direct investment flows and stocks.

10. The BD3 is currently being revised in partnership with the IMF and involving Eurostat and UNCTAD. The revision is closely related to the current revisions to SNA 1993 and BPM5.

International Trade in Services

11. The second main methodological pillar has been the joint development of the Manual on Statistics of International Trade in Services and its publication by six international organisations¹ in 2002. This development is described more thoroughly in a paper by Andreas Maurer in the same session of the IAOS 2006 conference. This framework elaborates the information needs on trade in services in the balance of payments, and on majority-owned foreign affiliates in delivering services in foreign markets. MSITS is also in the process of being updated to include changes in SNA and BPM.

Economic Globalisation Indicators

12. The third important methodological work that has developed indicators to analyse the trends in globalisation, and the particular role played by multinational enterprises in this process, has been the OECD HEGI. This work was led by Thomas Hatzichronoglou of the Directorate of Science Technology and Industry (DSTI). The HEGI was published in 2005.

13. The HEGI provides guidance on the concepts of economic globalisation; foreign direct investment; the economic activity of multinational enterprises; the internationalisation of technology; and aspects of trade globalisation. It addresses the impact of foreign control of economic activity. This methodology can be applied to look at the internationalisation of services.

14. One of the consequences of this work has been the development of framework of statistics on the activity of foreign affiliates as well as sets of indicators that show trends in globalisation, these include trade indicators, direct investment indicators and others.

¹ EC, IMF, OECD, UNSD, UNCTAD and WTO.

Other OECD work relevant to internationalisation of services

15. The information and communication technology revolution is a crucial enabler of internationalisation of production of services. OECD DSTI aims to develop internationally comparable indicators and analysis of the Information Society for policy making. OECD Working Party on Indicators of the Information Society (WPIIS) have standardised definitions of e-commerce, ICT goods and services, and model surveys. The Guide to Measuring the Information Society was produced in 2005.

16. Another aspect of internationalisation of services is the increasing movement of people, whether short-term visits (business and personal travel), medium term as temporary workers or students, or as long-term migration. Here the work of OECD DELSA is important:- i) on measuring the foreign-born population with plans to include characteristics by sex, year of arrival, occupation, sector of activity, field of study and labour force status and ii) international migration.

Which services are being internationalised? And How?

17. I will begin with some general remarks about the development of trade in services, and then examine what evidence of services internationalisation emerges from the aforementioned pillar frameworks and other relevant sources.

18. Firstly I should say a word about barriers to trade in services. Unlike goods, services are not 'tradable' in the sense that they cannot be bought and resold. There has to be some communication link and in many cases a physical proximity between supplier and customer. There are many natural barriers to trade in services, such as language, culture, physical distance. However there are also many more regulatory barriers, which receive close attention in trade negotiations such as restrictions on foreign capital or ownership of firms or land, government licensing policy for various service activities, discriminatory or preferential access to domestic markets, distribution and communication systems, or government purchasing, lack of recognition of foreign qualifications, and restrictions on movement of people. The literature is extensive and most barriers are described as non-tariff barriers. This analysis does not explicitly look at these barriers but rather takes them as given. It rather looks at how internationalisation and trade goes on regardless of the existence or not of particular barriers.

19. In general terms the internationalisation of production has commonly been mainly associated with manufacturing, especially with successive rounds of trade negotiations post 1945 each reducing tariff barriers. The consequent huge increase in trade in goods required certain basic services such as freight transport services and more recently with 'just in time production, the development of specialised logistics services, that can help to manage increasingly complex supply chains. In the same vein couriers, wholesale distribution, freight transport and, insurance, and the services related to financing of trade have all become increasingly internationalised in themselves.

20. The expansion of FDI also has stimulated the internationalisation of certain infrastructural support services (wholesale) financial services and business advice, business services including, a variety of consultancy services, accounting, legal services, as well as the creation of SPEs and holding companies, sometimes in low-tax locations.

21. Information and communications technology (ICT) inc telecommunications and Internet services have enabled further waves of internationalisation of services, e.g. international courier services, offshoring of IT services, business process outsourcing (call-centres, data-processing, book-keeping, airline ticketing are examples). Other examples are film post-production editing and medical diagnostic testing, which can be carried out, to some extent, at remote distances with computer links.

22. Increasing movement of people and worldwide information networks (International TV channels) are also important factors impacting to a (limited) degree on the internationalisation of culture, sport, marketing, fashion as well as increasing the rate of knowledge transfer.

23. Financial deregulation measures have opened national financial services markets to increased competition including from foreign retail financial service suppliers.

24. Annex 1 sets out a table of means by which various service activities can be internationalised.

FDI Trends

25. The OECD International Direct Investment Statistics database compiles data annually from countries reported according to the standards set out in the BD3. The database is well established and reinforced by the strong link to the IMF BPM5 standards on FDI data reporting.

26. Flows of FDI are inherently volatile, and when broken down by activity, data often become commercially confidential, and are rather broad brush. But taking the G7 countries together services FDI inflows as a percentage of total FDI inflows have risen significantly in the period 1995-2003 from under 60% to over 65%. For FDI outflows the rise in the proportion in services was sharper rising to nearly 75% in 2001-2003 – see chart 1. Information on stocks of FDI in services, which are more stable show a similar trend.

27. The OECD International Direct Investment statistics database defines services industries by activity as follows in terms of ISIC Revision 3 – see table 1.

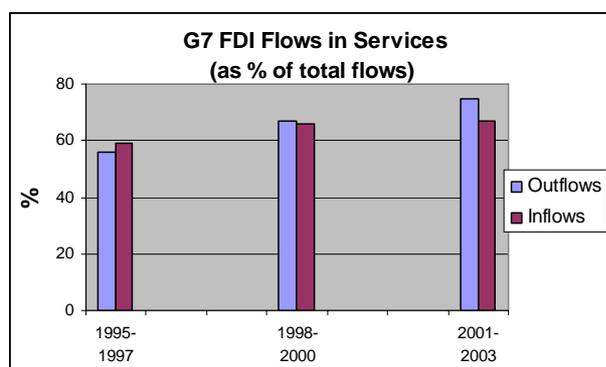
Table 1 OECD FDI Services Broad Classification by Activity

| |
|-------------------------------------|
| Electricity, Gas and Water |
| Construction |
| Distributive trade and repairs |
| Transport and communications |
| Financial activities |
| Real estate and business activities |
| Other services |

28. Which services attract the most foreign direct investment? Once again a precise answer is problematic due to confidentiality issues. The following picture emerges for the G7 over the period 1995-2003. The top three service categories for FDI are i) financial services; ii) real estate and business services; and iii) transport and communication services. Financial services (which includes banking and insurance) are particularly strong in outward FDI flows from G7 – see chart 2. This development coincides to some extent with, and may be boosted by the growth in investment in Special Purpose Entities and holding companies, which are increasingly involved in the investment of multinational enterprises¹.

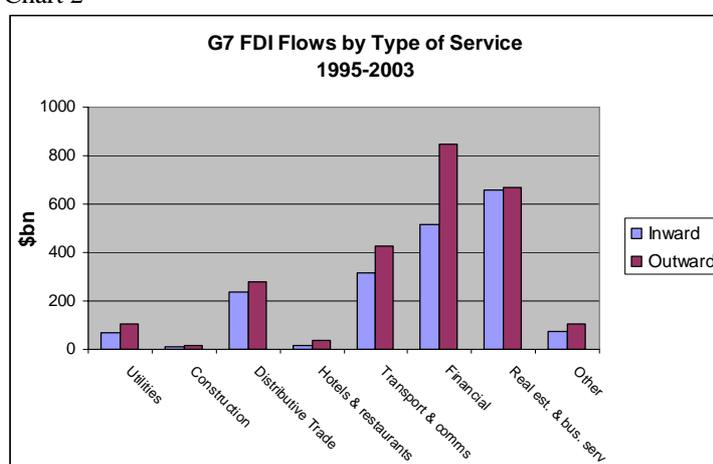
29. FDI can take many forms, which can include mergers and acquisitions, greenfield investment, joint ventures, business alliances (through exchange of minority equity stakes), additional investment in existing affiliates, purchase of real estate and so on.

Chart 1



Source: OECD International Direct Investment Database

Chart 2



Source: OECD International Direct Investment Database

International Trade in Services

30. International trade in services in the national accounts and the balance of payments refers to service transactions between residents and non-residents of an economy. It represents a small proportion (about 20%) of total trade in goods and services (worldwide). This proportion has varied little over the past decade.

31. The data sources are, at the world level the IMF Balance of Payments Statistics database, which provides extensive information on trade by type of service together with summary analysis and for OECD member countries some additional detail including trade in services by partner country in the OECD Statistics on International Trade in Services:- Volume 1 Detailed tables by service category (TIS); and Volume 2 Detailed tables by partner country (TISP). The presentation of the data is highly standardised.

32. Some recent research by Kimura and Lee² investigating the OECD TISP database and how the gravity equation applies to trade in services confirm that the gravity model³ is at least as robust for services as it is for goods and that geographical distance is a more important factor affecting trade in services than it is for trade in goods.

Levels and growth in trade in services

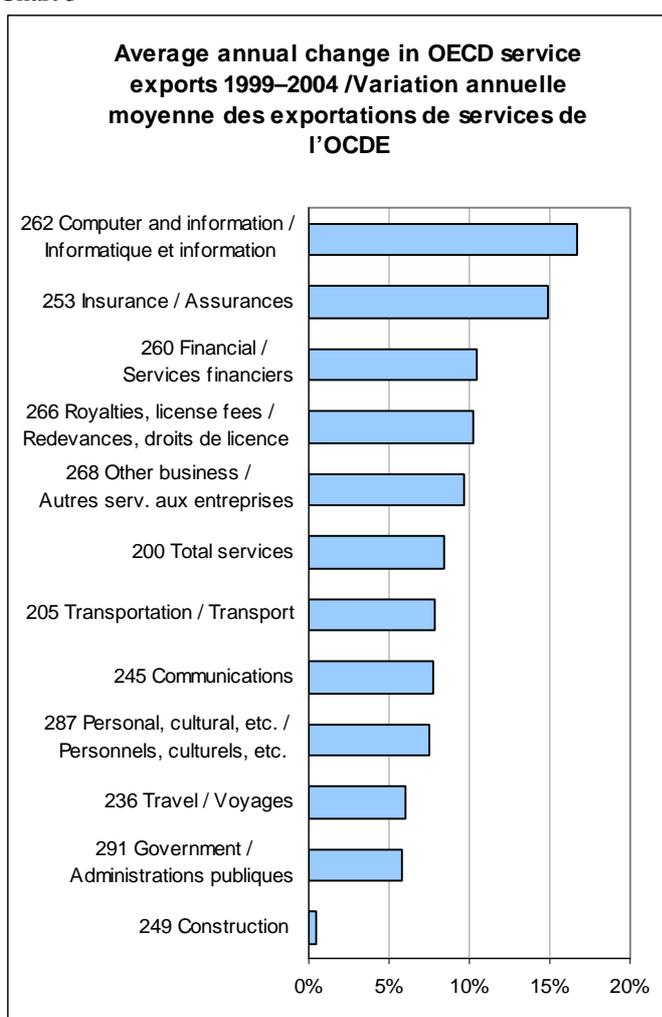
Table 2

| World Services Exports by Type of Service | | | |
|--|--------|--------|---------------|
| | 1999 | 2004 | Mean annual % |
| | US\$bn | US\$bn | growth rate |
| Total service exports | 1437 | 2234 | 9.2 |
| Transportation | 321 | 497 | 9.2 |
| Travel (expenditure) | 446 | 624 | 7.0 |
| Other Commercial Services | 626 | 1051 | 10.9 |
| Government Services n.i.e. | 45 | 63 | 6.9 |

Source: IMF BOP Statistics Yearbook 2005

33. In the period 1999-2004 transport and travel accounted for half of trade in services, but the trade that has been growing fastest is in the broad area of *Other commercial services* and from OECD export evidence within that *Computer and information services, Insurance services, Financial services, Royalties and license fees; and Other business services* - see Chart 3

Chart 3



Source: OECD TIS 2006

Estimated worldwide flows by partner

34. Using the OECD TISP database, which covers 75% of world exports in services, rising to around 90% if bilateral mirror imports are used to proxy for other countries exports, it is possible to construct an estimated model of world trade using assumptions, akin to those used in a gravity model. This shows one third of world trade taking place between OECD European member countries, and about 50% of world trade taking place within and between NAFTA and OECD European countries.

Table 3 Estimated world trade flows in services 2003

| Destination Region Exporting region | World | OECD | | | | | Africa | America | Asia and Oceania | Europe | Int Orgs |
|--|-------|-------|-------|-----------------------|-------------|-------|--------|---------|------------------|--------|----------|
| | | Total | NAFTA | OECD Asia and Oceania | OECD Europe | | | | | | |
| | | | | | EU15 | Other | | | | | |
| World | 100.0 | 76.0 | 19.3 | 8.8 | 42.7 | 5.2 | 2.3 | 23.0 | 23.7 | 50.5 | 0.4 |
| Total OECD | 76.9 | 62.2 | 14.8 | 5.5 | 37.0 | 4.9 | 1.7 | 18.0 | 13.1 | 43.7 | 0.4 |
| NAFTA | 19.2 | 13.9 | 4.3 | 2.7 | 6.2 | 0.7 | 0.4 | 6.4 | 5.1 | 7.2 | 0.2 |
| OECD Asia & Oceania | 7.5 | 4.9 | 2.3 | 1.0 | 1.5 | 0.1 | 0.1 | 2.5 | 3.3 | 1.6 | 0.0 |
| EU15 | 44.5 | 38.4 | 7.3 | 1.6 | 25.7 | 3.8 | 1.2 | 8.2 | 4.4 | 30.6 | 0.2 |
| Other OECD Europe | 5.7 | 5.0 | 0.9 | 0.2 | 3.6 | 0.2 | 0.0 | 1.0 | 0.3 | 4.4 | 0.0 |
| Africa* | 2.2 | 1.6 | 0.2 | 0.2 | 1.2 | 0.0 | 0.4 | 0.2 | 0.4 | 1.3 | 0.0 |
| America | 22.7 | 16.8 | 6.0 | 3.1 | 6.9 | 0.8 | 0.4 | 8.5 | 5.7 | 7.9 | 0.2 |
| Asia & Oceania* | 21.8 | 12.1 | 4.5 | 3.6 | 3.8 | 0.2 | 0.3 | 4.8 | 12.4 | 4.3 | 0.0 |
| Europe | 53.2 | 45.3 | 8.5 | 1.9 | 30.7 | 4.2 | 1.2 | 9.4 | 5.3 | 37.0 | 0.2 |
| Intl Organisations | 0.1 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.1 | 0.0 |

Source: OECD TISP 2006

35. For international trade in services the broad BOPS classification is a hybrid classification, mainly a product breakdown but with significant exceptions based on the transactor (most notably for travel and government services).

Table 4 EBOPS Classification (broad list of items by product or transactor)

| |
|--|
| Transportation |
| Travel |
| Communication services |
| Construction services |
| Insurance |
| Financial services |
| Computer and information services |
| Royalties and license fees |
| Other business services |
| Personal, cultural and recreational services |
| Government services n.i.e. |

36. Although an approximate concordance exists between EBOPS and the activity classification ISIC, in practice for many services items there is a very weak link between EBOPS and activity and it is difficult to link TIS data to activity in general. This is a source of frustration to analysts. Revisions to the SNA 1993 and BPM5 for the treatment of goods for processing and merchanting will further weaken the EBOPS link to activity classifications, while strengthening the link to the product classification CPC. This will pose new challenges to analysts.

Economic Globalisation Indicators: the Role of Multinationals and the Activities of Foreign Affiliates

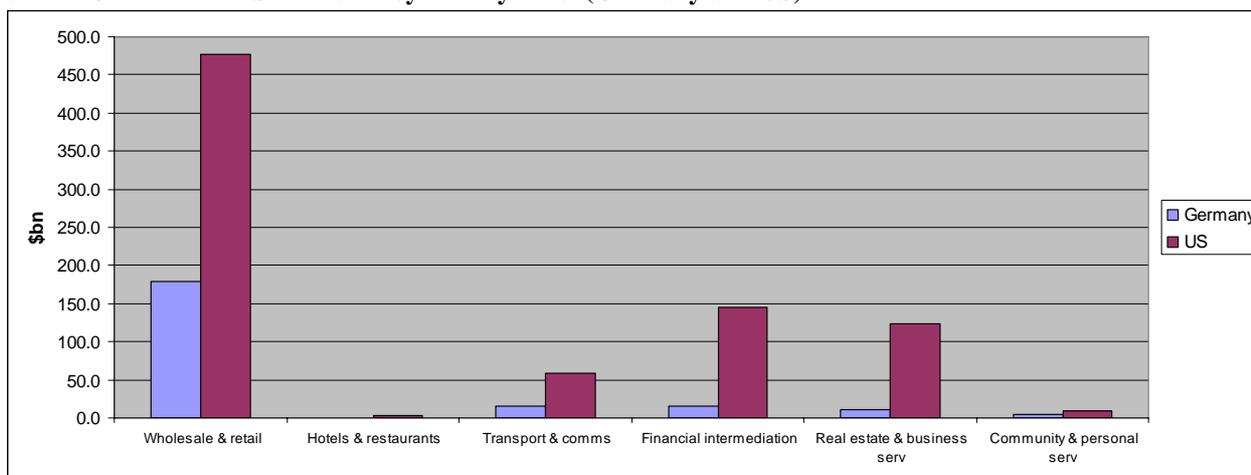
37. The OECD Foreign Affiliates Trade in Services (FATS) database aims to provide detailed data on the role played by multinationals in the service sectors of OECD countries, concerning inward and outward foreign direct investment. The database covers five variables: turnover, value-added, employment, exports and imports for both inward and outward activities. A new publication (Indicators of Economic Globalisation) was published in 2005 according to the guidelines set out in the HEGI and seeks to integrate FDI, FATS, Trade, R&D and other indicators, bringing together work done in various OECD Directorates.

38. This is a fairly new data source and data reported by countries are relatively patchy and international aggregation is not yet a practical possibility. Thus insights are rather partial.

39. For many services access to foreign markets is more likely to involve the establishment of a commercial presence (through a foreign affiliate) than through exports. However each service sale through a foreign affiliate will in general be worth proportionately less to the home economy than a direct service export.

40. Once established foreign affiliates are more likely to sell their services locally (in the host economy) than are foreign affiliates selling goods⁴.

Chart 4 Outward FATS Turnover by activity 1998 (Germany and US)



41. The patchy nature of the data limits the analytical potential, but the sales of outward foreign affiliates in services is largest in wholesale and retail in 1998 in US and Germany. This may reflect the high value low-margin of commodity type (goods) distribution, otherwise the financial services and real estate and business services are prominent.

42. A recent Statistics Canada study on foreign banks⁵ is illustrative of a number of issues. It concluded that between 1997 and 2004 foreign-owned bank subsidiaries and full service branches increased their share of the Canadian deposit-taking industry accounted from 5.7% to 7.9% by value of services produced. First the share is small but increasing. Second there was a change in the regulatory environment in 1999 foreign banks were allowed to open full service branches. Third the banking industry depends on trust and banking customers tend to be conservative preferring to stay with banks they know, to deal with their financial affairs. Fourth the share depends on the type of service – the area of banking that was the most open to foreign-owned banks was wholesale banking or “corporate and institutional finance”, where

foreign banks had 24.6% of the market in 2004. In general wholesale banking and insurance services tend to be inherently more international in nature than retail services.

Table 5 Broad Services Classification for FATS by Activity

| |
|---|
| Wholesale and retail distribution |
| Hotels and restaurants |
| Transport and communication services |
| Financial intermediation |
| Real estate and other business services |
| Other services |

Other OECD areas of work relevant to internationalisation of services

IT services and offshoring

43. OECD's Information Technology Outlook (2004) concluded that the *ICT sector* is highly and increasingly globalised, with ICT services trade increasing faster than ICT goods trade and being increasingly the focus of FDI. "As services become the focus of deregulation and trade liberalisation, and market services become a larger part of economic activity the trends seems likely to continue."

44. The offshoring, or international sourcing, of IT services or ICT-enabled business support services, is a relatively recent development. An increasing range of business services can be digitally delivered from a remote location that has the necessary pool of skills and often cost advantages. The potential of various business services to be digitally delivered is summarised in this publication, based on a 2003 OECD study –see bibliography. This depends, inter alia, on to what extent the "service" can be clearly specified or codified explicitly. India has become a focus of remote delivery of a variety of IT and business process services, but is not the only one.

45. The same publication raised a statistical puzzle, and a challenge for statisticians that arose from discrepancies in service exports reported by India and service imports reported by OECD countries from India. This has since been the subject of US GAO investigation.

46. Digital delivery over the Internet of entertainment and leisure-related services to individuals, including music, reservations, gambling, on-line games among others, is internationalising production of these services and sometimes raising new regulatory concerns.

Trends in Migration and Foreign-born Persons

47. OECD International Migration Outlook 2006 shows increasing inflows of foreign population into OECD countries between 1999-2004 in Europe and N America -up about 40%. The work to increase the variables collected related to foreign-born persons in OECD countries should yield increasing insights and analytical possibilities regarding their economic impact.

48. A particular and related challenge, raised by G8 leaders, that needs cooperation between migration, employment and balance of payments statisticians is to improve the quality of information on remittance flows, in most cases inadequately measured in the balance of payments, that migrants send to their countries of origin. This challenge, on the balance of payments side, is currently the subject of work in the Luxembourg Group.

Private sector sources on multinationals

49. There are a number of private sector sources of company information. There are ranks of international companies according to size ranked, by sales, profits, assets, market value or a combination of these, all giving spectacularly different results. For example Forbes combined rank 2006 puts six service companies in their world's top 10, all six in financial services, boosted by high asset values. There is also information on ownership of companies as well as individual company reports.

50. UNCTAD sends a questionnaire to MNCs asking about foreign affiliates and sales and makes use of company information databases.

51. It is difficult to square the resulting information with official statistics, and there are problems with different accounting standards worldwide, but it is a means of obtaining some information on the worldwide operations of companies, to complement the more standardised information coming from the national perspective of national statistical institutes.

52. The challenge set to NSIs by multinationals is prompting a search for a more international approach to collecting information on MNCs, for the moment it is easier said than done but the prize for workable solutions is growing.

Degrees of internationalisation

53. From the variety of information sources, all to some extent difficult to compare, it appears that a variety of services provided to business are the most internationalised. This includes wholesale financial and insurance services, IT services, freight transport and couriers, and some business consultancy services. Services that can be delivered digitally, are more likely to become increasingly internationalised, if the regulatory environment allows.

54. Increased numbers of short-term visitors and migrants, bring cultural habits and expectations, including tastes in food, with them, which strengthens the internationalisation of hotels and restaurants, sometimes achieved through franchises. In the case of hotels this is further strengthened through Internet booking, where clients may prefer to book with Hotel brand names they know.

55. Among the least internationalised services are government services and some personal services, that do not yield much to economies of scale, like hair-dressing (with the exception of a few international franchises at the top of the range).

Conclusions and suggestions for further work

56. The various strands of OECD work set out above provide some limited insights into internationalisation of services. The internationalisation process is going on in almost all sectors, but mainly in services to business, in digitally deliverable services, or where there are clear economies of scale and a permitting regulatory environment. Distance, culture and language as well as regulatory obstacles are important brakes on the internationalisation process.

57. It is difficult to analyse FDI, FATS and Trade-in-services and Enterprise statistics in the same picture due to differing definitions and perspectives on what is a service. More cooperative work to try to link these data sets, both conceptually and through linking the data, where possible or meaningful, at the enterprise level, is suggested. The weakening link between product and industry classifications is likely to increase the need to collect more, or more intelligently, product information in Enterprise statistics.

58. Multinationals by their nature need to be examined at the international as well as the national level, but this poses major legal problems for official statisticians and may require more imaginative approaches including selective use of private sector data sources.

59. Further consideration should be given to ideas about comparing trade based on the concept of national economic control of production with trade using the SNA concept of residency.

60. There is a need in measuring movement of people and the economic impacts for more cooperation between balance of payments work on remittances and movements of people (travel and migration) data.

Annex 1**Means of internationalisation and delivery of services by sector**

| Type of service | Mode 1 Cross-border | Mode 2 Consumption abroad | Mode 3 Commercial presence | Mode 4 Movement of people |
|---|--------------------------------|--|---|--|
| Retail | E-commerce small but growing | Tourism | Yes | |
| Wholesale | E-commerce | | Yes | |
| Hotels/restaurants | | Tourism | Yes | |
| Transport, logistics, post and couriers | Yes | Yes | Yes | Yes |
| Telecommunications | Yes | Yes | Yes | |
| Financial services | Yes mainly wholesale | Yes | Yes | |
| Insurance | Yes mainly wholesale | Yes | Yes | |
| Real estate | | Yes | Yes | |
| Equipment rentals | Yes | Yes | Yes | |
| IT services | Yes | Yes | Yes | Yes |
| R&D services | Yes | Yes | Yes | Yes |
| Legal and Accounting Services | Yes | Yes | Yes | Yes |
| Other business services | Yes | Yes | Yes | Yes |
| Public Administration | Yes | Yes | | |
| Education | Yes | Yes | Yes | Yes |
| Health | Yes | Yes | Yes | Yes |
| Sanitation services | | | Yes | |
| Culture, sport, recreation | | Yes | Yes | Yes |
| TV, Film and Radio | Yes | Yes | Yes | |
| Personal services | | | Yes | Yes |
| Households as employers | | | | Yes |

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¹ OECD Economic Globalisation Indicators 2005 – page 42

² The Gravity Equation in International Trade in Services Fukunari Kimura and Hyun-Hoon Lee September 2004

³ The Gravity Model seeks to explain trade between two countries in terms of the GDPs of the trading countries, the distance between them, and their relative remoteness from the rest of the world.

⁴ US BEA “Survey of Current Business” October 2005 Article on “US International Services” page 40

⁵ Foreign Banks in the Canadian Market – Christine Hinchley – Statistics Canada No. 11-621-MIE2006041