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**International Trade in Services**

***International Activities of Enterprises of Services Sectors :  
The role of the Balance of payments in Integrated Approach***

***by Marie P. Benassi***

## INTERNATIONAL ACTIVITIES OF ENTERPRISES OF SERVICE SECTORS: THE ROLE OF THE BALANCE OF PAYMENTS IN AN INTEGRATED APPROACH

### Introduction:

Today, statistical systems are faced with major changes in the World Economy. Growing economic integration, increasing complexity in the relationships between agents and development of very diverse service activities need to be taken into account. Concepts have to be revised in order to better assess the development of international activities of enterprises. And methods have to be adapted to a new and fast moving environment. A study just published by the US National Research Council states: "As the US economy becomes increasingly internationalized, it is essential that public and private decision makers have timely, accurate, and relevant information on US international activities"<sup>1)</sup>. The same holds true for the European Community.

At present, the balance of payments (BOP) is the only source available on international activities of enterprises of service sectors at EC level. It offers a conceptual framework coherent with the National Accounts to measure and analyse transactions between residents and non residents and particularly cross border trade in services and direct investment in/of enterprises of services sectors. It is a source available in most countries of the World and, in theory, harmonised (by following the rules of the IMF manual). The BOP alone is not sufficient to analyse all the international activities of enterprises and particularly the turnover of establishments abroad, but it is an important source of information, one building block to understand internalisation of enterprises of services sectors.

Eurostat and EC Member states are doing a lot of research work in order to better apprehend internationalisation in the field of services. A first aim is to improve the quality and the accuracy of BOP figures, but also to try and develop a more integrated approach to relate BOP to domestic figures and to other types of statistics like "turnover of establishments" in order to offer the most complete set of figures to the users.

### Paper object:

The object of this paper is to explain the conceptual framework of the BOP to analyse the international activities of enterprises of services sectors and to explain the BOP role in a broader approach. It is also to discuss the main practical and conceptual problems encountered so far in collecting data on international trade in services. And finally it is to present the work undertaken by Eurostat and the EC Member States to improve the BOP data in the field of trade in services, particularly by using other types of statistics and defining ways to improve the coherence between all service statistics.

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1) "Behind the Numbers, US trade in the World Economy", National Research Council, 1992 National Academy Press. This Book contains the major conclusions and recommendations of an expert panel on foreign trade statistics

**1) The balance of payments: a framework coherent with SNA to cover international activities of enterprises of service sectors.**

The balance of payments <sup>2)</sup> records all transactions between one economy and the rest of the world. It is a national statistic which takes part in the general National Account conceptual framework. This means that only transactions relevant for the elaboration of national GNP are taken into account. These transactions are real economic flows: exports and imports, income, transfers, long term investment. The balance which is an accounting document is completed by the recording of financial flows which describes how the transactions have been financed.

**1.1) What are the relevant concepts to measure international activities of enterprises of services sectors?**

The most frequent approach to international phenomena is based on a defined territory. Enterprises which constitute basic statistical units are characterized by a residency criterion and their activities inside the territory and with the rest of the World are measured. It is a territorial approach. The BOP fits exactly in this frame.

This approach does not always match the enterprise logic. Big enterprises do not care for "national territories" because the entire World constitutes their territory. They have a supranational view.

Characterising enterprises with ownership would enable one to get rid of geographical frontiers and to analyse the enterprise activity in its globality. A patrimonial approach complementary to the territorial one is needed.

Statistics based on territorial rather than patrimonial approaches can be chosen by the users according to their primary objectives. Using both can give a complete view of internationalisation phenomena.

**1.2) What kind of information on international activities of enterprises of service sectors is to be found in the Balance of payments?**

Basically services or industrial enterprises have the same kind of international activities: trade, technological transfers, direct investment abroad, portfolio investment, trade credits, long term credit, ... These transactions are theoretically registered in the same way in the BOP. What differs in the case of services and introduces major difficulties is the form of trade and the analysis of transactions occurring between related companies.

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<sup>2)</sup> The words "balance of payments" may be misleading, and one must understand that not only effective payments are recorded but economic transactions. This means that flows entered in the balance of payments are recorded on a gross basis and at the date of the real transaction. Also, one must not conclude that only paid transactions through the banking system are recorded. Banking settlements are used in many countries but they constitute only a part of the collection system which is completed by a lot of different sources including direct surveying of enterprises.

### What are trade activities today ?

In a traditional trade activity, a company produces finished goods or services in one country and sells them in another country. This type of activity is the most ancient international activity and used to be nearly the only one.

Nowadays things are less clear because the production processes may be spread all over the world and semi-finished products are shipped a lot. In industrial activities this phenomenon is obvious and can be traced off by looking at the circulation of goods. In the field of services things are far more complicated for reasons such as:

- the non materiality of the products
- the use of telecommunications
- the impediments related to institutional requirements
- the sophisticated worldwide logistic needed in certain areas (transport, telecommunication, courier services,...).

Because of all these reasons, a great variety of international relationships have to be settled by enterprises in order to produce the finished products. These relationships can occur between enterprises, establishments or even individuals and can have any organisational form.

In such an environment trade cannot be considered as an isolated, well defined activity any longer. It is a complex matrix of multinational transactions that have to be split in several different elements if one wants to understand and measure them.

Let us take some examples and try to draw a kind of typology of international "trade" activities of enterprises of services sectors. A clear characterization will help to better understand what is recorded in the BOP, what is not and what have to be recorded in another framework.

#### **a) Direct cross border trade**

##### **- The product moves**

The typical case: a finished product is done in one country and directly sold to a final client abroad. This may concern studies (marketing, legal, accounting, research), software, databases, press agency services. In this case, the provider of the service has contacts with his clients mainly by post or telecommunications. This situation is supposed to be quite rare because generally the services are not standardized, they cannot be bought on catalogue and the clients have difficulties knowing the foreign providers and getting in contact with them.

##### **- The provider moves**

Providers of services are going temporarily to another country to render their services: technical support, construction, consulting, training, entertainment... The staff is supposed to come back when the work is achieved and the company continues to manage this staff. In some cases, the temporary mission may last more than one year and involves the moving of equipment.

##### **- The client moves**

People travelling are buying services during their trips: transport, lodging and catering, entertainment, hairdressing, health, training ...

**- The transport moves or a space equipment is used**

In transport activities, space launching or satellite services (telecommunication, teledetection, space experiments and so on) international trade occurs when the client is resident of a different country than the transport operator or the owner of the space equipment.

All these transactions are exports and imports of services recorded as such in the BOP services account.

**b) Indirect cross border trade (through a "commercial presence").**

For the reasons already mentioned, it may be difficult to establish direct contacts between service providers of one country and final clients of another country. A "commercial presence" is necessary. It can be any related company or agent: an individual commissioned, a permanent agent, an establishment, an associated company. In fact, this entity acts like wholesale traders for goods. It has contacts with the clients and the providers: it produces nothing but an intermediation service. The main services are clearly produced by the foreign company: it is cross border trade with no direct contact between the provider and the final client. The sale of the product will be recorded in the accounts of the provider company and the buying of the product in the account of the intermediary company.

In the BOP, this is recorded like direct cross-border trade as exports and imports of services

**c) Services requiring an international logistic**

International services like railway transport, courier, telecommunication, postal services require a worldwide logistic and special equipment. Sometimes the equipment belongs to separate companies (national post offices and telecommunication network, railway companies) and sometimes it belongs to the same company established worldwide (courier).

Ideally, the service should be divided in as many parts as there are providers. For example, when a French person phones the States he uses the French network, an English satellite and the US network. There are two international services: the transmission by the English satellite and the communication on the US network. Another example: a Spaniard sends a letter by express mail to Finland: a local agent carries the letter to Madrid, there a plane of the mother company takes it to Brussels, it is parsed, then another plane takes it to Helsinki and a local agent carries it to its destination. All these operations except those made by agents of the first country are international services.

In both cases, the client has no direct relationship with foreign companies, but parts of the services have been provided by non-resident agents so they constitute cross border trade in the BOP framework. In such cases there are no theoretical problems but data collection is difficult in practice. In the first example, companies are distinct, they keep detailed account of all the transactions and pay offset amounts to each other. The gross transactions can be declared to the BOP. In the second example, as it concerns only one company, the relevant information may be simply not available, it depends on the accounting system adopted by the company.

**d) Services produced within international agreements**

In certain very technical services, like professional services, highly skilled experts are needed. And very often, they associate to produce a service. It is a kind of international joint production process. These

associations can take place in a wide gamut of organisational bodies ranging from verbal agreements to capital participation. But what is important is that service providers of distinct countries are identified.

In the BOP all kind of services transactions done under contract agreements are considered as imports and exports.

#### **e) Services totally produced by direct investment establishments**

Companies may invest in other countries and set up establishments, owning at least 10% of the capital. These establishments can be complete productive entities and trade their production locally.

Neither in the BOP nor in the SNA is the turnover locally produced and sold considered as international trade because domestically owned establishments abroad are non-residents and foreign owned establishments in the domestic territory are residents. Nothing will be recorded in the present BOP.

The turnover of these establishments and other economic statistics can be recorded in an extended framework. Usually one refers to this framework as "establishment trade" figures. This framework is based on the patrimonial approach. However, the concept of ownership is delicate to put in practice and some reflexions need to be carried out on that point.<sup>3)</sup>

#### **f) Intra-group miscellaneous service transactions**

Between members of an international group one can find a lot of miscellaneous service transactions like computing, management, auditing, training. These transactions are of a general interest, they do not constitute the main production of the group.

They are considered as imports and exports in the BOP. The only problem is that they are sometimes not separately identified in the companies account because they are calculated on an apportioned basis.

#### **g) Technological and other knowledge related activities**

Sales of trade marks, patents, other types of knowledge, rights to use them, royalties of any kind, franchising fees constitute frequent transactions in services sectors. They are recorded in a special BOP item. It has not been clear from the beginning where to classify such transactions, but in the next BOP manual they will be part of the services account.

This typology is somewhat simplified and enterprises can have international activities that match all these categories. But it shows that all forms of trade except the turnover of establishments should be recorded in the BOP framework as cross border trade and be classified in the services account.

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3) Companies can have a very complicated capital structure and it may be difficult to attribute ownership to one peculiar country. The concept of effective control of the company may be more pertinent but it is impossible to define a priori because it is not directly linked to the share of capital owned. According to the cases, ownership can be attributed to share holders owning between 10 and 50% (or more) of the capital.

### 1.3) Uses and advantages of the BOP information.

The major uses of BOP figures for macro-economic analysis are well known. Above all, BOP is an indispensable statistic for international transaction analysis, National Accounts purposes and monetary policy.

BOP can also give certain micro-economic information on international markets of services products and on transactions of economic sectors, especially their direct investments.

BOP has also other advantages: It is a complete and closed framework where one can calculate net positions by types of transactions. In many countries it is a monthly or quarterly statistic, it offers short term information with a certain level of geographical breakdown.

#### **a) Trade in services: a market approach**

In the BOP, trade in services (identified cross border trade) is recorded on a product basis except for travel. Eurostat and OECD have developed quite a detailed nomenclature derived from the CPC that should be implemented progressively by OECD member states. The detail of such a nomenclature cannot be very high because of collection problems and because of the rather complex and mixed nature of the transactions. At present, at EC level, about fifteen different types of services can be individualized, this number is even greater in certain member states.

This approach which is similar to that of external trade statistics for goods enables the user to have a market view. For each type of service one has total exports and imports on a quarterly basis with a certain detail of geographical breakdown. This permits one to calculate balances and assess the position of the national Economy, to identify surpluses or deficits and so on. Times series give a good indication on the modifications of the position. Trade figures can also be compared to domestic production by product in order to calculate exports and penetration ratios.

Using IMF statistics at World level, one can calculate market shares on different types of product. Using time series can help define dynamic or recessive products, etc...

#### **b) Direct investment and income: a view on the international strategy of enterprises**

Direct investment flows and related earnings are important for understanding international strategy of enterprises. These statistics are split by economic activities of the resident enterprises. Eurostat and OECD have defined a common activity breakdown which will be implemented progressively by OECD member states. From a territorial point of view this statistic gives information on the foreign productive capital allocation within the country, on the allocation of the national capital outside the country and on the evolution of the flows of investments. Direct investment income is also very interesting from a territorial point of view to know earnings received from other countries and paid to the rest of the world

#### **c) BOP by activity: to complement the market approach**

In most EC countries additional information is available on the main economic activity of the transactors. This permits one to calculate BOP by sectors of activity. These figures are very interesting because they show the complete set of international transactions and capital movements of enterprises of a defined economic sector. They can give the total goods and services exports and imports, the incomes and the transfers. They can be compared to production figures by main economic activity and be used to build

National Accounts by economic sectors. This will complement the market approach. Crossing activity and product breakdowns would also permit one to complete input output tables.

#### **d) Accuracy of other statistics on International trade in services**

One can find information on international trade in services in other types of statistics. In annual enterprise surveys questions on exported turnover and sometimes on imported intra-consumption can be found. But generally there is no product detail nor geographical breakdown. The sampling which is used is based on production figures and to catch external trade figures is not so efficient as the BOP which is completely devoted to this aim. Although one can hope to catch exports figures quite well in such surveys it is certainly not the case for imports.

### **II) Main problems encountered in the field of international trade in services**

Problems should be split in two categories: practical problems linked to specific collection systems, that could be easily solved, and conceptual problems.

It should be stressed that conceptual problems are not specific to the BOP at all. The deepest difficulties arise from the very complex and fast changing forms of international trade in services. Any kind of statistic designed to collect such data is in fact faced with the same problems. This is why concepts and methodology used in the field of international trade in services need strong assessments and theoretical investigations.

Eurostat and EC member states (joined now by EFTA countries) are currently thinking about the best ways to collect BOP data and to solve the two types of problems. Within 2 or 3 years, this work should end with major improvements. Before presenting the stage of progress of this research work (part III), the two types of problems will be rapidly discussed. --Advantages and drawbacks of the different BOP collection systems used at present are not treated in that paper<sup>4)</sup>.

#### **II.1) Conceptual and methodological problems**

##### **a) Nomenclatures are difficult to build**

Eurostat has commissioned a study of international transactions in a number of business service sectors (further explained in part III). As a preliminary result, the study shows the difficulty of designing nomenclatures for complex and rapidly changing types of services. Neither the activity approach, nor the product approach offers easy solutions. This holds true as well for other non-business services. The task of finding out about trade and external payments is rendered even more difficult by the lack of data on domestic activities.

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4) Eurostat already has a lot of studies on the subject, they are available on demand



The study shows that in these business services, the markets and the types of products are evolving rapidly towards less segmentation of the providers: firms belonging to different sectors of activity are invading each others' sectors and increasingly offering identical or rather similar types of services. For example, courier services are experiencing a slower growth in letter/document transport and a much faster expansion in the demand for transport of parcels, both in numbers and of increasing size and weight. They have in fact become suppliers of a particular type of transport: express door to door delivery. National post offices are also developing their express services. Accounting practices have massively entered the consulting and advice business in the legal, tax and management areas. Management consultants as well as accountancy practices are intensively engaged in supplying computer services. In sum, boundaries between these services have been blurring, the overlap between the various business and professional activities has been growing. Statistical differentiation on the basis of suppliers is becoming even harder.

#### **b) New types of services and packages are being developed**

New types of services are constantly appearing on the market, often as a result of externalisation of previously in-house activities. Discrete services are being bundled into complex packages often without separate invoicing of the components. Dynamic service companies are constantly moving into products for which the demand is rising fast and abandoning the others, sometimes to providers in less advanced regions or countries. Also, services are being replaced by products incorporating sophisticated characteristics. All these transformations are accelerating.

The study referred to above gives examples showing how difficult segmentation by product can be. One such instance concerns courier firms that take over from clients the entire distribution function of their goods (for instance computers and parts). Storage, stock keeping, logistics and on time delivery are among the services provided. This is a new kind of services not described in the CPC. Another example concerns packages of consulting services. Clients interested in buying a foreign enterprise can obtain from consultancy practices, from banks or other specialised firms, overall studies that cover all aspects of the acquisition: legal, accounting, market research, financing such as launching of shares, etc.... In construction services, complete packages including not only the actual building but also a host of other aspects such as design, choice of equipment, financing are on offer.

When different services are bundled into a package, the various components should be split for statistical recording purposes. The companies concerned, even if willing to do so, may often not be in a position to supply the necessary details. In that case, the whole package has to be attributed entirely to a category that corresponds to its main component, i. e. if one can be found.

#### **c) Finding transactions behind the complex financial arrangements between related companies.**

The study shows also that companies can have multiple types of links ranging from simple association agreements to full capital participation. The financial arrangements between all these companies may be very complex and do not fit in the traditional transactions classification (see annexed paper on legal services particularly page 5). For example, in an association of firms there may be overhead transactions calculated on a prorata basis. In a federation of firms there may be various contributions to a central organisational body. Fully integrated groups may be organised in profit centers where all the incomes are pooled and then redistributed according to certain performance criteria and not to the capital structure. The allocation criteria of costs and expenses among units located in different countries are often also dictated by fiscal considerations. To assess the real transaction behind any transborder financial flow, a case by case analysis of such arrangements is needed. Payments may cover a great

variety of reciprocal services and perhaps even non-service payments. Or it might turn out that there were no real transaction at all.

#### **d) Treatment of International services networks**

For certain types of services (transport, telecommunication, courier, professional services, advertising) it is an entire set of producers who participate worldwide in the elaboration of a service. It then becomes nearly impossible to differentiate the elementary operations and to identify separate transactions. The collection of the data will have to stick to the accounts of the companies that can give a rather aggregated picture of all the transactions. Furthermore, the invoices, if any, may include intra-group transactions like overhead costs, royalties or franchising fees.

#### **e) Services not invoiced (Financial services)**

Some services will always be impossible to apprehend directly because they are never explicitly charged. It is the case of most financial services. Very often the value of the service is included in the financial transactions. For example, the service charge is sometimes not distinguished from interest paid for loans or from premiums paid for insurance. In such cases, the total amount for premiums or interest will be known and it will be impossible to split it to obtain the service fee. For insurance, the IMF recommends that one calculate a ratio on premiums, this will be implemented as soon as the new Manual has been adopted. For other financial services, after long discussions, the idea of calculating imputed bank services has been abandoned because of practical problems. But in cooperation with national accountants, a memorandum item showing estimates of imputed bank services will certainly be produced.

#### **f) Lack of volume indexes**

Volume indexes would be very useful to complement BOP figures on trade in services. At present very few countries are producing such indexes. Direct observation will certainly be very difficult in many cases because international services are rarely standardized. Indicators have to be found, but at present few are available even for domestic statistics.

#### **g) Classification of Governmental services**

At present, the major part of such services is put under the item governmental transactions. In this item one can find all types of expenses of embassies and military forces and certain services produced by government like technical aid. Services produced by national enterprises like telecommunication are put under the corresponding services items. A question, not yet solved and subject to controversy, is where to classify marketable services produced by central or regional governmental bodies: in the services items or in the governmental transactions.

#### **h) Geographical allocation criteria**

When several operators take part in the same transaction (pooling in transport, subcontractors in construction works,...) the geographical allocation becomes a problem. No clear rules have been defined yet.

## II.2) Practical problems linked to collection systems

The problems mentioned below are entirely relevant for BOP collection systems as applied at present in EC countries. In many cases they concern only few countries and can be solved easily.

### **a) Non-recording of flows**

One major criticism to the services account in the BOP concerns the non recording of certain flows. Though invisibles are by definition difficult to record, it is not an impossible task. Generally speaking, studies on World asymmetry have shown that the coverage of flows is correct except for some well known items.

Maritime transport is the area where the biggest asymmetry is found. Ship owners are sometimes difficult to locate and they do not declare their transactions. They may have accounts in financial off shore centers and the money shipped through their domestic accounts corresponds only to net incomes. This causes an under-recording of World sea transport receipts. This phenomenon has been well analysed in the IMF study on the World current account asymmetry.

Another problem may come from the use of foreign accounts by enterprises. These operations are developing. A special declaration has to be requested from the enterprises so that they describe all the transactions made using these accounts.

Another problem comes from the fact that in certain countries some enterprises had known a certain "independence" vis a vis the exchange control. Despite its abolishment, statistical authorities continue not asking for complete information. This should be solved in the future.

### **b) Bad quality of the declaration**

Declarations on the nature of the transactions are not always of a good quality. Efficient procedures to collect the information and regular checks should warrant high quality as it is the case in any statistical system.

### **c) Net valuation of flows and offsetting payments**

In principle all transactions should be recorded on a gross basis. But in certain types of services, payments are often offset. This is the case in telecommunication, in courier or postal services, in railway transport. It can also be the case between companies who are doing a lot of business together. In most EC collections systems companies involved in offsetting mechanisms are asked to give the gross amounts.

### **d) Services related to trade in goods**

There are a lot of services related to trade in goods and provided by the same enterprise: transport, insurance, technical aid, training, installation, softwares, and so on... Sometimes, enterprises do not make separate invoices for such services and they are comprised in the value of the merchandise. All countries are faced with the problem whatever collection system they use.

When comparing settlement figures and customs figures one can find big gaps which partly come from that problem. In France, for example, a model tries to fill in the gaps and ends up with a significant

residue that is put under the heading other goods and services not allocated. This type of problem is quite important and it is one of the reasons why it is often stated that services transactions are under estimated whereas merchandise is slightly over estimated.

#### **e) Transport.**

Problems of non-coverage of certain sea transport receipts have already been exposed. Another problem lies in the fact that the major part of freight expenses are estimated using external trade figures. This means that the freight estimates depend on a lot of factors including the quality of trade figures and of other available information.

#### **f) Travel**

Travel is a demand oriented item. All expenses of people travelling are supposed to be recorded. This means that billions of very small transactions are concerned, the major part of which being paid in banknotes. A lot of problems are encountered for this item and countries have constructed quite complicated systems to make their estimates. Major problems concern the gross evaluation of banknotes transactions with all the re-exchange problems, the problems of currencies used world-wide (US dollar, DM), the breakdown of banknotes transactions by purpose (travel, capital operations, transfers, illegal transactions,...), the geographical breakdown when currencies are the main source of information. In survey based system, one can also find all sorts of problems related to people or household surveying.

#### **g) Intra-group transactions**

Another major critic of BOP is the idea that a lot of transactions between related companies may not be well classified because the enterprises do not declare them properly for many reasons including tax evasion. This is a problem for all economical statistics, and no study has proven that it was extremely frequent in BOP statistics. Furthermore, the abolishment of exchange control in the Community will alleviate such problems, if any.

#### **h) Geographical breakdown**

Nearly all OECD countries are producing geographically broken down BOP. In the current account, the partner country of the final transactor should be taken into account. The use of currencies in certain systems makes the allocation difficult, this is particularly important for travel. Sometimes, when there is an intermediation it is very difficult or even impossible to know the final transactor and it is the country of the intermediary which is recorded. This problem is particularly important for sea transport, it is the country of the ship's real operator that should be taken into account, and with the use of free flags it is sometimes very difficult to know this country.

### **III) Eurostat and EC Member States Projects of Improvement**

Eurostat and EC Member states have done a lot of methodological work to improve the BOP quality in order to be in a position to produce a good quality EC Balance of payments for the Economic and Monetary Union. Twice a year there are working party meetings with EC and EFTA members. 4 thematic task forces are currently preparing improvements: general aspects, current account, capital, EDI-BOP. (Task forces programmes are to be found in annex.) The current account task force is the one dealing with trade in services.

In parallel with this work and for the drawing up of the trade in services classification, Eurostat is carrying on research work to understand better international services transactions and particularly business services.

As an every day work, Eurostat is also producing harmonized BOP figures at EC level (later on at EEA level). Finally, Eurostat is studying the needs for establishment trade figures and the feasibility, in collaboration with DG I (responsible for trade negotiations).

#### **III.1) The current account task force work**

This task force has Mr Senff from the Bundesbank as reporter. It is preparing a common methodology for each item of the current account except the investment income. This methodology will complement the IMF manual and will be followed by EC and EFTA countries at least. The Task force recommendations should be completed by 1994.

One objective of the task force is to use related statistics in order to make better estimates and to assess quality. It is also to ensure that the same information is not asked twice from the enterprises in order to alleviate their statistical burden. Greater cooperation with other statistics and in some cases integrated approaches should be aimed at. The task force will work with other Eurostat units and working parties to achieve this objective.

Another objective is to exchange information between EC and EFTA countries or even other OECD countries in order to have better coherence, to suppress asymmetries and in a way to reduce statistical burden.

All the problems presented in part II will be studied by the task force. Only problems that have been studied so far are presented below.

#### **a) Merchandise account, merchandise transport and insurance.**

##### **- nature of the transaction**

The task force has prepared a classification of the nature of the transaction for EC external trade statistics. Since 1988, external trade statistics are harmonised at EC level. They constitute the main source to build the merchandise account in the BOP. The nature of the transaction classification is used to transform external trade figures so that they are conform to the BOP methodology. This new classification will be implemented in 1993 for intra and extra EC trade statistics. This classification

enables one to differentiate goods for processing and repairs, goods taking part in joint production programmes, goods for temporary use, financial leasing and operational leasing,...

**- new intrastat system**

Intra EC trade figures will be collected with a new system in 1993: intrastat. This system will furnish the statistical value for merchandise, ie the CIF/FOB values. BOP statisticians will have to find new estimate procedures to calculate transport and insurance on merchandise imports. These procedures will be used by all EC member states in order to obtain intra-EC compatible information.

**b) Passenger transport**

At present, figures on tickets sold to passengers are obtained directly from air and railways companies. Discussions are being carried out so that the same information is not asked in the new surveys in preparation on transports. A method for geographical breakdown of these data using statistics on provenance and destinations of passengers has to be drafted. The coverage of sea passengers also has to be improved.

**c) Travel**

Eurostat has undertaken a huge work program on tourism statistics in order to produce a general methodology. Tourism in the balance of payments is one chapter of this methodology. A report has already been produced, explaining how the present systems work, what are the main problems and what kind of solutions should be looked at. The task force is currently working on the design of a common system to build travel figures.

This system will probably be different for intra and extra flows after the completion of the Economic and Monetary Union. For extra flows the present systems will remain approximately the same but improvements on the geographical breakdown using exchange of information and various types of tourism statistics are planned.

For intra flows the present systems mainly based on banknotes transactions will not be feasible with the unique currency. Households surveys, maybe completed by special surveys on business travel will certainly be used to build a general framework, other types of estimates (based on nights or arrivals statistics) will be used to furnish short term data. The household survey referred to is another part of the tourism methodology which is in preparation. This survey will contain quite detailed expenditure questions. This survey will give good information of expenditure abroad of residents which can help to build the total travel debits. An exchange of information between the participant countries can help one to draw the credit part. Other data on tourism, like the HORECA surveys can also be used in order to perform checks.

In the short term a complete exchange of information will be organised in order to reduce intra-EC and EFTA asymmetries in the travel account. All information used at present to build the travel account will be recorded in a special questionnaire designed by the task force and exchanged between the participants. A first test is currently being carried out between the task force members. The information will be cross-checked in order to assess the main asymmetries and to correct them.

#### **d) Other services**

The other services category regroups all services other than transport and travel. The task force has not yet worked on this category. It is waiting for publication of the new IMF Manual. At that time, the Eurostat-OECD nomenclature will be updated and finalised in order to be completely coherent with the IMF recommendations. The task force will design a common methodology for each item of this nomenclature. The problems seen in the previous part, among other more technical ones, will be of course studied carefully and improvements will be looked at in coordination with all statistical or international bodies concerned. All information produced by other types of statistics should be carefully looked at by the task force in order to see what can be used and if there is no duplication of work.

#### **e) Prices and volume indices in trade in services**

The task force will have to suggest ways to build prices and volume indices in the field of trade in services. The British example will be studied carefully and Eurostat will conduct tests.

#### **f) Use of registers and drawing up of BOP figures by sectors of activity**

Eurostat is currently working on a regulation on registers. The use of a unique register would permit one to build links between all types of statistics.

France, where a common register is used by all statistics, is making annual estimates of BOP by sectors of activity. This work takes place in the annual report of the service commission. International transaction figures coming from the BOP are completing domestic figures on production and employment.

### III.2) Study on business services

A Eurostat consultant, Mr Luyten, formerly responsible, inter alia, for GATT negotiations for the EC Commission, is currently drafting reports concerning international transactions in a number of business services.

The study is exploratory. Its objective is to identify the main international transactions in the field of business services, to try and make recommendations on the nomenclature and ways to collect the data, including prices and volumes indices, and more generally to obtain a better knowledge of international activities in the different business services.

Drafts have become available on accounting/auditing and tax consultancy, legal services and courier services (to be found in annex). A draft on management consultancy is almost ready as well as one on computer services and related services.

#### **a) Main general provisional conclusions**

##### **- Internationalisation has multiple forms**

The exploratory work shows that international activities are important for all the sectors analysed so far, but that such activities are undertaken mainly by a limited number of large enterprises that have turned

themselves into international groups or participate into international networks. Pure cross border trade without any intermediary is very limited. Smaller enterprises have difficulties in overcoming the obstacles to access foreign markets: establishment is nearly indispensable for regulatory reasons and because of the practical need to be close to the clients. Reputation of firms is of key importance and competition is very intense. Group organisations can take complex and very diversified forms according to the services considered: in courier services, establishments are usually majority controlled if not owned 100%. In legal or accounting services the integration formulas of multinational practices or networks are usually less tight and informal types of organisation can be found.

**- Statistical recording has to consider the organisational form of firms**

One of the study conclusions is that the international organisation of enterprises is a key element to understanding how transactions are made and to try and measure them. International business services are nearly always rendered with the presence of local agents on both sides of the transaction and sometimes in between. These agents are producing the totality of the services or only some parts. In courier for example, the local agents are responsible for the pick up and delivery of the letters and "central agents" are taking charge of the major part of the transport including a journey in the central hub. In legal services, an association of lawyers from several countries can be used to solve problems of a client in another country with the help of a "central" documentation and logistic service.

The accounting system of enterprises is likely to be the best source for tracing the various service transactions. In the case of loose group organisation, all intra-group transactions will be invoiced but not necessarily at arm's length prices. In more structured organisational systems, profits may be pooled and redistributed later according to predetermined criteria. General expenses for the group may similarly be apportioned to the different units of the group. What complicates statistical recording is that in most cases intra-group or intra-network transactions are settled through offsetting mechanisms. They may then be difficult to collect either because of a lack of basic information or because the companies are reluctant to declare them.

**b) Sectoral tentative conclusions**

**- Courier services**

Competition in that sector is intense. The "express transport business", as they prefer to be called, is rapidly adapting to changing markets. At the international level, concentration is increasing. Technical progress is modifying the markets. Fax and electronic data interchange are affecting the growth rate of the demand for letters and small documents, though the pace remains rather high. The parcel market is increasing extremely fast. The courier enterprises are progressively shifting themselves towards the handling of parcels and goods mostly of high value. Thereby, courier services are now more close to transport services with the special characteristics of "express services" (ie any transport done more rapidly than it is generally the case) and "door to door delivery". The classification of such services should take these features into account. Data should not be too difficult to collect and volume indices could be based on the number of transported items subdivided into weight categories.

**- Legal services**

The law profession is highly regulated and access to foreign markets remains extremely difficult. International activities are possible mainly through foreign establishment or through the setting up of links with legal practitioners abroad. Such links take on various forms ranging from loose associations to, more rarely, full integration. Large internationally well placed firms maintain sophisticated communication networks to manage their resources. They tend to move experts around to meet local



needs. Legal teams specialized in international affairs congregate in specific financial places such as London and New-York, where they tend to dominate world markets. Next to a number of US large practices, there are a host of EC law firms, led by those of the UK, that are in a strong position. But none of them, except a UK firm, seem engaged yet in a complete corporate world strategy.

The demand for legal services has increased very rapidly in the 80's so that this service sector has attracted considerable resources. Despite the present slowdown, future prospects remain excellent. Key export markets are the main financial and trade centers in Europe, in the US and in Asia. Prospects in parts of Eastern Europe are also bright. Levels of lawyers' fees have risen to such extent that some enterprises show a tendency to develop their in-house legal services.

Data collection appears rather difficult in that sector. Product nomenclatures cannot be very detailed because the firms themselves cannot really differentiate their services; in some cases they provide very broad services and in some other cases one can find legal services rendered by other sectors of activity. Mr Luyten's conclusion is that the services should only be described as "transactions of lawyer firms". The gathering of data for international transactions should be done by direct surveying of enterprises because intra-firm compensation is very frequent. A volume index could be based on employment figures.

#### **- Accountancy/tax consulting services**

In many respects, this sector is similar to that of legal services with a high degree of regulation particularly for auditing. Accountancy practices wishing to provide their services abroad mostly do so by acquisitions or associations with foreign local practices. However, internationalisation seems to be more ancient and one can find 6 big companies strongly engaged in a world corporate strategy.

Accounting companies are more and more engaged in consultancy and in computer services and not only in accounting services. In fact, markets have grown more rapidly on consultancy or computer services and firms have had a tendency to widen their fields of competence but they have rarely created specialized branches.

It appears difficult even to differentiate accounting and tax consultancy. Mr Luyten's recommendations on this type of services are similar to those for legal services.

### **III.3) Eurostat other projects**

#### **a) Establishment trade figures.**

DG I of the Commission which is in charge of trade negotiations would have great interest in establishment trade figures. It has prepared a document on its needs for such figures. This document (to be found in annex) constitutes a problem statement for the design of a new system aimed at obtaining these figures.

On a practical point of view, Eurostat envisages a rather economic solution. It is based on the use of a register of enterprises participating in direct investment operations abroad and of foreign owned establishments on the domestic territory. This register exists in nearly all countries and is maintained by BOP statisticians in order to record the direct investment flows. This register could be used in two ways:

- to record the turnover of foreign owned establishments on the domestic territory by using links, through the register, with domestic statistics. This, of course, would require that a common register is used for both statistics.

- to record the turnover of domestically owned establishments abroad by adding some question to the direct investment questionnaire sent to all domestic enterprises having establishments abroad.

It should be added that an appropriate exchange of information between countries would allow to restrict the additional questions to establishments in countries not participating to the exchange.

This type of system is already available in countries like France or Germany and for the domestic side in the UK.

The conceptual framework should be built from the OECD benchmark definition on Direct Investment. But further reflexions are needed on the shares of the capital to be taken into account and how to split the turnover in case of multiple participations. The concept of effective control should be investigated.

#### **b) EC complete and harmonised balance**

Before the end stage of EMU is reached, Eurostat will try to produce a fully harmonised EC BOP. At present, Eurostat calculates only parts of the BOP that are harmonised (current account and direct investment). The harmonisation is not complete because the intra-EC asymmetry is not zero. In cooperation with the task forces, Eurostat is going to produce a fully harmonised and complete EC balance. This balance will have no intra-EC asymmetry and will contain a capital account coherent with the current account. This work is completely complementary to the methodological work carried out by the member states. Eurostat will correct the problems discovered by the task forces before the new complete system has established for the Monetary Union. Harmonisation will also be done on EFTA figures beginning for reference year 1992

#### Conclusions.

Today, internationalisation is a major issue for economic analysis and policy. An integrated approach relating domestic production, production abroad and international transactions has to be adopted by economists in order to understand the phenomenon, its consequences for the World economy and especially for the allocation of productive factors and wealth. Statisticians have to take these needs into account to provide convenient and coherent statistics. Each type of available statistic has to be reviewed in that sense and links have to be improved.

The balance of payments, as the most convenient framework to measure international transactions, is a building block for this global approach. It is certainly far from perfect for practical and conceptual reasons, but other statistics would be faced with the same types of problems. It is then important to improve the quality of BOP figures and its compatibility with other statistics.

The EC balance of payments statistical systems will be subject to great changes in the next years. A lot of improvements are on the way. An increasing cooperation with other statistics would help to achieve coherence, high quality and also to reduce statistical burden on enterprises.

Major progress has to be made in order to have common enterprise registers, household surveys on travel expenses and other tourism statistics, transport statistics. The compatibility of the different nomenclatures should also be considered. And finally, a large effort should be made for the renewal of the concepts used.

**Annexes:**

- The need for statistics on establishment trade - DG I EC Commission
- Work program of BOP task forces - Eurostat
- Courier & express delivery services, Legal services, Accountancy/tax consulting services- 3 draft research papers written by Mr Luyten.

**Eurostat reference publications:**

- International trade in services - EUR12 1979-1988
- International trade in services - EUR12 1980-1989 (to be issued soon)
- Geographical breakdown of EUR12 current account - 1980-1989 (to be issued soon)

These publications provide the most detailed information on international trade in services for EC Member States and EUR12 aggregate.

THE NEED FOR STATISTICS ON ESTABLISHMENT TRADE1. Defining Establishment Trade

Establishment trade can be defined as trade realised through establishment enterprises. Establishment enterprises are companies established in one country, part or all of whose capital is owned by residents of another country, i.e. enterprises which have been subject to foreign direct investment.<sup>1</sup> The term "Establishment trade" covers the complete set of activities of establishment enterprises, i.e. the total turnover, production and employment of establishment enterprises.

2. The Growing Importance of Establishment Trade

For both manufacturing and service industries, establishment trade has assumed an ever-increasing importance. The internationalisation of commercial activities has naturally led to more and more companies to establishing a commercial presence abroad. For service industries establishment trade has particular significance. For the majority of service sectors the establishment of a commercial presence abroad is the dominant mode of delivery. For service sectors such as financial and professional services, companies will almost certainly need to establish a commercial presence if they wish to provide services in a foreign market. For manufacturing companies the establishment of a commercial presence abroad has increasingly become an alternative to production in the home country.

3. The Absence of Statistics on Establishment Trade

At present the EC has no statistics on establishment trade. This means that the EC does not have adequate information with which to evaluate and monitor the performance of EC-owned companies established abroad. Equally the EC cannot accurately assess the performance of foreign-owned companies established in the Community. To date the EC has relied on the information provided by Balance of Payments statistics.

<sup>1</sup> The OECD nomenclature on direct investment considers all companies where 10% of the capital is owned by non-residents as "Direct Investment Enterprises". Under the GATS provisions (Article XXXIV j i)) a company is defined as "owned" by persons of GATS Member "if more than 50% of the equity interest in the company is beneficially owned by persons of that Member." In defining an establishment enterprise it would appear preferable to follow the GATS definition of ownership. The use of this 50% ownership criteria may simplify the collection of statistics on establishment trade.

#### 4. The Inadequacy of Balance of Payments Statistics

Balance of Payments statistics record all real and financial transactions between residents and non-residents. BOP statistics therefore provide information on direct investment flows, lending and borrowing abroad, repatriated earnings from capital investment abroad and interest from foreign loans. BOP statistics do not provide any information on the turnover, production or employment figures of companies established abroad. The EC's current knowledge of the activities of EC companies established abroad is therefore restricted to information concerning the amount of initial direct investment made and information on the level of profit which a company established abroad may decide to repatriate rather than re-invest. The EC is not able to measure the level of market access achieved by EC companies established abroad, their level of market share or their performance relative to their competitors within a foreign market.

#### 5. Establishment Trade Statistics and Bilateral Trade Negotiations

The absence of statistics on establishment trade poses a number of substantial difficulties for the EC in the conduct of trade negotiations with third countries. The lack of statistics on establishment trade means that the EC does not possess adequate information concerning the performance of EC-owned companies operating in foreign markets or indeed on foreign companies operating in the Community. At present the US is alone in publishing establishment trade statistics setting out information on US companies operating abroad.

Establishment trade statistics are particularly needed in the negotiation of bilateral framework and cooperation agreements (e.g. Brazil, India, Morocco). The absence of sufficient statistical information means that the EC is not able to assess accurately sectors of particular economic interest to EC operators. Establishment trade statistics would allow EC negotiators to identify priority sectors in foreign markets where EC-owned companies are under represented or under performing. This information would assist the EC in determining where improved market access should be sought. Statistical information on the performance of EC-owned companies in individual markets would assist EC negotiators in identifying discriminatory measures which third countries may be applying against EC-owned companies established in their markets.

A practical example of the importance of statistics on establishment trade can be provided in the analysis of EC trade relations with Japan. DG I is currently attempting to study the degree of openness of the Japanese market. This study is encountering considerable difficulties since the EC does not possess adequate information concerning the performance of EC-owned companies established in Japan. Establishment trade statistics on the market share, turnover and production of EC-owned companies operating in Japan would allow a comparison with the performance of Japanese companies. Such information would assist in identifying possible barriers to entry to the markets and discriminatory measures applied to EC-owned companies established in Japan. Equally, statistics on establishment trade would allow the EC to assess the performance of Japanese-owned companies operating in the Community.

## 6. Establishment Trade Statistics and the GATS Negotiations on Services

This paper has mentioned the particular importance of establishment trade for services, stressing that the establishment of a commercial presence is the dominant mode of delivery for the majority of service sectors. The GATS negotiations on services have highlighted the EC's current statistical shortfall. Establishment trade statistics are especially relevant to three areas of the GATS negotiations. These are the evaluation of offers, the modification of schedules and the procedures for dispute settlement and enforcement.

### **a) The evaluation of offers of initial commitments**

The draft final text of 15 December 1991 states that in order to accept the Multilateral Trade Organisation (MTO) Treaty all members must submit a schedule of initial commitments for services. These offers of initial commitments detail the service sectors which each GATS partner is prepared to bind according to multilateral rules. For each sector offered the GATS partners are required to schedule any restrictions limiting market access for foreign companies and any national treatment restrictions which discriminate against foreign service providers operating in the country. Market access and national treatment restrictions are listed for each of the four modes of delivery possible for the provision of services. These four modes of delivery can be defined as the cross-border provision of services, the movement of consumers, the establishment of a commercial presence and the temporary movement of persons. As previously stated the key mode of delivery for the majority of service sectors is through the establishment of a commercial presence. EC negotiators therefore focus on assessing the economic importance of third country offers to remove or maintain market access and national treatment restrictions on the establishment of a commercial presence. Establishment trade statistics capture the economic activities resulting from a commercial presence.

To date, four rounds of bilateral negotiations on offers of initial commitments have been held in Geneva. The EC has pursued these bilateral negotiations with all of the 50 countries that have submitted offers. During this negotiating process it has become increasingly apparent that the EC is not able to make accurate assessments of the real value of these offers without statistics on establishment trade.

Clearly, in order to determine the value of the offers made by its partners, the EC needs detailed information on the areas of economic interest to the EC service operators. Statistical data on the levels of activity of EC service operators established in individual sectors would enable the EC to form clear sectoral negotiating priorities with its partners. In order to evaluate the significance of a third country's decision to remove or maintain barriers to market access for a commercial presence in a sector the EC will need to be aware of the level of activity of EC-owned companies established in that market. Equally in order for the EC to assess accurately and quantify the value of the commitments it is undertaking in what is the largest and broadly most liberal single market for services, EC negotiators require information on the level of establishment trade carried out by foreign-owned service providers. Without figures on

the performance of EC-owned companies established in foreign markets EC negotiators are forced to estimate the importance of individual markets and the significance of the maintenance of restrictions for specific service activities. In short, without establishment trade statistics to provide a framework for assessing the commercial value of offers of initial commitments the EC finds itself negotiating without sufficient data. In the context of the Uruguay Round which has introduced the first round of GATS negotiations of services, the EC has broadly based its negotiations with its trading partners on a standstill binding of current regimes. In future rounds, GATS negotiations will be increasingly based on liberalising commitments. The successful evaluation of these liberalising commitments will be even more dependent on detailed establishment trade statistics.

**b) Modification of schedules**

Under the rules of the GATS (Article XXI) after a period of three years from the date of entry into force of the agreement, GATS members may modify or withdraw commitments included in their schedules. If a GATS member does wish to modify or withdraw a commitment in its schedule it must enter into negotiations with any interested GATS partners to agree on any necessary compensatory adjustment. In order to evaluate what may be judged to be appropriate compensatory measures detailed statistical information will be needed.

Statistical information will be needed to determine the economic value of the sector where the commitment has been withdrawn and any other sector where a new commitment may be made. In such a situation, establishment trade statistics would play a major role. Statistics on establishment trade monitoring the performance of EC-owned companies established in foreign markets would allow the EC to assess accurately the value to EC operators of the sector which is being withdrawn and the adequacy of the proposed compensation. The successful negotiation of this type of economic rebalancing will be dependent on the EC's possessing sufficient statistical resources.

**c) Dispute Settlement and Enforcement**

The provisions on dispute settlement and enforcement in the GATS (Article XXVII) allow GATS members to request the initiation of dispute settlement procedures if they consider that a GATS member is failing to carry out its obligations or specific commitments set out under the Agreement. Under these provisions the GATS Dispute Settlement Body may authorise GATS members to suspend the application to the offending country of such obligations and specific commitments that it determines to be appropriate. In such a situation the GATT Dispute Settlement Body will need accurate statistical information in order to determine what may be judged to be appropriate compensatory measures. As in the case of the modification of schedules, establishment trade statistics would play a vital role in this process.

EC statistics on establishment trade would form a major part of the Community's submission to any dispute settlement panel. Establishment trade statistics would allow the EC to demonstrate the economic effect that failure to live up to particular commitments has had on

EC-owned companies established in the offending country. Establishment trade statistics would also allow the EC to evaluate accurately what should be considered as appropriate retaliatory measures. The EC would be able to present a dispute settlement panel with figures on the performance in the relevant sector of service providers from the offending country established in the Community.

In addition to cases where GATS members fail to live up to their commitments, GATS signatories can also request the initiation of dispute settlement proceedings if a GATS member considers that benefits it could reasonably have expected to accrue to it under a commitment from another GATS member have been nullified due to the application of a measure by the relevant country.

In this type of "reasonable expectation" disputes cases, statistics on establishment trade would be vital in assessing the economic value of expected benefits. Establishment trade statistics would allow the EC to present a dispute settlement panel with figures predicting the effect of the application of any measure on EC-owned services providers operating in the market.



STATISTICAL OFFICE  
OF THE EUROPEAN COMMUNITIES

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Directorate C  
Unit C3

BP/92/21/E  
July 1992

**BALANCE OF PAYMENTS  
WORKING PARTY**

**MEETING**  
**12 - 14 October 1992**  
**Luxembourg-Kirchberg**

**TASK FORCES**  
**PROGRAMME**  
**AND**  
**WORK IN PROGRESS**

31 July 1992

## TASK FORCES PROGRAMME AND WORK IN PROGRESS

### I INTRODUCTION

This document is a new version of the preceding document (BP/92/4/E) which have been updated in order to take into account the recent developpements of the work. It needs to be fully discussed, amended if necessary and approved by the Working Party in order to provide a good basis for the work to be carried out by the Task Forces.

In order to facilitate the reading of this document, it should be mentionned that mainly the following parts have been updated: Work Programmes of task forces "General", "Current" and "Capital" (Parts VI,VII,VIII) and Timetable and work in progress( part IX).The members of the working group are asked to comment on these changes and to approve (after amendements) the work programme.

### II GENERAL OBJECTIVE

The general objective of the different task forces is to design a compatible data collection system for the Member States in order to obtain information of high quality, sufficiently detailed and which could be aggregated at the EC level.

The system design should be sufficiently precise and not give rise to different interpretations. It should be complete and cover all information required at the EC level. Different alternatives could be proposed but these should provide compatible information, i.e. information which could be aggregated at the EC level.

The design should include:

- Definition of the minimum information requested at the EC level.
- Harmonisation of the basic information regardless of the form in which this information is requested (e.g. questionnaires sent to enterprises in the U.K. survey system, "déclaration directe" sent to the main enterprises in France, information asked to complement the payorder in Germany).
- Definition of procedures in order to avoid overlaps in the basic information.
- Definition of methods of estimation for flows for which the nature of the transaction is not declared (non-reported transactions: e.g. transactions under the threshold in the Dutch system and sample surveys for small enterprises which are not surveyed systematically in the U.K. system).
- Harmonisation of related statistics (external trade statistics, surveys on merchandise transport enterprises, surveys on merchandise insurance enterprises, surveys on households related to tourism, capital stocks statistics).
- Harmonisation of methods of estimation for the items: e.g. merchandise on a FOB-FOB basis, merchandise transport, merchandise insurance, tourism.
- Definition of EDIFACT messages for transmission of the information whatever the data collection system is.
- Design new procedures in order to improve the rapidity of the transmission of information from the Central Banks / Statistical Institutes to Eurostat/European Central Bank in order to produce timely Eur12 aggregates.

### III WORKING RULES

In order to set up a good work organisation and ensure an integration of the work, rules should be respected :

- Task forces should include a limited number of participants in order to be efficient.
- Taskforces will be co-directed by the Rapporteur and Eurostat
- The Rapporteur of each task force will draw up a report which will be the only document of the task force. Members of the task force will make oral or written contributions on it for each task force meeting. These comments should be sent directly to all Task Force Members. The report will be updated after each meeting of the task force. The Rapporteur will provide minutes after each meeting. The rapporteur will be responsible for the update of the report. Each new version will be made available to all Task Force Members. The most recent update should be submitted at each meeting of Working Party which should make amendements to it. The final version should be approved by the Working Party.
- In case some members of the task force disagree on some points of the report, their point of view will be annexed to the report.
- Comments on the report can be made at any time by Member States and EFTA countries not participating to the Task Force. They should be sent to the Rapporteur and to Eurostat which will take care of their dispatch.
- Other officials of Eurostat (outside Unit C3) will be invited to participate in this work when necessary. For this reason meetings should often be held in Luxembourg.

#### **IV COMPOSITION OF THE TASK FORCES**

##### **TASK FORCE 1: GENERAL ASPECTS**

**Rapporteur:** Mr BOURGUIGNON-Banque de France

**Members:**

Germany (Mrs. Steger, Mr Widera), France (Mr Bourguignon), Netherlands (Mr Hofman), United Kingdom (Ms Lakkin, Mr. Stock), Belgium (Mr. De Boeck, Mr. Melis), Spain (Ms Bravo), Italy (Ms Bentivogli), Sweden (Mr. Lars Forss), Austria (Ms Nesvadha)

##### **TASK FORCE 2: CURRENT ACCOUNT AND RELATED STATISTICS**

**Rapporteur:** Mr. Kurt SENFF - Deutsche Bundesbank

**Members:**

Germany (Mr. Senff), France (Mr. Bourguignon), United Kingdom (Mr. Stock), Ireland (Ms Banim, Mr. O'Hagan), Greece (Mr. Pantelides), Spain (Ms Morales), Portugal (Mr. Agostinho), Norway (Mr. Halvorsen)

##### **TASK FORCE 3: EDI-BOP**

**Rapporteur:** Mr. Peter HOFMAN - De Nederlandsche Bank

**Members:**

Germany (Mr. Widera), France (Mr Gauduffe, Mrs Sellier), Netherlands (Mr. Hofman, Mr. Elfferich), UEBL (Mr. Melis), United Kingdom (Mr. Woodward), Italy (Mr. Bertini), Finland (Mr. Nordquist), Austria (Mr. Hille)

##### **TASK FORCE 4: CAPITAL FLOWS AND STOCK**

**Rapporteur:** Mr. SEILER- Deutsche Bundesbank

**Members:** Germany (Mr. Seiler), France (Ms D'Hoine), Netherlands (Ms Pronk), UEBL (Ms Donkers), United Kingdom (Ms Lakin, Mr. Heath), Denmark (Mr. Held), Switzerland (Mr. Schlup), Sweden (Mr. Tomas Niemelen), Italy (Mr. Loi), Spain (Mr. Rodriguez-Tenez), Portugal (Ms Saraiva)

## V TASK FORCE 1 WORK PROGRAMME: GENERAL ASPECTS

### 1. Definition of the information required at the Community level.

#### a. What detail of information is needed?

- For each type of statistics:
  - . BOP statistics
  - . International Investment position
  - . Establishment trade
- For each periodicity:
  - . Month
  - . Quarter
  - . Year
- According to each classification:
  - . Eurostat-OECD Classification on services
  - . Standard components
  - . IIP classification
  - . Eurostat-OECD geographical classification
  - . Currency breakdown (for capital flows)
  - . Activity classification
- Within a given timetable  
(in order to avoid that late answers of some countries slow down the aggregation at the EC level).
- Before/after stage 3 of the EMU

#### b. Particular points deserve special attention:

- Monthly data (at present some Member States have no monthly information)
- Intra EC information
- Establishment trade
- Breakdown by economic activity of all current transactions (at present this information is not collected at the EC level).

### 2. Strengths and weaknesses of BOP collection systems

A real cost/benefit analysis is probably impossible to carry out. However it is possible and necessary to indicate for each country (participating to this task force) the pros and cons of their system. This will provide some basic information which will help for designing a compatible data collection system or at least the rules which Member States systems should satisfy.

For each Member State (participating to this task force), the analysis of strengths and weaknesses should be carried out in indicating explicitly the specificities of each system vis a vis others and stating its pros and cons. It should include:

- The staff and volumes of data treated
- The detail of the information provided
- The agents responsible for providing the information (banks, enterprises...); what are the different burdens for the different agents.

-The procedures of data collection: how they insure a complete coverage, how they prevent overlaps, how they give comparable information for credits and debits.

-How estimates are done for information below the threshold (for the general direct reporting systems) or for enterprises which are not surveyed.

-Rate of returns for surveys

-Quality control: how the information provided by the agents is checked by the national statistical authorities.

-Evaluation of the level of "Net errors and omissions" and possible explanations.

### 3. Estimation, harmonisation and corrections at the EC level

Indication of the present main problems for aggregating Member States figures (which mostly give rise to intra-Community asymmetries)

This chapter will be drawn up by Eurostat and submitted to the task force. It will highlight the problems with which one is faced when aggregating Member States figures. It will focus upon the items for which the harmonisation of the data collection system is the most important.

It will suggest general principles for making estimates (for data not completely provided by a Member State), harmonisation and corrections. Harmonisation should be done when a national classification is not completely identical to the EC classification (e.g. activity classification for direct investment). Corrections should be done on the basis of existing differences between the data collection systems which lead to different valuations and which are reflected in bilateral asymmetries. Only general principles should be indicated in here; practical proposals for each item should be decided in the specialised task forces ("Current" and "Capital"). Estimates, harmonisation and corrections will certainly be necessary during stage 2. Even when a "compatible" system is set up, corrections will most probably be necessary (although estimates and harmonisation will be no longer needed hopefully).

### 4. Proposal of a "compatible" data collection system

This is the most important work to be carried out by task force 1. In principle a system will be considered as "compatible" if the information it provides can be aggregated because it uses the same classifications and has an identical high level of quality. In theory "compatibility" is linked to the fact that different systems can lead to exactly the same statistical results. The Task Force should look carefully upon such an assertion and see if on practical grounds it can be accepted (in the light of the problems encountered above see point 3 "Estimation...").

- Definition of the legal basis at the national level: obligation to declare, statutory surveys, penalties for non-reporting, confidentiality of the information provided.
- Definition of the legal basis at the EC level: transmission of information to the appropriate bodies (Eurostat and/or EMI/ECB) for stages 2 and 3, transmission of intra-EC information between the Member States, confidentiality.
- Definition of appropriate administrative rules for transmission of data from the reporters to the national administrative body in charge of the data collection (e.g. only one administrative body in charge of the data collection, no preaggregated information sent to this body)
- Definition of the quality control (checks)

- Harmonisation of the information requested from the different agents regardless of the collection system (survey based system or general collection system). Information requested on a payment order (e.g. Germany, Netherlands) should be identical to that requested directly from enterprises on a monthly/quarterly basis (e.g. France, U.K.).
- Definition of procedures in order to avoid overlaps (e.g. use of enterprise codification in order to avoid double declaration of identical flows through different procedures ("déclarants directs généraux" et "compte rendu individuel de paiement") or through different questionnaires (securities reported both in "direct investment" and "portfolio" surveys)).
- Definition of methods of estimation for transactions below the threshold (for "general direct reporting systems").
- Definition of a register specifically adapted to BOP surveys for countries willing to use a survey (in line with the IMF compilation guide). Definition of methods of estimation for enterprises which are not systematically surveyed (for "survey based" systems).
- Possible alternative (for surveys systems): use of SWIFT information to provide a basis for survey in identifying important transactors and in providing a basis for sampling.
- Intra-community information. Explore the idea of exchanging all intra Community information and recording only one side (debit): this will diminishes costs fundamentally. This is probably only possible with a strong harmonisation of the collection systems.
- Registers: examine how registers should be used in the BOP collection systems, how registers (used for general purpose by the National Statistical Institutes) fit with BOP objectives.

#### 5. Easier cross border payment

The Commission has drawn up a document "Easier cross border payment". Its intention is to facilitate cross-border payment in particular in reducing the statistical burden of banks. The task force should give an answer indicating if and what solutions can be given. All possibilities should be envisaged provided they are compatible with a good quality of the BOP information:

- increasing the thresholds
- diminishing the information required to what is strictly necessary for the BOP
- asking only for debits on intra-community transactions
- reducing the role of banks to the transmission of the information and no more (e.g. use of a document annexed to the payment order and filled in by the customer) or extending the role of the "Déclarants directs généraux".
- improving the messages for providing the information (EDIFACT)

#### 6. Answer to the GNP Committee

The task force has committed itself to give an answer to the GNP Committee which is not in a position to appreciate the validity of the information provided by the BOP to compute the GNP. A possible answer in line with the task force programme (see above point 3 "Estimation...") could be that Eurostat will provide an harmonised BOP (according to rules approved by the Task Force) indicating the main corrections which have been made for this harmonisation and the reliability of the information. This will allow the GNP Committee to take into account these corrections.

## VI TASK FORCE 2 WORK PROGRAMME: CURRENT ACCOUNT

1. The report should indicate for each standard component of the current account (excluding investment income):
  - a. IMF Definition  
To refine the definition if necessary
  - b. Main transactions/transactors.  
To indicate the main types of transactions and transactors. In principle they should aim to cover the quasi totality of the flow. To indicate borderline cases.
  - c. Problems encountered by Member States  
On a basis of an open exchange of view, to indicate problems encountered by any Member State. Recommendations should be made.
  - d. What sources should be used and how estimates should be done at the national level.  
The report should mention the related statistics which are used for:
    - .Correcting the main BOP source (e.g. transport statistics are used for the FOB-FOB valuation of goods).
    - .Improving the geographical breakdown (e.g. passenger transport statistics are used to correct the basic banknotes information)
    - .Replacing missing information (e.g. tourism statistics will be used for travel when banknotes information is no more available with the single currency).
 The report should indicate how estimates or corrections should be done.  
 If alternative methods are proposed, they should provide identical results.  
 Stage 2 and 3 should be distinguished.  
 Intra and extra EC flows should be distinguished.
  - e. Estimation, harmonisation and correction at the EC level.  
The report should suggest estimation, harmonisation and corrections in line with the general principles drawn up by the "General" Task Force (see above V.3 "Estimation..."). Estimation should be done when a data is missing for a country. Harmonisation should be done when the classification of a country is not compatible with the EC classification. Correction should be done when an over or under evaluation is detected for a country. In principle the need for estimation and harmonisation will disappear when the compatible system is set up (stage 3 of the EMU).
  - f. Evaluation of prices and volumes
2. Proposal for related statistics  
 The report should make proposals on related statistics which are used for drawing up the BOP. As far as possible these statistics should be adapted in order to fit as well as possible with the requirements of the BOP system and to avoid any duplication of work. In connexion with point d above ("What sources...") the report should mention proposals on:
  - External trade statistics: nature of the transaction
  - Transport statistics
  - Insurance services statistics
  - Tourism



## **VII TASK FORCE 3 WORK PROGRAMME: EDI-BOP**

1. Definition of EDIFACT Messages which could be used for by any data collection system to provide the required Balance of Payments information.

Messages should :

- be convenient for all types of data collection system ( "closed" systems, "survey" systems, "declarants direct generaux"...);
- cover all data flows ( from customers to banks, from banks to Central Banks, from enterprises to Central Banks...)
- cover aggregated or individual information;
- cover information sent by Central Banks to Eurostat;
- preserve confidentiality
- cover current/capital transactions and capital stocks
- be coherent with financial messages.

2. Test and implementation of the messages.

## VIII TASK FORCE 4 WORK PROGRAMME: CAPITAL

### 1. Scope

- a. Investment income
- b. Changes in assets and liabilities:
  - Direct investment
  - Portfolio investment
  - Other Capital
- c. International investment position

Probably the item "trade credit" should be discussed within the TF "Current". The item "establishment trade" should probably be discussed in the TF "Capital".

### 2. Definition of the information required at the EC level

This information has been partially defined by the task force 1 and with the Eurostat-OECD document on direct investment. However it should be decided if the standard components of the new IMF manual are sufficient or need to be more detailed and how this should be done.

### 3. Strengths and weaknesses of the collection systems for the capital account and the IIP.

On the basis of work previously done by the IMF and Eurostat, the Task Force Members should have an exchange of views on the main characteristics of their own systems, the main sources used and the main problems encountered. They should give some recommendations in order to obtain information of sufficient quality at the EC level.

### 4. The report should indicate for each item:

#### a. IMF Definition

To refine the definition if necessary. To indicate the content of each item and the borderline cases. This should be done particularly in relation with the following breakdowns: direct investment/ other investment, equity/debt securities, bonds and notes/money market instrument/financial derivatives, monetary authorities/general government/banks/other sectors. Clear cut definitions should be provided in order to set up practical rules for the delimitations of each component of each of these breakdowns. The relations between direct investment and the 7th directive as well as between the sector of monetary authorities and the 2th directive should be considered.

#### b. What sources should be used and what estimation should be done at the national level.

The report should take into account the possible differences between stage 2 and 3 of the EMU, intra and extra EC flows.

#### c. Estimation, harmonisation and corrections at the EC level.

In line with the general principles drawn by the "General" Task Force (see above V.3 "Estimation..."), the report should suggest how this should be done in practice for the capital account. This work is parallel to what is suggested for the current account (see above VI.1.e). Eurostat will prepare a document suggesting some solution with real data. However this will only be possible if Member states provide Eurostat with sufficiently detailed information.

**IX Timetable and Work in progress****1. General Aspects**

This TF started in April 1992. Point 1 (Definition of the information required) is done. Discussions have begun on points 3 and 4. TF work should be finished by end of 1994.

**2. Current Account**

Propositions have already been made concerning the nature of the transaction (Point B). Discussions have begun on merchandise, transport and travel (point A). TF should be finished by end of 1994.

**3. EDI-BOP**

All messages have already been drawn up (Part 1 is finished). Test of messages (part 2) should begin by the end of the year. TF work should be finished by the end of 1993.

**4. Capital**

This TF should start working in September 1992. The method of work and the american proposal of a portofolio survey will be discussed in September. Direct investment should begin to be discussed before the end of 1992. The definition of the information required should be discussed as soon as the new IMF standard components are defined. The TF work should be finished by the end of 1994.

## RESEARCH PAPER

## Courier &amp; Express Delivery Services

## Service activity description

## Definitions:

-On-demand picking up, transport and express delivery of :  
--letters, newspapers, journals, periodicals, brochures, leaflets and similar printed matters,  
--parcels and packages, and increasingly also heavy consignments, by private operators using self-owned or subcontracted and occasionally also public transport media. The private sector likes to stress that compared to ordinary mail/parcel delivery by the public services they provide a value added service i.e. door to door, domestic or international express transport of documents and parcels. A posteriori invoicing, account management and possibility of rerouting after pick-up are additional characteristics. In international traffic, another area of potential comparative advantage is that of efficient customs clearance for cross-border items as compared to other private transport media. In Europe five national postal administrations have teamed up with one private operator jointly to provide door-to-door express services (joint venture TNT/GD-Express worldwide). Some sixteen other postal administrations continue to cooperate in EMS-Unipost to supply express delivery but they are reportedly negotiating changes in their arrangements<sup>1</sup>.

-The characteristics of such "express delivery services" are: (i) on-demand, i.e. not in accordance with a time schedule set by the express service provider but collected when ordered; (ii) the adjective "express" conveys the notion of speed in the transport of time-sensitive items i.e. of speed that is about as fast as physically possible. A time-definite delivery is a characteristic of a service of quality; and (iii) direct door-to-door delivery with responsibility of the service provider for the total journey, i.e. end to end administrative control and liability for the entire transport chain. Monitoring of the entire movement, with immediate tracing of the shipments through electronic tracking devices and bar code techniques helps to ensure reliability; (iv) the items transported are mostly hard-copy communications and parcels (e.g. samples), but increasingly also heavier commercial shipments such as fashion goods, circuit boards, computers. A convenient benchmark is weight that can be handled easily by one person and that can go through automatic sorting chains of distribution hubs.

-This paper does not focus on instant response, short-distance express delivery services which concern only local or at most regional markets. It addresses express services mainly in so far as they concern international services and specially, but not exclusively, shipments in and out the EC.

<sup>1</sup>See page 4

#### Practical means of providing the service:

- Originally express services were rendered by real couriers, i.e. persons who actually carry or accompany the consignments (mostly documents or valuables) from departure to arrival (e.g. by air, travelling on commercial flight). Nowadays the express items move unaccompanied through a variety of transport media such as trucks, aircraft and even sometimes ships and rail. The transport equipment used is mostly owned (or leased) by the express company, but for part of the transport, publicly owned means may also be used such as trains and vehicles of the postal authorities or airline services;
- Consignments collected in each place are sent to a central point from where they are sorted and forwarded. In Europe such hubs and spokes are to be found in Brussels and Cologne.

#### Evolution in the activities of the service:

- In modern economies more and more companies are shipping goods in single or few items rather than in bulk, particularly for products high in value, yet low in weight and easily transportable. This is part of a strategy to produce on demand, cut inventories and deliver "just in time". Lines of demarcation between letters delivery, parcel transport and heavier (cargo) freight and "courier/express services" are fading. Although specialising in items of a weight that can still be easily handled manually, private express companies will normally not refuse to take up heavier shipments from established clients (but in that case they may handle the transport separately).
- Express companies are entering into new types of activities such as warehousing and inventory management on behalf of manufacturers at, or near, their transport hubs. Such activities are called contract distribution/logistics business. Federal Express has created a separate organisation "FE Business Logistics" to deal with this activity. UPS has "central warehouses" in four member states. DHL has set up partsbank facilities in Brussels and Bahrain to serve in the region as a distribution central stock of parts and materials for customers. Danzas and NedLloyd are also in this warehousing business. Thus distribution services and express services mingle.
- Express companies offer remailing services whereby they pick up their clients' mail and send it on "in bulk" to the country of their choice from where regular postage will choose the optimal mix of transport and logistic services. This consolidation of mail saves on cost to the express company, on price to the client and also often on time. Some express companies as well as freight subsidiaries of airlines, work hand in hand with some national post administrations with which they centralise such bulk mailing. Lines of competition and cooperation between public post office and private services blur. The world market for remail is estimated to be around Ecu 3 bn. Until recently it rose at a vigorous double digit rate.

#### Differences between export and import (at EC level) :

No information seems to be available except that it would appear that the Community's post offices as a group receive many more letter post items as they send out. As regards the traffic of private express companies, in order to maximise revenue by optimal use of transport means, they naturally try, by appropriate marketing, to reach the best possible balance between incoming and outgoing flows. As far as express parcels is concerned, the natural trend is for flows between the Far East and the EC and between the US and the EC to be more inward than outward.

## Quantitative description

### Market size

There is at present no source with standardized data on private express delivery services. Figures on market size that are available are only estimates about variously defined markets. According to recent data in the EC Commission's Green Paper on postal services, the EC market for all mail services i.e. letters, parcels and express packages cross-border and not including services by postal administrations amounts to an estimated annual turnover of Ecu 46bn (1988). Private operators would account for Ecu 20 bn (43%) of that total but for only 2% of the revenues from letter delivery.

According to the Green Paper, in 1990 intra EC cross-border letter traffic would have represented Ecu 1.6 bn (5% of the total letter turnover) and extra-EC traffic the same amount i.e. a total of Ecu 3.2 bn. Cross-border letter traffic of private operators would have represented Ecu 0.4 bn (12.5%), i.e. a much greater part than of total letter traffic.

In parcel traffic, the postal authorities would have 38% of the overall EC market (cross-border or not) with the rest in the hands of the private sector. No figures about cross-border traffic only are given. Surface parcel traffic is dominated by large transport companies and freight forwarders, but air movement tends to be dominated by the large express companies.

As regards express traffic, the overall EC market (including some overlap with the parcel segment) would be Ecu 16 bn (the US market is three times larger) and cross-border services would be about Ecu 1.8 bn. Of the cross-border express market originating in their countries, the postal administrations would hold only some 10%, most of the rest being carried by the four integrated private express operators (see below).

The UK express market was recently estimated at slightly over Ecu 2bn.<sup>2</sup>

### Structure of the market:

The industry consists of a very large number of mostly small local and regional operators and of a few large express carriers with significant international volumes. These account for only slightly over 15% of the total market, but for a much higher percentage of the international EC traffic. Four "integrated" express service providers with specialised air-and-ground distribution networks (including telecoms) operate on a world scale. They generally own their airlines and fleets of vans and even telecom facilities (radio channels). These companies which are also prominent on the internal transborder European market, are the following:

-DHL: of US origin, privately owned, occupies a leading position in the international air express market. "DHL Worldwide Express Network is comprised of (i) DHL International Ltd", Hong-Kong based, which serves all locations outside the US and has its worldwide coordination center in Brussels, and (ii) DHL Airways Inc. in San Francisco which covers all locations in the US. DHL Int. has about half of the Asian international express market and well over one quarter of the European cross-border market. In 1990 it restructured its capital to make room for Lufthansa, Japan Airlines and Nissho Iwai (a Japanese trading company) as minority participants. Recently these companies raised their share in DHL Int. to over one half. DHL's subsidiary, European Air Transport, is in charge of air transport.

<sup>2</sup> Source: Ibid. May 20, 1992.

Total staff is 26.000. Estimated group turnover is expected to reach some Ecu 2 bn in 1992 with some 80 mn international shipments. The European revenues for 92 are forecast at Ecu 0.8 bn (+25%). Documents are the bulk of DHL's business and the segment in which its share of the market is largest. It has been expanding into heavier services. Brussels, DHL's hub for Europe handled some 30 mn express packages in 1991.

-**Federal Express**: US based and leader on that market with a 40 % share. Total employment 87.000; turnover is close to Ecu 7 bn (1.5 in EC in 1990). Carries about 1.5 mn items a day. It specializes in small package distribution. In March 1992 the company decided largely to withdraw from domestic European delivery services and to concentrate on intercontinental connections only, between the US where the company enjoys a strong position and 16 cities of which London, Paris, Brussels, Amsterdam, Zurich and six cities in Germany. It has abandoned its hub in Brussels but keeping small administrative headquarters there.

Federal Express has sold its domestic French activities to TNT Chrono service and much of its UK business to Securicor Omega Express. Britain's largest independent carrier of overnight parcels. Securicor also became the subcontractor for Federal Express's international package business, to and from UK locations no longer served by it. Recently Federal Express took a share in PIK (Prestwick International Ltd) which manages Prestwick airport near Glasgow. It uses it as a gateway for its aircraft to Europe. Fed Express now carries less than one tenth of the European cross-border market.

-**TNT** : Australia based. Staff: 70.000. Combined turnover worldwide about Ecu 3 bn (Ecu 1bn in EC)<sup>3</sup>. European hub at Cologne. Reportedly leader in the market of parcels and heavier shipments. TNT claims to be Europe's leading operator of domestic express business with very strong operations in the UK and also a significant presence in Italy, Spain and Germany. At world level it is also ahead in remailing. In terms of European cross-border operations, TNT with its subsidiary XP has about 22% of the market.

With the Amsterdam-based grouping GD Net BV of the postal authorities of Germany, France, the Netherlands, Sweden and Canada TNT is a partner in **Global Delivery Express Worldwide** which was set up early in 1992. It constitutes a first public-private partnership in the express service sector (each side owns 50%). Open to other national post offices it allows TNT to fill up aircraft spare capacity and gives it exclusive access for two years to all postal outlets of the partners. Second largest in Europe for cross-border express after DHL. TNT is the major operator worldwide in remail.

TNT recently also became a subcontractor for Federal Express in continental Europe and several small mediterranean countries to handle inbound deliveries in a total of 10 European countries. In France TNT recently purchased Chronoservice from Federal Express.

-**UPS United Parcel Service** is with Federal Express dominant in the US market. Although the largest of the big four, Atlanta-based UPS specialises in the parcel delivery business particularly inside the US and inter alia inside Germany so that internationally it is in fact the smallest of the major operators. Reported turnover worldwide: Ecu 12 bn (EC 0.5 bn in 1990)<sup>4</sup> with an estimated 11.5 mn consignments a day in the US (0.75mn overnight and 2nd day air) and well over 0.1 mn in Europe. Its European hub is in Cologne. The last to enter Europe, at least in a broad-based way, UPS has built a pan-European network through

<sup>3</sup> Green Paper, figures for 1990

<sup>4</sup> Idem

acquisitions in all member states for a total of more than \$ 1 bn since 1987. Its share in the European cross-border market is close to 10%. Its equity is privately owned, mainly by employees.

-Sixteen of the original twenty one national post office administrations continue to cooperate and cooperate deliveries in the International Post Corporation, an Amsterdam based company. Members are the US, Canada, Australia, Japan and a number of Western European administrations. IPC operates through EMS with Cologne still serving as a hub and Unipost<sup>5</sup>. The Union Postale Universelle used to be the basis for management before the departure of five of its members. According to UPU, EMS carried 15 to 20% of the world's express traffic.

-According to the Green Paper, all the other carriers, i.e. other than the four major ones, had a turnover of some Ecu 20 bn in 1990.

Among the smaller international companies with significant activities in Europe, the following seem to be among the more important ones:

-Emery Worldwide USA, owned by the US company "Consolidated Freightways". Emery shares its transatlantic airlift with DHL and uses DHL's network for distribution in Europe.

-Jet Services Worldwide Courier (Roissy) is essentially a regional operator with focus on the French market and some links with neighbouring countries such as Spain. It tends to specialise in express freight transport for a number of industries such as clothing.

-Overseas Courier Services, is present in Brussels but main operations are in Japan (Japanese capital) and in South Korea.

-World Courier operates without a hub. It specialises in real courier i.e. with the assistance of persons actually carrying the items to destinations.

-Deutscher Kurierpost is the international (EMS) express side of the German Bundespost (internal is Deutscher Paket Dienst).

-Deutsche Paket Dienst is a joint venture which does the door-to-door delivery transport for a dozen of German trucking companies.

-Air Express International (AEI) is more in the category of freight forwarding agents with its intra-european express delivery "Pandalink". It does not cater for the large public but concentrates on a smaller number of important clients.

-Danzas is the largest one of a number of freight forwarding companies that offer on-demand controlled door-to-door delivery services, mostly for heavier goods. Ned-Lloyd (with Van Gend & Loos its "local" subsidiary operating in Belgium and the Netherlands), Billspedition and Kuhne & Nagel are also among the major operators partly engaged in this kind of dedicated delivery business.

All the above companies and joint ventures operate in competition with each other as well as with numerous regional and local express carriers and also airlines and smaller freight forwarders some of which also offer door-to-door services. Thus Sodexi SA is the express subsidiary of Air France which is setting up joint ventures abroad. BA has bought a minority stake in London-based international courier FRX and supplies wholesale air speedlinks for express companies. Ziegler and Scanspeed (a subsidiary of Billspedition) are freight forwarders which have a somewhat smaller presence in the door-to-door delivery business.

There are also providers of international wholesale courier/express services which are used by small and medium sized companies and forwarders which lack the resources to develop and support their own worldwide express delivery network. Wholesale operators offer them a possibility to compete with the majors in international coverage. Some industry giants also use such wholesalers for routes and markets when

<sup>5</sup> The partners are still renegotiating their mutual arrangements.



running their own operation is not viable or as backup. "Universal Express" is such a wholesaler with basis in France. "Scan Courier" operates principally from and to Scandinavia. Japan's Airlines' wholesale operator is "Jupiter Air". "Bridges Worldwide" operates from London.

In addition to all the companies mentioned above, there are also innumerable small parcel and express carriers which work at the local, regional or national level. In Belgium alone there would be some 250. At the EC level there are thousands of them, most employing only two or three people and together they generate large amounts of revenue. Many of the more important ones have been absorbed by the four major private carriers in recent years.

#### Employment:

In the EC private operators are substantial employers in the EC. They employ some 350.000 people while the public postal administrations have 1.35 mn staff (including 150.000 on postal financial services). The majority of the private sector is employed by the smaller operators limited to local markets. According to the Green Paper, the four major operators employ (1990) some 87.000 people in the EC, many on cross-border operations. This figure seems to be too high. At present DHL's employment in Europe totals some 10.000 people, that of Federal Express 9.200 (to be reduced to 2.600); UPS has some 10.000 employees and TNT together with GD Express 10.500 people with some 70% of this total estimated to come from TNT, the rest coming from the five postal administrations. The precise share of these staff numbers that is engaged in the international side of the services is impossible to estimate.

#### Share of service delivered internationally :

It is estimated that some 60% of all cross-border express shipments of the twelve member states are intra EC cross-border.

#### Recent market trends and prospects:

-Local express delivery service seem to correlate to a significant extent with economic activity and in several of the internal markets of the twelve, the market has recently been growing rather slowly. In stark contrast, all the main cross-border express operators, both private and public, pronounce themselves confident of strong revenue growth in the EC with growth predictions in the range of 15 to 25% p.a. The recent continued buoyancy of the international express service market indicates that this service industry is still in an ascending phase. The difficulties recently experienced in Europe, mainly but not only by Fed Express, are essentially due to an increase in delivery capacity combined with a smaller upturn in volume than had been too optimistically expected.

Express services for hard copy documents are suffering from recourse to facsimile and electronic mail but to a much smaller extent than initially expected. Original copies and lengthy documents cannot go by fax. Forecasts on the future impact of expected higher quality fax systems and the spread of electronic data interchange are very hazardous. About the only rather confident conjecture is that the average weight of transported documents will rise.

Within Europe, express parcel and package traffic is growing along with trade intensification stimulated by European integration. That segment of the market is growing faster than that of letters and documents. Less than two thirds of businesses at present make use of express services thus leaving plenty of scope for expansion. Positive economic developments in Eastern Europe could further raise growth rates.

The negative impact on express delivery suppliers of easier road transport within the EC and the European Economic Area which may substitute for

air transport is hard to assess. Anyhow, new major entrants in the international side of the business are hardly expected as the capital requirements to set up the required infrastructure have become enormous.

In addition, increased recourse to just-in-time logistics systems and growing sophistication of modern economies call for more frequent and speedier distribution. Express companies initially specialised in a set menu of fast, door-to-door delivery services, are now developing efforts to provide custom-designed services such as stock-keeping and warehousing geared to meet the often complex requirements of modern logistics operations. DHL among others has created a special interface team to work out customized formulas with interested leading customers.

Value and volume indices:

There do not seem to be such indices at present, at least not in Europe.

### Other Information

Type of market:

There is intense competition in the EC market, not only air-based as within the US, but also ground-based. In addition to the traditional express delivery firms, airlines, freight forwarders and post offices have been fighting for the door-to-door delivery market. Large, well established firms have an advantage because of notoriety. The heavy logistics required for building up a network for transnational service makes it difficult for newcomers to start from scratch. Prospects for the market are : fierce competition between the major operators, the national post offices and world airlines and forwarders; further room for smaller operators specialising in particular market segments where they can provide high levels of service.

Market determinants:

*on the demand side:*

-the main clients of express services are businesses, both commercial and industrial. They are not related to the express delivery providers. Household demand is limited to letters and small parcels. Some 300 large companies in Europe are the main clients of the four integrated operators. Each of these clients can bring annual earnings of up to Ecu 1 mn a year. TNT considers that 90% of its customers base is corporate (mostly multinational), while some 80% of the post office's business would come from over the counter. (Only 20% of the services supplied by post offices is from and to private individuals, the rest is related to business as recently confirmed by the German post office).

-other factors stimulating the demand are (i) production/manufacturing changes (i.e. the division of labour with rising specialisation and sophistication of modern economies); (ii) the move from production-for-stock to production-on-order; (iii) the advantage of a single transport partner (one-stop-shopping) which relieves the sender from much hassle. It is a form of outsourcing.

*on the supply side:*

-there are few regulatory barriers. This explains the high number of new entrants in the local and regional courier market with a corresponding high number of dropouts. Acquisitions and cooperation agreements in many forms are frequent, but there are rather few mergers. At the transborder level the number of express delivery operators has diminished and the four remaining large ones have been investing

heavily, not only in transport but also in telecom and tracking equipment. They occasionally cooperate and make joint use of certain facilities. Thus TNT has an agreement with Federal Express to co-load express freight on the latter's daily transatlantic flights. DHL has similar agreements, for instance with Emery. For the large operators the "outsiders" are the postal administrations, the airlines, and the freight forwarders.

The public post administrations benefit from their access to the infrastructure of postal networks which in this respect puts them in an advantageous cost position for all their activities.

Airlines are a rising source of competition in the cross-border express services as the following examples show. In Asia, Cathay's affiliated Linchaul Express offers on-board courier service on key routes such as London/Hong-Kong including tracking/tracing, clearance and delivery to the door. Singapore Airlines has similar operations. Swissair which had developed "Skyracer", a door-to-door service with fellow carriers Crossair and Austrian Airlines terminated this service in June 92. Lufthansa and Japan Air Lines have adopted a different approach and decided to invest in courier specialist DHL. It appears that in the US the two airlines use DHL aircraft during daytime to carry their freight. Most other airlines are concentrating on developing wholesale express services for freight forwarders as well as for interested express companies rather than seeking to build retail door-to-door services. This has been the case with British Airways with its Speedbird airport-to-airport services for forwarders and express companies.

As regards express delivery operations of freight forwarders there is for example the Eurapid system run by Swiss-based Danzas. It is road based, covers the European Economic Area and guarantees 24/48/72 hours delivery. The Scandinavian ASG forwarding group provides a similar road and ship based service throughout continental Europe and Scandinavia. Forwarders also tend to make increasing use of information technology systems and they have great flexibility when it comes to handling larger consignments.

#### Price determinants:

Cost, both fixed and variable, is the starting basis. Distance plays a role but pick-up costs at departure and delivery costs at destination are relatively more important factors. Well managed operators constantly update their cost price calculations for each connection to adapt to changing input costs. In the worldwide networks of express carriers, local costs are normally calculated at the regional unit level and integrated with other costs in accordance with directives from the headquarters that take account of competitive conditions and other expense and profit factors. Like all transport activities, the aim is to maximize utilisation of the available two-way transport chain, with high fixed costs but low variable costs for the marginal shipment. With major carriers such as Fed Express until its recent partial departure from the European market, attempting to increase their presence on the European market, competition at the cross-border West-European level has been severe with hefty discounts being granted to retain large customers and gain market share.

Prices actually charged for express services mainly reflect competitive conditions. Prices are not identical for both directions of a given journey. For example a package sent out of Brussels or London to the capital of another member state can be up to double the price for the reverse connection. Prices of the services of EMS which benefits from the support of the postal monopolies tend to be lower than those of private operators. Well over half of the cost structure of the major express delivery service providers seems to consist of expenditure on personnel. Transport

equipment, computers, office accommodation and advertising are the other main cost sources.

Examples of basic prices on which discounts can be obtained for volume both from private operators and from EMS (but less so) :

In Ecu from Brussels to :

		a letter of 500gr	a parcel of 5 Kg
New York:	Fed Express	38	96
	EMS	24	59
Tokyo	Fed Express	44	144
	EMS	31	130
Sidney	Fed Express	44	144
	EMS	36	178

Source: La Libre Belgique, 13.6.92

Role of the public authorities:

Regulations applying to the national postal authorities of the twelve member states and, even more so, those in force abroad have a considerable impact on express services. In addition, divergencies between these, mostly restrictive, regulations abound. The regulations determine the degree to which member states reserve to their postal administrations' monopoly, printed paper and some or all express services (e.g. Spain, Portugal and Ireland). Regulations for instance define the range of the monopoly in terms of maximum limits of letters and cards. In Britain the post office has a monopoly determined by price: letters and cards delivered for less than £1 (Ecu 1.45). In the Netherlands the upper limit is set by weight: 500 grammes combined with a price limit of Ecu 3.60. In other countries, the monopoly extends to letters/documents up to one kg [Germany with a price limit) and Denmark] or two kg (the rest). In most member states (except the UK and the Netherlands), the sending of cross-border letters is reserved for the postal administrations but enforcement is not very effective.

In the EC, the Single market is calling for a degree of harmonisation and in particular, some common definitions of the range of courier (weight, price, and speed) that member states would be allowed to reserve to their postal monopolies. The rest, including delivery of international mail would be opened up to competition. Elements for discussion to prepare proposals to this effect are contained in the EC Commission's "Green Paper" mentioned before. Ideally action by the EC Council should be taken by the end of 1992. In the meantime however, and following initiatives by the EC Commission and sometimes rulings by the European Court, parts of express services previously considered to be part of the postal administration reserved area, have been moved to the non-reserved area in Belgium, Denmark, France, Germany and Italy. Further similar actions are proceeding.

Customs also play a role in courier services. For instance, documents and parcels below certain weights and sizes can be sent through the post without customs charges but the thresholds differ from post to post. Diskettes with information are considered information and not dutiable, whereas empty diskettes are classified as parcels etc.

Types of supra-national relations between firms:

The integrated carriers aim for total ownership of their express transport chain as it is a sales argument with their clients of reliability of door-to-door control. Direct 100% subsidiaries, or where this is not allowed, the highest possible level of ownership or control in joint ventures or agency arrangements is the objective. There are exceptions such as the joint

venture GD-Net between TNT and five post authorities in western Europe. Networking and cooperation agreements are the feature of the middle sized express carriers. TNT Express Worldwide provides Federal Express with sub-contractor services for Europe-bound delivery from the US to 10 continental European countries and several Mediterranean ones.

## Statistical issues

### The various nomenclatures

•The draft CPA<sup>6</sup> nomenclature of the EC, classifies "Courier services other than national post services" under heading 64.12. This item is a subsection of "Post and courier services" (64.1) itself coming under "Post and telecommunications services" (64).

•NACE rev1 the activity nomenclature of the EC follows a similar classification structure. Both the CPA and the NACE classifications are geared more to domestic than international transactions.

•The proposed joint OECD-Eurostat classification for trade in services follows the same approach. Its structure is set out below:

- " 3. Communications
- " 3.1 Postal and courier services
- " 3.1.1 Postal services
- " 3.1.2 Courier services
- " 3.2 Telecommunications services.

Explanatory notes to this draft nomenclature indicate that postal services relate to services rendered by the national postal administration and encompass the pick-up, transport and delivery services of letters, newspapers, journals, periodicals, brochures, leaflets and similar printed matters, and of parcels and packages..... The commentary notes that postal services are subject to international agreements and give rise to compensation between operators of different countries, but that transactions should be recorded on a gross basis. For courier services it is stated that they cover the same pick-up and other services as described above, but that they are provided by other operators using either self-owned or public transport media. It can be presumed that reporting on a gross basis is expected.

### Classification issues

#### *Definition of operators:*

All the above nomenclatures use the word "courier" and only consider services provided by non-national postal administrations i.e. by other (i.e. private) operators using either self-owned or only partly or occasionally public transport media. Many problems arise:

-where to draw the line between dedicated (exclusive) express service operators and e.g. airlines and freight forwarders many of which also handle door-to-door express transport? If such activities were to come within the definition of express carrier, how to avoid for instance double counting with air cargo transport by these airlines and multimodal freight forwarders? What to do with TNT-GD (Nct) which is a joint venture with a 50% postal administration share?

-could constant monitoring (i.e. controlled door-to-door by electronic tracking and tracing methods) be one distinctive element? Time reliable/time predictable time/definite delivery are other notions characteristic of real express delivery service. It means a predetermined time of arrival at destination which the client is entitled to expect. The door-to-door services of some airlines and forwarders also respond to these characteristics.

-if the description were to cover only "companies whose unique activity is express service" the data would be incomplete. But to cover all that do

<sup>6</sup> CPA (draft 0.6 of Dec 91) is a classification of products (including services) by activity derived from the central product classification (CPC) of the UN.

offer such services, even only among traditional transport services, would raise insuperable difficulties of identification and collection. Alternatively only operators dedicated to express delivery services as defined and in practice only the large ones with plenty of (cross-border) activity could be retained as respondents for more detailed statistics.

#### *Definition of activities.*

-despite its somewhat romantic connotation, express delivery carriers do not like the term "courier" which they tend to consider antiquated. In the real world, only a few small operators still actually use "couriers" who carry the consignments with them. Some express operators also prefer not to be associated, even if only in a nomenclature, with post or communication.

-increasingly heavier freight is being sent by express delivery carriers. Door-to-door delivery goes up to 100 kg and beyond. This tends to blur the traditional distinction between mail/parcels and cargo.

-there are difficulties of distinguishing within the activities of door-to-door express service providers, the express delivery activity from the new types of activities such as warehousing and inventory management on behalf of manufacturers at or near the hubs of express service providers. At this stage this kind of warehousing/distribution function of the major operators can no longer be ignored even if the major part of their services is still express delivery.

-where to classify "re-mailing"? This is not really "express" service but rather a plain "cost effective transport service" which private operators including airlines such as KLM provide in cooperation or competition with national post offices. In re-mailing there is no door-to-door service nor is it time-definite. It should therefore not be recorded with statistics on express delivery services and anyhow it does not seem to represent a large share of any of the express operators' activities. (But including that traffic in the service activity of post offices would overstate their importance and could lead to double counting).

#### *Tentative conclusions:*

-the view of the European Express Organization seems to be that express services of the kind described in this paper are probably better classified somehow as "dedicated transport services" together with, or close to, transport activities such as multimodal transport and not as "communications services" next to the post or as "business services". In the transport nomenclature there are probably classification issues with "multimodal transport". Express delivery could be subject to the same statistical treatment. It seems for instance that in France, for the purpose balance of payments statistics, only the first mode of transport (for outflow) and the last (for inflow) determine the classification of the mode of transport of the whole journey.

-define operators as service providers which not only ensure transport, mostly express (overnight), but also collect on-demand, sort, consolidate, track and trace, clear through customs and ensure final time-definite delivery to the addressee.

-establish categories of "items". Examine possibility of distinction between non-declarable and dutiable as presently done by customs. For parcels, the normal maximum weight for the major carriers are as follows:

DHL : 50kg.

Fed. Express: 70 kg.

UPS about 31.5 kg.

EMS : 20 or 30 kg (dependent on country of departure or destination)

Could one on that basis envisage: (i) up to one half kg. to cover mail, documents and very small parcels; (ii) a class from 0.5 kg to a range of 30-35 kg which would correspond to what can be handled easily by a person and by the sorting equipment of the integrated express delivery providers. It would be understood that notifying entities would be free to

choose their own cut-off figure within a narrow upper bracket; and (iii) all items above that weight range.

#### Production of statistical data:

##### *Gathering of data:*

-Collection of data cannot be obtained on the basis of voluntary collaboration. That is the definite view of several operators after a number of unsuccessful attempts.

-The choice for public authorities is either to impose on the private sector the periodic supply of information or to limit the collection to that what "crosses borders". In the case of the EC's external borders, the customs are data collectors for this "non-invisible" service trade. They collect data on both declarable (dutiabale in principle) and non-dutiabale consignements and record the names of the companies involved. The standard administrative document mentions the nature of the consignment, value for customs duty purposes and normally also for VAT purposes. These values include the cost of the transport from port of departure to point of destination, the latter two also being indicated<sup>7</sup>. A similar document is used for exports out of the EC. All this data can be processed through EDI which is an essential tool for the express industry to accelerate release and clearance of shipments through customs.

-With respect to intra-EC border traffic, VAT administration might until 1997 when the taxation at the point of origin might become the rule, be a point of collection of at least some data on the value of the service on which the VAT is levied but it will not produce as much information as above.

-For any other data on the domestic activity of the service industry, the obligation to report at EC level to Eurostat could be imposed on all operators or at least on the major ones on a periodic basis, for instance every two years. The necessary legal guarantees by Eurostat of secrecy of individual company data, not only vis-à-vis the public but also with respect to the other parts of the EC administration, would have to be ensured.

-If the EC, as expected, comes to a definition of mail/courier reserved for the postal authorities, all that is handled by such public operators in the so defined sector could perhaps be classified and reported separately and thus improve upon the homogeneity of data under the present item in the nomenclature reserved for the public postal services. Figures reporting the other express delivery activities of the postal administrations i.e. the non-reserved ones, could be recorded separately and depending on the nature of the consignment or mode of transport, classified either under the postal administration heading or under that of the private sector somehow with multimodal transport.

##### *Nature of the data (both internal and external)*

-the number of items shipped is a basic data. This could be split up in letters/documents (non-dutiabale) on the one hand and parcels/packages (dutiabale items?) on the other.

-categorisation by weight and distance travelled is not impossible but except for what is available at cross-border point, it would involve an administrative burden for the respondents. Calculation of average weight of items shipped in each of the two categories is theoretically possible but certain companies specialise in heavier packages while others focus on

<sup>7</sup> It appears that when incoming consignments are not brought for combined customs and VAT settlement purposes, some of the information mentioned is not available.



lighter ones. Some take on maximum weights which vary according to destination.

- to obtain an indication of the turnover of the service, income of operators (published in their accounts) might be used. But not all publish as much information since for example DHL and UPS are not publicly quoted companies. Moreover their income proceeds from various service activities (such as remail or warehousing logistics) which are not all express delivery services and from operations at world level and not EC related ones only.

- to give a correct picture in balance of trade and balance of payments statistics, express services should be recorded on a gross basis (i.e. exports separately from imports) even if in fact operators may not make such a distinction in their internal accounts. While it is not known whether there are significant differences between the inward and outward flows of the EC's express delivery services and in their composition (there is a greater inflow than outflow of mail), it is easy to ascertain that there are differences in prices charged for the same connections, depending on the direction of the flow.

- to complete the economic picture on "trade in express delivery services" the possibility of assessing worldwide sales of such services by foreign affiliates of EC majority-owned companies (there do not seem to be many) may have to be explored. And the same with worldwide sales by affiliates in the EC of foreign-owned companies of which there are several. But the definition of foreign-owned is tricky as two of the four largest operators are not publicly-owned and -quoted companies and the ownership of many others may not be traceable.

#### *Choice of index:*

- a volume index could perhaps be based on the number of items forwarded, with letters and documents (all printed material) distinguished from parcels and freight (dutiable items)? Evolution of staff numbers would be an interesting element and not too difficult to define and collect.

- turnover seems much more problematical in terms of gathering of significant data.

- for documents, value of service rendered could possibly be estimated on the basis of average weight of letters/documents (see above weight classification)? and in terms of distance (subdivided into categories)?

(draft)

## RESEARCH PAPER

## Legal Services

## Service activity description

## Definition

The legal services industry, in the broad sense of the term, consists of firms and individuals in practice as law professionals, providing various kinds of legal services to clients, both individual and corporate, in public and private life. A distinction is usually made between judicial activities i.e. those directly involving the functioning of the judicial system (court proceedings, etc), normally reserved to members of the bar, activities closely regulated by the public authorities such as trust and estate work, and non-judicial activities with legal content of lawyers, legal counsels, law professionals specialised in business matters etc. The judicial activities proper, especially the right to plead, are the most typical and the most regulated part of the work of lawyers. Legal advice and assistance form the core of the other legal services provided by lawyers. However in most countries other professionals such as accountants, fiscal advisors, patent agents, accountants also supply such advisory services. The relative importance of these three categories of activities varies from country to country. On the whole, however, only very few issues of all those taken up by lawyers end up in court litigation. Lawyer specialising in pleading in court are few as compared to others. In England and Wales where the two activities are distinct, there are only about 7000 barristers practising independently as against 51.000 solicitors in private practice (Some solicitors do plead in narrowly defined cases). All lawyers are expected by their code of conduct to stand up to the same principles of independence and integrity. Indeed their task is to help their clients to shape their proposed actions and transactions in the best possible way in terms of laws and regulations and make them enforceable if necessary.

Across the EC, the legal profession is organised by law at the national or regional level. In parallel, elements of Community law and common legal institutions are gradually being put into place. Several types of legal services are reserved to special branches of the legal professions although such classifications still differs largely between member states. Most continental states divide legal work between advocates and notaries, who handle transfer of property and succession on death. Pleading before tribunals is normally reserved to specific categories of lawyers and there are also many partial monopolies for lawyers in respect of notarial activities. Where separate law professions exist they are very often required to maintain strict separation from each other (no partnerships or no joint practices). Only in Denmark are lawyers permitted to engage in all activities.

Legal advice is reserved to members of the legal profession in some member states (Greece, Luxembourg, Spain and more recently, France). In others (Belgium, Denmark, Ireland, Italy, the Netherlands and the UK) there is no monopoly on the giving of such advice. Other occupational groups, whether within the liberal professions like accountants, or outside, such as bankers and real estate agents, are also increasingly offering legal services in relation to economic activities. The competition of such outsiders has lately been intensifying.

In all member states except Spain, to practice as a lawyer i.e. as an avocat, rechtsanwalt, solicitor, barrister, it is necessary to qualify and register and be a member of specific professional bodies (bar or law society). Such registrations or licences cover a variety of activities or functions. Only in Spain does graduation entail right to register. Professional organisations operate at the national level in all member states except France and Spain and in some ways in Greece and Italy. However, in many states they function at different degrees of decentralisation. For instance in Germany there is the Bundesrechts-anwaltammer, a federal regulatory body, with compulsory registration and the head office in Bonn in addition to offices in each Land. In France all avocats (including legal advisers) are under the jurisdiction of the local Bar and these are grouped in a Federation presided over by the French bâtonnier, the president of the Paris Bar. In the UK there are three regions: England and Wales, Scotland and Northern Ireland.

Lawyers' services are provided either by self-employed single professionals, by lawyers employed in-house by companies, by professionals with associates or by various other kinds of groupings of professionals (see section below on the structure of the market). In-house use of lawyers is on the rise.

Most lawyers are in general practice and serve private clients or local companies. Their tasks can be divided into litigation, counselling and lobbying. Many specialise. The specialisation may be:

- in a particular legal field such as libel, patent, criminal law, social law, human rights, matrimonial and family matters, tax (e.g. tax planning or pension plan), etc.
- or in particular business law sectors, for instance maritime transport, insurance, real estate (e.g. commercial property), travel (e.g. for tour operators), domestic commerce (distribution) laws.

Law firms also engage in monitoring of the activities of public authorities and in lobbying on behalf of their clients (e.g. in Brussels of EC activities).

In the international context, lawyers specialise in trade law (e.g. antidumping), shipping and air transport disputes, competition and anti-trust matters, mergers & acquisitions, international tax advice, company flotation and related advice, commodities, international arbitration such as in construction disputes etc.

Multidisciplinary practices comprising practising lawyers and other professions such as engineers and accountants are only allowed subject to conditions in Germany and the Netherlands (not accountants) and may soon be in Ireland where a Committee is looking into this possibility.

### Professional characteristics and regulations

The law profession requires intensive training and high skills. To be proficient lawyers must acquire a large body of country- and sector-specific knowledge. In order to keep on top, modern large law firms need substantial funding not only in premises but also in information technology, legal books, training and foreign offices or in tie-ups with other, mostly foreign, practices. Most try to obtain all these necessary support services and information without substantial external outlays. Accordingly most partners invest part of their profits back in their firm. Statistics on profits per partner can therefore not be taken as figures on home-pay.

Of all regulated professions, that of lawyers and legal services in general presents the most complex situation. Access to, and practice of, the legal profession are highly regulated in all countries. Professional qualifications requirements are precisely defined as are also the different professional activities reserved for a variety of specialised professionals. In France for example it is now a criminal offence for a non-avocat to give legal advice of

any sort.<sup>1</sup> Complex regulations also govern the establishment of law firms, both domestic and foreign, and associations between the latter and local lawyers. The right temporarily to provide legal services in other member states was introduced by a 1977 EC Directive (see next section). Limited liability partnerships are only allowed in Belgium, the Netherlands and Luxembourg. Belgian law permits foreign lawyers to enter into partnerships with members of the Brussels Bar provided that at least one member of the practice has been registered on that Bar. Registration by foreign lawyers requires inter alia a commitment not to practice Belgian law.

A "foreign lawyer" is a lawyer practising in a jurisdiction other than the one in which accreditation is held. Usually his practice is more limited in the services it may provide than a locally accredited lawyer's practice. Outside the EC, the degree of openness to foreign lawyers of various countries is far from even. The issues revolve around conditions of professional qualifications, citizenship, residency, licensing/registration, partnership, use of foreign firm name etc. Some countries allow foreigners to give advice on so-called international business law, their home country law and local law; others, restrict their practice to international business law and home country law. Some countries (e.g. Japan) allow legal advisers of foreign countries to establish but then do not allow their offices to recruit fully accredited members of the local bar (bengoshis), making it impossible for them to provide full legal assistance to local clients.

Most EC countries have become relatively liberal in the way they allow foreigners to carry out non-litigation work and on the scope of laws about which foreigners may advise. In some southern member states establishment of foreign lawyers does take place even if formally not allowed. Luxembourg restrains access for non-EC lawyers. An agreement between Portugal and Brazil which provides for mutual recognition of both legal qualifications and nationality is causing anxiety on the possible influx of Brazilian lawyers via Portugal into other member states. In the US the situation varies from state to state with only eleven of the fifty states not being restrictive. Mutual recognition of professional qualifications through bilateral or plurilateral agreements to facilitate movement of lawyers has so far made little progress between nations.

#### EC harmonisation

There has been progress towards the Single market in legal services, but much remains to be done to ensure complete opening. With the EC Lawyers' Services Directive of March 27, 1977 lawyers in the EC obtained the right temporarily to provide legal services everywhere in the Community while respecting the national regulations. Under this directive a "lawyer" (avocat, rechtsananwalt, solicitor, barrister) from one member state is allowed, on an occasional basis, and without establishment in the host country, to provide legal services and do advocacy work in the courts of the host member state subject to any local rules requiring him or her to work with a local lawyer who has the right to appear as an advocate before the court concerned. The Directive of December 21, 1988 concerning mutual recognition of higher education diplomas allows professionals qualified in one member state to practice in other states and become full members of the relevant bar association subject only to minimum qualifying conditions like passing an aptitude test or undertaking a period of supervised practice so as to satisfy any deficiency in knowledge. Only half of the twelve countries have so far introduced national legislation to give effect to the Directive. Member states remain free to regulate access of lawyers from third countries independently,

<sup>1</sup> Except notaries, in-house lawyers and to some extent accountants.

the directive being applicable only to EC citizens. Thus, partnerships between EC partners are allowed but rules about partnerships with non-EC lawyers differ (allowed only in the Netherlands and more recently in Germany and for solicitors in England and Wales).

What is still not settled in the EC context is home title establishment i.e. the regime for practise by lawyers of one member state from an office in another member state under his home title, this being in fact the most important modern form of transborder legal activity. In practice the establishment of such offices is already possible where the law and practice of the host state does not effectively reserve all forms of legal practice to its own national profession (legal or other). Spain, Portugal, Greece and recently France and Luxembourg are countries with such wide monopolies. But in Spain, Portugal and Greece there are in fact practices of foreign lawyers and in France those present when the new statute came into force were authorized to stay. Even in member states where legal advice is not subject to monopoly, there are areas of work reserved to local lawyers (pleading in court, notaries etc).

The Council of the Bars and Law Societies of Europe (CCBE)<sup>2</sup> is the professional organisation representing the Bars and Law Societies of the EC. The CCBE has produced a Code of Professional Conduct (deontology) designed primarily to govern worldwide the cross-border activities of lawyers. Broadly stated its object is to protect users of legal services. It has also made considerable progress with proposals for an EC directive which would settle issues of recognition of qualification, titles and home country registration thus contributing decisively to the achievement of the Single market in this sector.

#### Practical means of delivering legal services

Most legal services are delivered at the local level. Pure cross-border provision of legal services, for example through a report, telephone conversation, facsimile, computer to computer transfer of information or similar means is commonly used for legal counselling. Movement of the provider or of the consumer for face to face conversation, when it takes place is mostly in conjunction with the above communication means, not in substitution to them. In law service even more than in many other professional services, the client must in fact to some extent himself participate in the production of the service. Much of the process is embedded in the direct relationship between the clients and the lawyer. Often also pure cross-border trade is not possible simply for regulatory reasons: foreign lawyers are forbidden to serve local clients unless they have gained local qualifications and often even residency. Cross-border referral of a client to another law practice abroad was, and still often is, the classical way of responding to his need for legal services abroad.

In today's world, the dominant form of transborder interchange of legal services is by establishment of branch offices abroad or association or networking with foreign legal practitioners, most being of a non-exclusive kind (see below section on structure of the market). Large firms with offices in several cities are organised to the point that they have a ready pool of lawyers who can float from one office to another in the event of a large transaction. For instance teams for important capital markets transactions will tend to be staffed by London-based lawyers. If the London office comes up against a specialized area which it lacks the resources to handle, the matter may be referred to Paris or Brussels where the expertise may be on hand.

Many large legal firms are equipped with integrated information technology systems and computer networks to help sharing out their legal specialists in

<sup>2</sup> Formerly the "Conseil Consultatif des Barreaux Européens". The CCBE has also a number of observer delegations (mainly EFTA countries) and Czechoslovakia with consultative status.

the most efficient way to do work at different sites. They use it between their units within the home country and for communication with their foreign subsidiaries or partners. They also make use of data-bases on court case materials that are available commercially on world markets.

#### Legal practices' structures for trading

Law practices interested in giving advice on the legal aspects of foreign or cross-frontier transactions usually do so with two main kinds of practical services in mind: first, to help home country clients involved in business transactions in a foreign country. This service is provided by foreign locally recruited lawyers or in association with foreign local law firms; and second, to provide foreign clients with advice on the law firm's home country and international law.

There are several ways for a firm to organise itself to supply such "foreign" services. A first way is to set up a full fledged office abroad. This is expensive, can lead to professional complications, but it is the route followed particularly when demanded by local clients intending to use the new foreign located service. The philosophy behind this approach is to provide consistency of service and quality of practice through a distinctive one-firm concept. When possible, the single firm approach may be the most effective. A second way is by forming a permanent and exclusive (personalised) link with one or more law firms in other centres while partners keep their independence. The principal aim of such link is to be able to offer the client an effective and integrated service on work involving two or more jurisdictions (including in particular cross-border work). Separate firms working together often remain hampered by the inevitable cultural and organisational barriers. The main drawback of this kind of alliance is that once such a close association is made it tends to be exclusive of the maintenance of contacts with other firms in the same place. It thus often leads to the loss of referrals. Imbalances in reciprocal flows of referred work often become a problem.

Recourse to various forms of networking is the most frequent way for operating abroad. This can be very informal, a loose "association" or "affiliation" of autonomous members with no structure or pooled resources, which participating firms use primarily to exchange ideas and information and possibly to refer work to each other. They may be working together ad hoc on particular cases without continuous arrangements. Or at a more formal stage it can involve some kind of coordination of activities (periodic meetings), or even some sharing of facilities (premises, training) and the publicizing of the association. In that case members usually pay overheads on a prorata basis, informal quality assurance practices are introduced and the relationship is seen in the market as an association of firms<sup>3</sup>. If such arrangements are successful there is often a push by some members to increase integration to serve the clients' needs more efficiently. At the highest networking stage, short of reaching full integration, the grouping can be a federation, i.e. a formally organised association with constitution and membership obligations. This seems to be the approach of Baker McKenzie with its formula of associated offices. The international organisation has its own resources, a strategic direction, quality assurance procedures, a structure of committees periodically meeting at world and regional levels etc. Members give up a degree of autonomy, but the profits of member firms are not internationally pooled. Beyond this stage is the full multinational partnership or incorporated practice, i.e. the most integrated way for operating multilaterally. Local autonomy is abolished and firms operate as profit centres within one

<sup>3</sup> See the annex for two examples of groupings.

organisation. Profit pooling occurs worldwide and partners receive a distribution based on global performance. The worldwide strategy and policy of the firm varies only to suit local conditions. Resources are viewed globally and common approaches to management and clients is built up. Clifford Chance, the largest London law firm, seems to be following this line. It is intent on becoming a true international firm mainly through organic growth from the home base while retaining a partnership status where all offices are directed as part of the whole.

Such multinational partnerships of lawyers based on income sharing between lawyers not accredited in the same jurisdiction are not allowed in all countries. The UK and Hong-Kong and some other countries are moving towards allowing lawyers to share income in such multinational partnerships.

The EC for its part has no specific legislation for the legal profession but some forms of association have had recourse to the European Economic Interest Grouping (EEIG), a legal statute of incorporation introduced in 1989. The EEIG is only used as a supporting vehicle for forms of cooperation between separate firms and can for example include joint marketing in those countries where this is permitted. It has corporate identity but retains individuality of members. The main characteristic is that the activities of a EEIG must be ancillary to the principal activities of the members and that it cannot itself carry out such principal activities like e.g. the processing of clients' work.

#### Structure of the market<sup>4</sup>

In recent years the European legal profession has been growing and evolving fast. This is a result of the increasing complexity characteristic of advanced modern societies which call for ever more legal services. It is also related to continued integration of markets and the mobility of individuals and undertakings. The run up to the Single market, and the opening up of Eastern Europe are additional, specifically European factors. More generally, businesses expanding internationally often prefer to deal with the same legal firm as far as possible on a global basis.

It is partly in response to all these factors that plenty of regrouping and reshuffling has been taking place in the legal service industry of the EC which is otherwise still characterized by the permanence, particularly on the European continent, of single lawyers or small firms practising on a local and individual basis, and with a strong professional as opposed to managerial orientation. The smaller firms have traditionally relied more on cooperation with other practices than on expanding their own establishments. This rather atomistic structure is the result of tradition but partly also due to regulatory limitations in size of firms and earlier rules of confinement. The description hereafter is naturally devoted to the larger firms but they are not typical of the market. Big firms remain the exception even if there are scores of firms with 100 lawyers in the world (only a handful have more than 1000). But they are the most prestigious and the best paying.

For instance until 1989 German law firms were not allowed to merge with firms from other cities or to open offices abroad and until 1990 foreign lawyers were not allowed to establish. In a number of member states such as the Netherlands, Germany, Italy and Spain the legal profession has lately gone through a phase of domestic mergers.

<sup>4</sup> See table next page

Large Law Firms in the EC  
in terms of numbers of lawyers<sup>5</sup>

Source: Legal Business Magazine, April 1992

Firm	Nb of Lawyers home country
Belgium	
•De Bandt, Van Hecke & Lagae	100
•Loeff, Claeys Verbeke (merged with Dutch firm)	85
Liedekerke, Wolters, Fitzpatrick	80
•Stibbe & Simont (merged Dutch firm)	80
De Caluwé, Putzeys, t'Kint, van Frayenhoven	60
Denmark	
Kromann & Münter	70
France	
Fidal	760
•Gide, Loyrette, Nouel	205
Bureau Francis Levebvre	125
•Jeantet & Associés	113
•Clifford Chance	87
•Coudert Frères	60
Germany	
•Bruckhaus, Westrick, Stegemann	112
Pünder, Volhard, Weber & Axster	96
Boden, Oppenhoff, Rasor, Raue	84
Wessing, Berenberg-Gossler, Zimmerman	80
Gleiss, Lutz, Hootz, Hirsch & Partners	75
Droste, Killius, Triebel	72
Rädler, Raupach, Bezzenberger	62
Schön, Nolte, Finkelnburg & Clemm	62
Haarmann, Hemmelrath & Partner	60
Ireland	
•A & I. Goodbody	85
•McCann Fitzgerald	73
Italy	
Carnelutti	43
Greece	
Vgenopoulos & Partners	28
Luxembourg	
Loesch & Wolter	15
Netherlands	
•Nauta Dutilh	270
•Trenité Van Doorne	242
•De Brauw, Blackstone, Westbroek	214
•Loeff, Claeys, Verbeke(see Belgium)	165
•DSH Derks • Star Busmann	130
•Stibbe & Simont (see Belgium)	90
Houthoff	80
•Caron & Stevens (Baker & McKenzie)	75
Boekel de Née	64

<sup>5</sup> Except for the UK, the table lists legal firms with 60 lawyers (fee earners) and more as at 1.1.92. For each member state at least the practice with the largest number of lawyers is listed. The sign "•" indicates that the firm is significantly engaged internationally.



Portugal	
Am Pereira, Saragga Leal, Oliveira Martins, Judice, Torres & Associados	42
Spain	
Iberlora	164
•Bufete, Cuatrecasas	165
•J & A Garrigues	80
Gomez-Acebo & Pombo	70
•Uria & Menendez	62
United Kingdom <sup>6</sup>	
•Clifford Chance	921
•Linklaters and Paine	570
•Freshfields	449
•Slaughter and May	401
•Lovell White Durant	390
•Allen & Overy	369
•Norton Rose	334
•Simmons & Simmons	326
•Herbert Smith	306
•Denton Hall Burgin & Warrens	279
•Nabarro Nathanson	239
•Cameron Markby Hewitt	219
•Richards Butler	204
•Mc Kenna & Co	197
•Stephenson Harwood	195
•Wilde Sapte	180
•Clyde & Co	173
•Theodore Goddard	169
•Frere Cholmeley	160
•Ashurst Morris Crisp	156
•Baker McKenzie	110*

\*Baker McKenzie is added (figure of UK personnel only).

<sup>6</sup> Due to the absence of data on domestic staff only and because of the special characteristics of its legal service industry, for the UK the table lists the twenty largest firms in terms of numbers of partners and assistants at worldwide level.

In the UK where there is no limitation to the right to practise law (except in a few activities such as litigation and advocacy in courts and notarial activities), many solicitor firms and chambers of barristers based in London have over the last decade grown substantially, by merger or organically. The solicitors' branch of the British legal service sector like its American counterpart has been driven more by business dynamics much earlier than elsewhere in the EC. Foreign lawyers have been free to engage in a wide range of legal advisory work. The largest solicitors' firms, about half a dozen, have now more than 500 lawyers. They are very active in international legal practice with offices in all the major financial and trade centres. More than one thousand foreign lawyers practice in London which is the venue of about well over 50 US law firms. Services to the City of London have been crucial to this growth.

In France only a few large law firms have emerged, mainly in Paris. The main one, Fidal (KPMG's legal and tax division), has offices throughout the country and is the largest supplier of legal services of the EC on the continent. Next to a small number of very large clients (several multinationals), Fidal serves a vast French clientele through its 130 office all over the country. For Fidal 39% of the work is reported to be related to tax work, the rest 61% being legal work proper<sup>7</sup>. Although not very active in legal services outside so far, because of its open access policy until 1991 France is host to a considerable number of foreign lawyers. Some 20 English solicitors' firms and about half as many from the US are established in Paris. One of the expected consequences of the recent reforms is that more French firms will grow to a size that allows them to challenge foreign firms.

In Germany<sup>8</sup> until a few years ago, roughly nine tenths of legal services were provided by firms comprising one to three lawyers. Large German corporations have traditionally relied on large in-house legal departments. For example Deutsche Bank's in-house legal services handle all legal matters with very few exceptions. In 1990 foreign lawyers were allowed to practise their own law. As a result, international law existing German businesses expanded rapidly and foreign firms flowed in. A few (Sozialitäten) now comprise more than 100 professionals spread over several business centers but none has yet reached the size of the large British (and Dutch) firms. Stimulated by the reunification and the prospects in Eastern Europe, practise abroad has only recently started.

In the Netherlands several mergers have expanded the number of firms having more than two hundred lawyers. They practise internationally and are of a sufficient size and strength to compete abroad. These firms, with offices in London, Paris, New York, Brussels, are the major exporters of legal services in the EC after the British firms.

By contrast with its northern neighbour, Belgian lawyers have not been active outside Belgium but as the de facto capital of the EC, Brussels has attracted many foreign lawyers. Some 150 foreign law firms, 70 of them American or British are now present.

In Italy a few large firms have begun to emerge in Rome and Milan. These are also the cities where a few foreign lawyers have established. Italy is still small in international practice. Ireland's law service industry has doubled in size during the last five years. Local firms have become increasingly international in their outlook and expect to obtain increasing work from the new financial centre in Dublin and from abroad, inter alia from the establishment of captive insurance companies.

It is estimated that in the Community there are now tens of thousands of link-ups of one kind or another between legal practices both at the national and international levels. But often the terms association or affiliation connote more

<sup>7</sup> Fidal Peat Inc, a separate profit centre within the group, has about three quarters of its work related to tax, the rest being legal work.

<sup>8</sup> The western part.

than the true status of the relationship. Often named groupings are in many cases non exclusive arrangements backed by few joint prospects and activities and not much more than a sophisticated referral system rather than vehicles for legal practices.

Today the world market for legal services is dominated by big US business law firms and UK solicitor firms specialising in commercial and financial law. Firms like Baker McKenzie (Chicago), Clifford Chance and Freshfields (both in London) have little by little eased themselves into legal markets around Europe and the rest of the world. Freshfields and America's Cleary, Gottlieb, Steen & Hamilton, have integrated local lawyers into their partnerships and become genuine global practices. In recent years however, a small number of Dutch, German and French firms have been coming up strongly and begun to challenge the total dominance of Anglo American firms.

The nature of international law business is such that all the leading firms have been concerned primarily with being able to operate in major financial/commercial centres: New York, Paris, London, Hong Kong, Tokyo, Singapore and the Gulf States, and also in a few key administrative governmental centres: Washington DC and Brussels. American law firms following American investment in Europe have in actual practice met with few or no barriers in giving legal advice, especially in London where a highly liberal regime made establishment particularly attractive. On the continent, Paris was very open for foreign establishment until a new regime tightened entrance conditions for newcomers. US firms were fast in entering Brussels to offer significant services in EC law which European lawyers' firms had been slow in providing. After London, Paris and Brussels, the US presence spread to the rest of the continental Community only somewhat later.

## Quantitative description

### Employment

Statistics on numbers of lawyers raise difficulties on account of the various ways in which the profession is regulated across the EC. For example, in the UK and Ireland in-house lawyers or those working for the Government or local authorities are still considered as practising lawyers which is not the case in the rest of the EC. In other member states parallel professions such as those of notaries and procurador complicate comparisons between member states.

Some 325.000 lawyers are registered in the EC, notaries not included<sup>9</sup>. In the UK alone there are some 72.000<sup>10</sup>. Not all practise law. The numbers in other occupations such as public administrations or as counsels in-house in companies vary considerably between member states. In Italy it is estimated that up to one third of the registered lawyers are active in other sectors. The EC legal service industry also employs almost half a million additional staff, mostly administrative personnel and secretaries. In large international practices, particularly those in London, the personnel tends to be categorized in partners, assistant solicitors, articulated clerks and para-legals. A small but growing minority of law practitioners operates on a Europe-wide or even a global scale. To the above figures must be added some 30.000 notaries, an occupation involving legal work which is found in all the member states. However, only in nine of them is the function of notary performed by a separate profession. In Denmark, the post is conferred upon judges, while in the UK and Ireland solicitors generally have this responsibility. Notaries are providing legal services mainly in property and real estate and in the areas of company law

<sup>9</sup> Source: CCBE

<sup>10</sup> Source: Free Movement of Lawyers, Hamish Adamson,

(including mergers & acquisitions). It is in this last area that their cross border service activity is mainly to be found.

#### Market size

In the EC, legal services probably represent the largest segment in earnings of all professional services, followed by accountancy and management consultancy. However, in the legal profession average turnover per employed person may not be the highest.

The gross annual income of this service industry was a few years ago conservatively estimated at about Ecu 20bn. A breakdown for several member states for which some estimates were made are reproduced below:

#### Legal Services: Total Gross Income (million Ecu)(not all for 1989)

Belgium	280	
Denmark	300/350	
FRG	4.300	(1984: lawyers and notaries)
Greece	70	
France	4.300	(1986: lawyers, conseils juridiques, notaries)
Netherlands	540	
United Kingdom	4.300	(solicitors only in 87/88)

source: CCBE EC Panorama 1991

The data include notaries in Germany and France as a good part of their work is included in the solicitors work in the UK. Firms in the legal profession generally decline to give gross revenue figures. Estimates for the ten top London firms which include practically all the biggest in the UK and even in the EC (except Fidal) give a total of some Ecu 1.6 bn in 90/91<sup>11</sup>. (In comparison the ten leading US firms had some Ecu 2.4 bn in earnings).

Figures about earnings from foreign related legal services have not been obtained. Of the total number of professional lawyers, only relatively few have an activity that is mainly directed towards the law of other countries, EC law or international law. On the whole such activities are mainly found in the large practices and in those which are members of multinational groupings. Belgium has a relatively high number of lawyers dealing with EC law.

However, even for the leading world firms, the share of gross revenues coming from overseas offices does not seem to represent a large part of the overall income. For "Freshfields", a major commercial law firm in London, with over 100 partners worldwide and more than 500 fee earners, revenue from overseas offices (Brussels, Hong-Kong, Paris, New-York, Singapore, Tokyo and Frankfurt) was about 15% of total gross earnings<sup>12</sup>. To this must be added the foreign share in the revenue from the different kinds of services (eg financing, corporate finance, property) handled at the headquarters. For Denton Hall, a large London based firm, roughly 10% of the firm's earnings came from overseas offices in 1991 but again this figure does not reveal the work that came to the headquarters indirectly<sup>13</sup>. Compared to e.g. engineering consultants which may have up to 80% of their work overseas and staff of up to 3000 in the larger firms, law practices are not as much engaged internationally.

<sup>11</sup> Legal Business Magazine, March 1992

<sup>12</sup> Financial Times, 25.1.91.

<sup>13</sup> Legal Business Magazine, March 1992.

The US occupy the leading position in the law service industry in terms of international offices, followed by the UK. Five of the world's largest eight law firms are American while two are British. Eleven of the top twenty are American and five are British. Part of the international success of US and UK firms comes from following clients abroad. An advantage for them lies in the fact that many international business and financial transactions are written under New York or English law and that the English language dominates as is the case in for example financial services. In France and Germany the domestic legal industry is gradually overcoming the handicaps inflicted upon it by restrictive national regulations which have for long governed the profession.

#### Trade in legal services

As already indicated, lawyers and their services follow economic growth and trade patterns. Their international activities have been increasing in line with the expansion of international financial and commercial transactions and the progressive globalisation of the world economy. Raising large sums of money, financing debt, private mergers, acquisitions, joint ventures, public bids often involve the negotiation and putting together of complicated commercial and financial transactions with contributions of professionals from several countries. Invariably, because of their greater complexity, international transactions generate greater demand for law services than comparable domestic transactions; they often involve the law of at least two jurisdictions as well as international law. In addition, legal activities pertaining to international trade policies (e.g. dumping) and competition issues have intensified in recent years. Here also the increased complexity of laws, both national and international, governing international economic relations have stimulated trade in legal services. The EC Single market for its part has also in several respects contributed to the EC's legal service industry.

International arbitration, often under the rules of the International Chamber of Commerce, located in Paris, and mediation and conciliation are other areas involving "trade in legal services". Arbitration is also a large business in the UK where a special international court and institute are located. Skilled arbitrators/mediators, highly regarded internationally, are called upon to participate in meetings at the venue for dispute settlement written into business contracts.

The key export markets are the world's main financial and economic centers with the exception of Japan. They are New-York, Washington DC and other US cities, Hong Kong, Singapore and some other Asean capitals and the Middle East. The largest flow of services between the EC and outside is between London and New-York.

Traded legal services are recorded on the basis of the non-resident status of the payment source for the service (rather than that of the service receiver). For example the same service might be provided to a number of overseas clients: when paid for through an overseas company it is recorded as an export but if paid for through a local subsidiary of an overseas company, it will be considered a domestic transaction. Income received (or profits remitted) by overseas branches or subsidiary offices of domestic firms are not domestic export income and thus not reflected in service trade data. To the extent any are available, the data tend to underestimate the amount of international servicing. Figures on cross-border legal services transactions are difficult to collect and even to estimate. No really meaningful figures on trade in legal services seem to be available except for the UK which adds up trade in services and legal services sold overseas by branches, subsidiaries and affiliates (net overseas earnings in the legal profession in 1990 : Ecu 553mn). French balance of payments data for legal services include auctioneering services: the negative balance of cross-border trade (mostly lawyers' and notaries' services) was Ecu

15 mn in 1990. (see also US balance of payments figures below, which cover "declared payments").

#### US market

In the US, receipts of legal service establishments with payrolls were estimated at \$ 100 bn in 1991, up by almost 10% on the previous year (US Industrial Outlook 1991). This does not include the sums spent by companies on their in-house lawyers. According to the American Lawyer Magazine the top one hundred American law firms had gross revenues of \$ 13.9 bn in 1991 (+3%). The year before the rise had been 9%.

The US Census of service industries of 1987 reports close to 140.000 establishments. In 1991 there were 950.000 employees on the payroll of legal service establishments (+3.4%), two thirds of them being employed in legal services practices, the rest working for corporations, trade associations or governmental agencies. There are well over 50 US law firms practising in London, many of them working closely with British firms. US firms have been highly competitive in internationally mobile markets for legal services. The main US names are Skadden Arps (N.Y.), Baker & McKenzie (Chicago), Jones, Day (Cleveland) and Cleary Gottlieb, Steen and Hamilton.

US balance of payments data for private legal services in 1990 show \$ 455 mn in receipts (of which 153 mn from the EC) and \$ 110 mn in payments (EC 35mn). The figures for the UK only show a US deficit of about \$ 60 mn.

#### The Japanese market

"Bengoshi" lawyers are mainly litigators which handle only a small portion of Japan's legal work. There are some 14.000 of them. The other legal work is performed by judicial scriveners, administrative scriveners, patent attorneys and tax attorneys. In-house corporate legal staff (who have not passed the Bar examination) abounds. Together there are some 125.000 suppliers of legal services in Japan.<sup>14</sup>

Some 41 firms of foreign lawyers are established in Japan, all but three being British or American. They are mainly dealing with business law.

#### Market demand and prospects

The underlying trend over the present decade is for a continued increase in the demand, especially for business law services. At the EC level, after 1992, with the great mass of EC legislation in place and emphasis on subsidiarity and decentralisation, some legal work may shift back to individual member states for both litigation and enforcement but overall a healthy further rise can be expected. The joint ventures and other types of investment ventures now being created in some countries in Eastern Europe will also attract increasing legal resources. At the global level, continued expansion of world trade and investment and environmental issues will support the demand. Business litigation involving international property, liability, contracts, anti-trust will continue to rise.

Growing international economic interchange means dealing increasingly with the national laws of other countries, a service few lawyers can achieve personally. In such matters the present economic and political trends favor the larger law firms. But even they have their particular weaknesses and strengths in individual geographical markets, and their specialisations. Trends towards specialisation and towards alliances in adjacent sectors will be moving in parallel.

<sup>14</sup> Source: The Economist, 18.7.92.

There may also be further development of multidisciplinary practices (MDP) giving advice and assistance in legal, business and fiscal affairs. Pressure to be allowed to do so are rising in member states where this is still forbidden. In addition to lawyers, the staff of such companies comprise a widening range of experts in disciplines such as certified public accountants, notaries, patent agents, fiscal advisers, management consultants etc. In Germany, the Netherlands such MDP are already allowed. However, working against the spread of this kind of practice will be large business fraud cases that have recently come to light in some countries. These are inciting politicians and regulators to tighten up so as to avoid conflicts of interest and excessive concentration of power.

Going against the growth factors described above is the tendency for large businesses vigorously to expand their in-house legal staff, partly as a response to the escalation of lawyers' fees in the 1980's. They are helped in discharging routine work by the new technology linking them to legal databases. Outside assistance is called in for specialities.

The main EC centers of law firms will continue to be London, Paris, Frankfurt, Dusseldorf and Amsterdam with Milan and Madrid closely following. Copenhagen and Stockholm with highly qualified practices are also in the running. Brussels has become a center for eurolawyers (and eurolobbyists) very much in the way Washington DC became a similar venue for these professions. Foreign law firms have moved into Brussels in several waves over the past 40 years, generally pari passu with successive advances in European integration, frequently with some of them withdrawing after a while. The latest move was triggered by the Single market programme and the progress in EC law-making, in particular trade law and competition law. Certain mergers requiring EC Commission authorisation have created legal work to help in drafting the notification. This work is mostly in the hands of British firms led by Slaughter and May. The City of London for its part has acted as a magnet for legal business, particularly finance lawyers.

## Other information

### Type of market and competitiveness

There is intensive competition within the legal services industry and, in a number of practise areas such as taxation and financial law, a keen participation in the market by accountants, merchant banks (for mergers and acquisitions) and by management consultants. The law profession likes to emphasize that it has exclusive right of practice in certain activities, that it is subject to codes of ethics and that in the interests of its clients it enjoys statutory attorney-client privileges. In fact identical services are provided by different practitioners in different member states and not invariably on account of differences in professional regulations. In the UK for example, the financial side of insolvency work belongs to the accountancy profession whereas in most place in continental Europe and in the US it is the preserve of lawyers.

An example of the close relationship between lawyers and accountants is given by Fidal of France. It is the legal arm of a group whose major activity is accounting and auditing (Fiduciaire de France-KPMG). The legal and tax work of the firm and in particular of Fidal Peat International, its separate international profit centre, is in competition with other French legal and accounting practices, with Anglo-American firms and with the divisions in France of the other "Big Six" accounting firms.

Judicious recruitment, training, marketing, investment in technology, all serve to increase the technical expertise in the relevant field and the range of experience, the first critical elements of a law firm's strength. Evidence of a

broad network of useful contacts, proven capacity to provide practical service in a timely and cost effective manner also play a key role. All this determines the ability to provide clients with "quality service". Expertise across a wide range of practice areas allows the larger firms to pick up a bigger share of the available work. Language knowledge is essential along with local know-how. To control costs the legal profession tries to use more legal assistants, who function in much the same way as lawyers but concentrate on tasks that are time-consuming and detail-oriented.

As regards strategy, the most dynamic firms look at global trends and try to anticipate what services will likely be in demand by major corporations. At the transnational level they try to capitalize on their strength in the world's international business and cross-border transactions.

There is an economic cycle element in lawyers' activities overall even if various legal disciplines experience different ebbs and flows. During periods of strong economic growth, there is greater spending for legal services for forming new businesses, for mergers and acquisitions, real estate transactions etc. In times of recession transaction related business may diminish but contracts tend to be broken, bankruptcies and corporate restructuring as well as insolvency and litigation call for more legal work. Price fixing, cartel cases and white collar crime issues can run on for years. Thus, the recent economic slowdown in Western Europe, including in particular in the UK, has put quite a number of legal firms under great pressure, even the strongest ones. Personnel reductions have taken place, fees have been freezed. Also in the US, 44% of the 250 biggest practices were reported to have shed staff in 1991. Others with very broad-based practice areas or in more stable activities like tax advice and bankruptcy have shown more countercyclical strength.

Traditionally, legal practitioners have waited for clients to present themselves rather than be sought out. Gradually the rules against publicity by lawyers are being relaxed. In the UK, the Netherlands and Ireland virtually any form of publicity is now permitted, subject only to minimal restrictions related for instance to good taste. But despite this loosening up, at least in Western Europe and for most of the top US practices, the legal profession's culture remains one very much opposed to straightforward advertising. More discrete and subtle ways continue to be preferred.

#### Price determinants and earnings

Although legal charges are calculated mainly but not exclusively by reference to the time spent on the matter, they are to a significant extent subjective. Law firms are reported to charge whatever the job will stand. As indicated above, credentials, (other than Bar accreditation) have become increasingly important in the selection of lawyers and the level of their fees at the international level. A British study by O'Farrel considers that fee levels for professional firms are more connected with location, which affects clients' perception than with proven expertise.

Contingency fees in the sense of enhanced fees in relation to results (*honoraires selon les résultats*) seem to becoming more widespread but unlike in the US no EC country allows contracts at no cost to the client in case of failure. Bills are only fixed after services have been rendered. Large businesses with sizeable legal assignments increasingly have recourse to a procedure called "beauty contest" under which several legal practitioners are invited to bid. This procedure remains unusual for recourse to barristers. In the case of smaller, regular clients, a retainer fee is often the remuneration basis. Several professional associations give guidance on remuneration.

As is the case with most professions, lawyers and their firms are reluctant to communicate hourly rates let alone total fee earnings. The relatively best figures available are those concerning the solicitor's profession in the UK. Mean hourly billing rates in central London are now reported to be some Ecu



170 an hour but within a wide range extending from Ecu 75 to 300 and more. In France, billing rates for partners reportedly range slightly lower. Anglo American firms have a reputation for charging more than Paris firms<sup>15</sup>. American lawyers are said to be more expensive for clients because they tend to bill more hours and staff projects with more lawyers. Tax and other lawyers involved in the major corporate deals such as mergers and acquisitions operate at the most remunerative end of the market.

With respect to earnings by firms, there are wide variations between the best and the worst performing. For the measurement of earnings in the legal profession several parameters are commonly used by the specialised press. A number of these criteria are listed hereafter:

Gross fees: by itself of little interest except that it allows to rank firms by size and to make year by year comparisons. There are for example some 35 to 40 firms in the UK which make more than Ecu 25 mn per year.

Average gross annual earnings per fee earner: defined as total receipts generated by each lawyer from clients as fees and charges before VAT, minus those sums destined to third parties (adversaries, court ushers, experts etc) or received from third parties for a client.

In recent years the top leading firms in London generate turnovers estimated at almost Ecu 300.000 for each fee earner. By fee earner is meant every partner, assistant solicitor and non-qualified fee earner. Expenses for clerical assistance and all other costs vary from country to country, but tend to be between 30-50% of turnover. These relatively simple figures are further complicated by variations as between firms in the respective numbers of salaried partners as opposed to equity partners (i.e. owners of the firm). This naturally affects profit figures per partner.

Profit per partner: In the top firms in London a few equity partners make up to Ecu 0.75 mn and more a year but a good part of this is reinvested in the business. A 1987 study for Rand quoted by the Economist (18.7.92) showed the average take-home pay of Japanese international lawyers to be over \$ 100.000 (of 1987).

For assessing profitability, some large firms allocate a scale of "notional salaries" to partners and express the remaining surplus as net residual profit (or some such term). This is thought to be a minimum of around 15% for long-term survival.

A rule of thumb sometimes mentioned says that a lawyer in a practice would need to bring in roughly three times earnings in order to make a living, on the basis that his fee income would be split in three, a third on overheads, a third for the firm and a third for himself. But this is challenged by many who argue that much depends on the ratio of top fee earners to more junior assistants and supporting staff.

#### Demand determinants

As can be inferred from the description above, demand in general for legal services is atomistic. Demand for services which call for work by professionals on cross-border transactions will tend to come mainly from the larger companies and public authorities and will be mostly found in areas of business law such as corporate finance, large property transactions, trade, and business sectors e.g. telecom and energy. In the EC there is also a rising flow of cross-border demand between adjacent regions such as from north of Spain (Barcelona) and south of France (Biarritz), within Benelux and across the Dutch-German border. Changing regulatory environments and problems characteristic of times of economic stress tend to intensify or at least change the nature of the demand.

<sup>15</sup> Ibid.

## Statistical issues (tentative)

### The nomenclatures

• In the most recent draft CPA<sup>17</sup> nomenclature which classifies goods and services by activity, "legal services" coming under division 74 entitled "OTHER BUSINESS SERVICES" falls under group 74.1 covering also other services such as accounting services; market research; and business and management consultancy. The relevant heading simply reads "legal services" (74.11). This nomenclature is symmetrical with NACE/Rev 1, the EC nomenclature for activity classification. However, the proposed new CPA nomenclature would go much further and divide the group in five classes :

- (i) legal advisory and representation services concerning criminal law (74.11.11);
- (ii) legal advisory and representation services in judicial procedures concerning other fields (74.11.12);
- (iii) legal advisory and representation services in statutory procedures (74.11.13);
- (iv) legal documentation and certification services (74.11.14)
- and (v) other legal advisory and information services (74.11.15).

• In the NACE Rev1 nomenclature which classifies by activity, class 74.11 covers all legal services providers: lawyers, legal counsels, professionals specialised in business matters, public notaries and other independent legal experts such as patent agents and others.

Both the above classifications are geared more to domestic than to international transactions.

• The proposed joint OECD-Eurostat classification for trade in services limits itself to a one line item called "Legal services" which is part of the following structure:

- 8.4 Legal/accounting/management consulting services
  - 8.4.1 Legal services
  - 8.4.2 Accounting, auditing, bookkeeping and tax consulting services
  - 8.4.3 Management consulting services.

The explanatory comments specify that legal services cover legal advice, legal representation (lawyer's services) and certification and drafting of legal instruments (e. g. relating to patents). Tax consultancy is excluded. However, representation on behalf of clients before tax authorities is included.

### Classification

#### *Definition of activities*

The classification of legal services according to the articulated draft CPA nomenclature above may not correspond to the best way for reporting on activities. Most legal firms would not only be highly reluctant to supply such data, but many would indeed not be in a position to supply detailed figures about their various disciplines without considerable extra administrative burden. It would appear that in volume terms the class "other" 74.11.15 might include the bulk of legal services, i.e. assistance on business law. The question also arises where to classify commercial arbitration (enforceable in court) and other forms of alternative dispute resolution (ADR) such as mediation and conciliation (not legally binding). As these form a growing part of business law services they should be specifically mentioned in the nomenclature of legal services. There are also various professional activities in member states which

<sup>17</sup> The CPA is a classification of products by activity (CPA) derived from the central product classification (CPC) of the UN (draft 0.6 of Dec/1991)

may have to be looked at for possible inclusion. Thus for instance, under a recent Insolvency Act, the UK has created a new distinct discipline : Licensed Insolvency Practitioners. Qualified lawyers are permitted to be LIP's, as are accountants, but few lawyers have so far registered.

As regards statistics on trade, according to the explanatory notes the Eurostat-OECD draft nomenclature for item 8.4.1 excludes tax consultancy. Many law firms (as well as management consultants) do provide legal tax advice so that this part of their earnings would have to be classified under accounting (8.4.2). The definition also does not seem to help resolve the classification of "insolvency work" which is an important legal service in most continental member states but not in the UK where it was until recently the preserve of accountants. The question arises whether the precise nature of various kinds of professional services such as those rendered across border or otherwise by lawyers, accountants, consultants matters all that much for trade and balance of payments statistical purposes. Would it not be preferable to leave such refinements for a later stage when experience will have been gained by a modest beginning and when some more homogeneity may have been introduced in these diverse professional activities within the EC. The first goal might be to obtain some figures on the transactions of all kinds by "lawyer firms", "accountancy firms" etc.

#### *Definition of operators*

Definition : the EC directive of 1977 (see page 3 of the note) defines lawyers as any person entitled to pursue his professional activities under one of the following designations:

Belgium	Avocat/advocaat	Denmark	Advokat
Germany	Rechtsanwalt	France	Avocat
Greece	Dikigoros	Ireland	Barrister/solicitor
Italy	Avvocato	Luxembourg	Avocat-avoué
Netherlands	Advocaat	Portugal	Advogado
Spain	Abogado	U.K	Advocate/barrister/solicitor

A partner in a law firm is an "associé" in the French language, and an "associate" is a "collaborateur".

The structure of the legal services industry is atomistic. On the whole market concentration is low except to some extent in the UK. But in matters of the various modes of trade in legal services only a limited number of medium-sized and large legal firms, especially those with a network of offices abroad or those part of substantively integrated groupings, engage in such international activities, including in particular consulting and assistance in business law. They would form the core of respondents supplying data on trade for the current account of the balance of payments.

#### Production of statistical data

##### *Gathering of data:*

- collect data directly from the major operators, for instance every one or two years, on the basis of voluntary collaboration and confidential treatment of results. This is unlikely to produce results. Replies to questionnaires would probably have to be made mandatory.
- use the CCBE as a basis and conduit for the periodic collection of data? Use CCBE framework and definitions and charge Eurostat to collect the data directly from the firms with an obligation to ensure confidentiality of the replies including vis-a-vis other parts of the EC administration.

##### *Type of data:*

The following data might be relatively easy to collect or obtain from existing census systems:

- number of lawyers' firms and of their local offices in member states,
- numbers of staff: lawyers mainly in judicial activities,  
other practising lawyers, notaries, huissiers,  
other professional staff,  
supporting and administrative staff,  
total numbers?

Other data indicated below would probably raise considerable objections:

- earnings of practices : gross fee income, chargeable hours,
- fee income split: judicial activities, other legal services, tax advice  
arbitration and alternative resolution of disputes, insolvency/bankruptcy  
other?
- notional fee income per partner (total fee income divided by total  
number of fee earners)

As regards trade figures the respondents might be called upon to report:

- cross-border transactions, payments, receipts (gross figures).
- broken down into main geographical zones: EFTA, North America,  
Japan, rest of the world.

Cross-border services should be recorded on a gross basis (i.e. exports separately from imports). In reality intra-firm compensation takes place between units of the same company and net amounts only are transferred between firms across borders with little (controllable) indication about their composite nature.

In matters of receipts from establishment abroad and payments to resident firms owned by foreigners, it would be necessary to use investment surveys to collect the desired data.

*Choice of index:*

- feasability of an employment index of lawyers, legal assistants, notaries,  
patent agents and others and supporting staff.
- a volume index could be based on earnings of firms if such data were  
obtainable.

Examples of a major groupings with large  
cross-border transnational work.

"Alliance of European Lawyers"

Largest continental European cooperation so far in the form of an EEIG formed in the spring of 1990. It combines more than 500 lawyers and has a total staff of about 1000. Its central office is in Brussels and staffed jointly. Offices in Brussels, New-York and London have been integrated into single profit centres. The Alliance's objective is to find competitive advantage partly as a response to the UK and US presence, in particular areas of practice like corporate finance.

Composed of the following:

-Netherlands: De Brauw Blackstone Westbroek. (the largest of the group).

-Germany: Boden Oppenhoff Rasor Schneider and Schiedermaier (three offices).

-Belgium: DeBandt Van Hecke & Lagae (largest in Belgium).

-France: Jeantet & Associés (second largest in Paris, with 110 lawyers).

-Spain: Uria & Menendez (third largest in Madrid).

All these firms are leading operators in their own home territories. The alliance gives them large geographical spread. It has offices in Cologne, Frankfurt, New York, Brussels, Paris, London, Madrid, Barcelona, The Hague, Amsterdam, Rotterdam and the Ivory Coast. The individual firms continue to practise independently in their own countries. The principal aim of the alliance is to provide a cohesive pan-European service through teams of specialists from each member country. The teams advise on national and EC laws governing cross-border activities in the areas in which the members already specialise, such as mergers and acquisitions, tax, anti-trust, corporate finance and environmental law.

Another example of association but apparently less integrated is the link-up between the Dutch-Belgian firm Loeff Claeys Verbeke with French firm Gide Loyrette Nouel and the London based Allen & Overy. It is specified that the arrangement between Loeff and Allen does not cover maritime and insurance work.

(draft)

## RESEARCH PAPER

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## Accountancy / Tax Consulting Services

## Service activity description :

## Definitions

The accountancy service industry, in the narrow sense of the term, consists of firms and individuals in practice as public accountants, providing auditing, accountancy and book-keeping services to clients, both individual and corporate, in the public and private sectors. Auditing and accounting form the core services supplied by accounting firms. Auditing consists in examining financial statements and reporting on the appropriateness of their presentation in accordance with either statutory or generally accepted accounting principles. Auditing can be done pursuant to legal obligations or on a voluntary basis. Accountancy/book-keeping is the actual accounting work as well as the preparation of financial statements and the more general advice provided by accounting firms on accountancy matters. In many member states, accounting and statutory audit functions are regulated by separate professional bodies.

Throughout this report the term accounting services are used to cover auditing and accounting/book-keeping services together, but statutory auditing will be frequently singled out. Tax consulting is the other most typical activity of the accountancy profession even if, in some member states, it is also a major activity of lawyers. In Germany and in other member states such as France and Belgium, tax advice is very closely related to audit and accounting advice because financial requirements are firmly based on tax requirements. In fact, in Germany the tax consultant professional qualifications form an integral part of the main professional audit qualification. It can be said that, on the whole, the smaller the audited firm the more closely linked the audit and taxation aspects.

The present research paper attempts to describe accountancy and tax consulting services in a way which brings out the specific issues which arise in trying to establish and collect statistical data on this service industry. In the concluding paragraphs tentative views are offered on this subject matter.

## Practical means of providing accounting services

In addition to person-to-person advice, the delivery of accounting services usually takes the form of actual book-keeping and accounting work, often totally or partly on the premises of the client. Auditing generally takes place largely on the premises of the client and the final delivery of auditing work takes the form of a written report.

The need for some physical contact between consumer and provider explains why accounting, in the narrow sense of the term, and particularly audit services, more even than many other business services, are not usually traded over long distances and across borders. To this must be added the wide divergencies in national legislative, regulatory and administrative provisions, the requirement of national qualifications (with a variety of titles), of registration for both audit and accounting, of permanent residence and formal establishment.

There are however quite a number of accounting services in the broader sense of the term such as in corporate finance (advice on financial restructuring on new issue) or counselling and assistance on privatisation which fall rather within the ambit of merchant banks or management consultants, where physical proximity is not as necessary as for ordinary accounting and audit services. These broader activities of accountants are described more fully below in other sections of this paper.

#### Characteristics of accountancy/tax advice services

Accounting is a knowledge intensive activity which calls for staff with specialised abilities. A large proportion of the staff has common training in accountancy with added knowledge in various disciplines including, in particular fiscal affairs. For the intensively regulated accounting services such as auditing, these abilities invariably take the form of statutory professional qualifications. Qualification requirements for accounting services differ between member states. Also in the non-regulated activities professional staff is generally of high caliber.

A large share of the accounting services in the twelve member states is provided by small practices or sole practitioners which serve the vast numbers of medium-sized and small enterprises located near their premises.

Next to them, in the upper part of the market are the big, often multidisciplinary practices, which mostly serve the larger companies. Practically all the major accounting businesses present internationally, rather than sell their services directly from the home basis, have either set up practices abroad or more often, have formed international networks by affiliating independent firms. The links between the practices in different countries vary from common partnerships across borders (rather the exception) to loose affiliations. They differ considerably with respect to profit and cost sharing among affiliates. Some have a degree of profit sharing or kind of royalty payment throughout the network to reflect the positive "spill-over" effects associated with the ability to provide a broadly based geographical coverage. Others have only limited income sharing even between different offices of the same firm. Some networks pool costs such as travel and training expenses to encourage intra-network cross-border exchange of techniques and skills. Commission payment from one member firm to another in return for referred business is also sometimes provided.

The network pattern described above reflects the fact that, as already stated, accounting work, in the narrower sense of the term, on the whole tends to be a national business. It requires proximity to the clients, sometimes national registration, a thorough knowledge of the local, legal and other professional requirements, good command of the language and close, personal contacts between service provider and client. To follow their clients abroad, accounting practices have internationalised by establishing abroad either through branch or subsidiary creation or more often by merger, acquisition or affiliation.

Pure cross-border trade is minimal and mostly connected with highly specialised services such as international accountancy and taxation issues and audit aspects of cross border mergers/acquisitions. On the other hand the non-accounting and tax advice services provided by accounting firms such as corporate finance advice and management consultancy are on the whole more easily traded. To illustrate such activities one can cite the fast putting together of tricky corporate finance deals in a way that satisfies company managers, institutional investors, accountants, lawyers and tax specialists, the case for bringing together all these participants is pretty strong. That leads to cross-border trade in services through temporary

movement of service providers. But the example also shows that cross-border accountancy payments for such operations will often cover payments for mixtures of service activities and even other expenses.

#### Diversification of accounting businesses

Before pursuing this review of the accounting and tax consulting industry, it is necessary briefly to draw the attention to the strong diversification into other services which characterises the larger businesses of this economic sector. It is a trend which considerably complicates the quantitative and qualitative analysis of the accounting and tax work of firms in this service industry.

Traditionally, the accounting profession was dominated by accountancy work and only in some countries such as the UK and Germany did it widely extend to tax advice and, more seldom, to other related activities such as occasional insolvency and trustee work. However, during the last two decades, accounting has seen its main practising firms move from being mainly auditors, accountants and tax specialists to becoming advisers in many other areas of business and government services. Driven by the desire to diversify into more rapidly expanding and more rewarding areas of practice, particularly the large accounting businesses have launched out into all kinds of consultancy and related assignments. They have thereby become multidisciplinary providers of services even if, for various reasons, regulatory and others, many have set up separate firms to provide different services.

Today many large and medium-sized accountancy firms, (particularly in the United Kingdom) rely on audit clients to generate substantial fee income from other activities. Their growth has come about by further expanding into tax related matters and insolvency work<sup>1</sup> and then, in a massive way, into general consultancy services including particularly information technology in which their experience with computerized accounting systems places them favourably. This move has extended into an ever wider range of disciplines, especially the unregulated ones, such as corporate finance (help in acquisitions, disposals, flotation etc), litigation support (assembling paper work for lawyers), compliance with legislation work including "environmental audit", strategic consulting, human resources, economic research and "speciality contracting" ("facilities management" under which the financial work of a client and the preparation of his financial statements are taken over).

As a consequence, in most large accounting businesses, audit and accounting fees have declined as a proportion of the total earnings, to be replaced by the more profitable other activities. Today an estimated half of the professionals at large firms are not qualified accountants, but tax specialists, consultants, lawyers, economists information specialists etc. Indeed, it is sometimes claimed that audit fees are occasionally used as "loss leader" to attract clients to other, more lucrative services.

Still, accounting services remain the core business of the majority of the large accounting practices and of almost all the medium-sized and smaller ones. It is estimated that at the end of the 80's, for the main Six accounting networks in the EC (see below), accounting services represented about half of the total earnings in all the member states (less for A. Andersen) except in the UK and Spain, and about 60% in Belgium, Germany, Italy, Luxembourg, the Netherlands and Portugal. But that share had been coming down sharply in the second half of the 80's. Management consulting (including its largest component, information technology

<sup>1</sup> In the UK, access to insolvency services is regulated by a separate qualification which accountants and others may seek to obtain.



advice) and tax advice work make up the bulk of the rest of the business carried out by the six largest accounting businesses in the world.<sup>2</sup> In Germany, the Netherlands, and Luxembourg tax work remains on the whole significantly more important than management consulting. In the larger businesses, tax advice is often in the range of one fifth of total fee income.

The wide and diverse set of services described above explains the difficulty of obtaining separate data on specific "auditing, accounting and book-keeping" activities and on "tax consulting work", particularly in the member states where separate auditing incorporation is not imposed or where auditing and tax advice are closely linked in the accounting standards. In fact, today a substantial part of the work carried out by many accounting firms ought to be classified under other business services such as management consultancy, financial, legal and computer services etc. and not included in the accounting/tax consulting service industry. And the large accounting networks which have split up their activities in different "arms" do not publish details on the source of their fee incomes.

### Market structure

As already indicated, the accounting profession comprises a broad variety of service providers: multinational networks, large practices with international links of various kinds, medium-sized and small practices and individual practitioners. By far the major part of the industry is organized in the form of limited companies or partnerships. In the UK (except Scotland) and Ireland such partnerships do not have a legal personality. Numerous in all the member states, sole practitioners still provide an important but not precisely known part of the accounting services in the Community.

A small number of very large, mostly American and British-based multinational networks, operate worldwide and account for much of the accounting profession revenue. They use international trading names directly or in conjunction with local trading names. The larger ones, the "Big Six", are: KPMG, Coopers & Lybrand, Ernst & Young, Arthur Andersen, Price Waterhouse, and Deloitte Ross Tohmatsu.

Of the Big Six, Arthur Andersen is the only business with a relatively centralised management structure and closest to a single global partnership. All the partners belong to one Swiss-based organisation (divided into audit versus consultancy for operational purposes) but the actual executive leadership is located in Chicago and New-York. Price Waterhouse comes next in terms of centralisation. It considers itself very "federal", promotes a single worldwide style and culture and has established a single, profit sharing partnership for Europe. Although like A. Anderson it espouses the one firm philosophy, it is not as tightly run from the centre.

In Europe, these two businesses are the smaller players of the Big Six, each with approximately half the number of staff of Coopers & Lybrand or KPMG. The other four members of the Big Six are not genuinely international accounting businesses, in Europe at least. They generally developed the international dimension of their networks by forging links and agreements with major home-grown accounting firms in other countries. The national practices of these groups keep their traditional (national) identity and are largely "insulated" from one another, as

<sup>2</sup> See section below. A. Andersen Consulting for example has a larger worldwide fee income than the accounting arm of the firm. Other major accounting firms also have associated management consultancies.

illustrated by wide variations in hourly staff charge-out rates. KPMG for example makes a virtue out of giving its components as much autonomy as possible. For example in Germany, KPMG's affiliate is Deutsche Treuhand, in Belgium it is BBKS, in France, Fiduciaire de France. Ernst & Young for its part combines its resources in Europe where it has some 24,000 staff, through its European council. The group does not function on a profit sharing basis; the E&Y council is a cost center operating in the interests of all members which contribute their share to the costs.

For both the corporate and the collegiate styles of companies, the main advantages of size and international networks are to facilitate referral of work, and to generate a powerful shared marketing image. Coordination between fellow firms in different countries also give rise to common standards and techniques, and allows for staff secondments.

Next to the group of six heavy-weights, there is a second group, some nine accounting businesses, smaller, less multinational, more loosely federated but still important, most of them particularly strong in Germany, the Netherlands and Denmark largely because of the local strength of their member firms in these countries. They are: BDO Binder Hamlyn, Grant Thornton International, Howarth & Howarth (or is it Horwarth Int?), CLG/Clark Whitehill (or is it Clark Kenneth Leventhal?), Robson Rhodes, Pannell Kerr Forster, Moore Stephens, Moores & Rowland, and Nevill Russell International<sup>3</sup>.

On the European continent, many of the few remaining strong national firms are trying to come together, although what they are creating are not truly European firms but merely linkages between largely autonomous practices. Medium-sized and smaller firms are also forging alliances with one another, recognizing that if their clients are thinking and acting European so must they.

Finally, in all the Member States there are still plenty of small practices as well as sole practitioners which have successfully identified markets in terms of types of services or, more importantly, location. They predominantly service the small firm sector with a variety of accounting, business and legal advice. In Germany and France this category includes the small independent "Wirtschaftsprüfer" or "commissaires aux comptes" who do provide audit services also to large national companies (sometimes together with the major operators, as in France where two auditors are required).

## Regulations

EC member states have traditionally regulated and organized accounting and accountants in very diverse ways. The twelve countries have different business cultures, diverse professional qualification requirements, different auditing and accounting standards, a variety of laws for incorporation of accounting practices and a host of national regulatory bodies.

In the EC there are in total around twenty different accounting and auditing professional profiles (types of practice with own set of regulation) i. e. outside the tax advice sector. In addition to the regulations concerning the profession, there are also a variety of provisions relating to accounting standards. The range of accounting systems within the Community extends the UK system at one end to the German at the other. The UK system, based on "true and fair view approach", is praised by its supporters for its flexibility and condemned by its enemies for its laxity.

<sup>3</sup> Merged with Spicer & Oppenheim.

The systems of Ireland, Denmark and the Netherlands are close to that of the UK. At the other extreme, the German line, based on "tax compliance approach" is the more dirigiste and legalistic. It is to be found in various, somewhat weakened forms, in several other continental European countries. It bears the strong influence of tax laws and regulations. In several member states reporting requirements for privately-owned companies are less stringent than in others, such as for example in the UK. In Spain and Italy, there are different sets of accounts intended for the taxman, shareholders and bankers. The EC harmonisation process (see section below) has taken over a strong element of "true and fair view approach".

All the member states have their own legal provisions for incorporation of accounting practices. Until recently under British law, all accountancy firms had to be partnerships; only qualified accountants can be partners. In most other member states, practices are legal persons e.g. limited liability companies or other types of incorporation. In France accountants can also group themselves in "service companies"<sup>4</sup> under which only the logistic side of the activities of the partners are pooled.

The legal controls on activities also differ between the member states. Disciplines that are generally regulated and reserved for professional accountants are the following three: statutory audit of financial statements, control of mergers and public sector audit. The legal regimes for other activities varies in the extreme. Some accounting services might be open to all in one member state but might be required by law to be carried out by qualified and recognized accountants in others or altogether banned to them (e.g. insolvency practice open to qualified accountants in the UK and banned in Denmark). In Greece accounting firms are not allowed to perform statutory audits as this is reserved for civil servants members of a state body (the SOL). In the UK practically the whole range of activities is open to chartered accountants. In some member states accountants may be authorized to perform statutory defined duties such as representing clients before tribunals and issuing certain declarations and reports. Other countries may reserve this to other professions. Tax advice is the preserve of lawyers in many European countries, but not in Germany and the UK.

In an attempt to guarantee the auditors' independence, some countries (Italy, Belgium and France) ensure total or partial separation of auditing from other types of business including tax consulting and lawyers' services. In these countries accountancy firms are legally prevented from giving tax and consultancy advice to those companies they audit. However the firms concerned have devised various ways to prevent such segregation rules from keeping their services apart. Thus, for example in Italy KPMG has four independent member firms providing audit, management consultancy, small and medium-sized firm consultancy and tax advice. They operate from 5 or 6 offices. Italy also obliges to a rotation of audits every nine years and Spain every twelve years. France calls for two statutory auditors for all firms needing consolidated accounts. This affects the comparability of statistics about numbers of audits by auditors. The other, non-accounting and tax advice services provided by accounting businesses mostly escape the legal and regulatory restrictions affecting accounting services in the narrower sense of the term. However, the strong links between regulated and other services provided by the same professionals serve to ensure that to some extent at least, similar patterns of service delivery are observed also in these other activities.

<sup>4</sup> Sociétés de moyens

## EC harmonisation

Progress has been made in Community-wide harmonisation of company law, financial reporting standards and qualifications. Thus the EC 4th Company Law directive set out common principles for accounts (the British "true and fair view" approach) and laid down standards to ensure that all medium-sized and large companies are audited every year. As a consequence, the numbers of audits is to increase massively in Spain, Italy, Portugal and Greece but hardly in the UK and Ireland where practically all active companies were already subject to annual auditing. The 7th Company Law directive deals with consolidated accounts. Together with the preceding directive it allows for greater comparability between the accounts of the member states. The 8th directive sets minimum requirements and training standards for auditors and calls for competent regulatory bodies in each member state. The directive on Mutual Recognition of diplomas in the Liberal Professions makes it easier for individuals to have their qualifications accepted in other member states. All this helps to create a new, but still unharmonised statutory framework and as yet no single accountancy market exists. The EC "accounting profession" is still a composite notion with variable dimensions covering diverse realities in the twelve member states. The cursory descriptions in the two sections above make it clear that, at least at this early stage of the EC approximation process, it would be difficult to define a common scope, even if only for certain segments of the accountancy/tax consulting profession, which could be translated into a precise EC statistical nomenclature in this sector.

## Quantitative description

### Market size

As is typical of many business service industries, official data on accounting/tax consulting services are limited or non-existent (with the partial exception of France). Available figures are mostly rough estimates, drawn from a variety of sources; they rarely cover specifically accounting or tax advice services and are not comparable between countries. About the market size of accounting/tax consulting services only indicative estimates are available. They do not usually draw clear dividing lines between the different sources of earnings. This shortcoming is important: it happens in many member states that the management consultancy arm of an accounting business is the largest management consultancy firm.

Publications such as the "International Accounting Bulletin" (Lafferty Groups Publication) and "European Accounting Focus" (WLP Newsletter Ltd) periodically produce national surveys on the accounting service industry on the basis of voluntary, unattributed, contributions by firms or on the basis of rough estimates. These figures do not cover the whole market but only data supplied in response to enquiries by a number of practices. The information is proprietary.

The Big Six in the EC  
(estimates)

	Earnings in mn Ecu (1989)	Staff in the EC (1990)	Fee Income % from acc/ audit/tax
KPMG Peat Marwick	1.500	30.000	60 %
Coopers & Lybrand	1.300	27.000	70 %
Ernst & Young	1.050	22.000	70 %
Deloitte Ross Tohmatsu	600	15.000	-
Arthur Andersen	850	13.000	50 %
Price Waterhouse	650	13.500	70 %

Earnings of the first four firms listed above have since risen by an estimated 40% or more, while the two last ones have experienced somewhat smaller growth.

Similar indicative data available on some of the largest accounting firms coming after the Big Six are given below for 1990:

BDO Binder	400	6.000	75 %
Grant Thornton Int.	250	5.000	-
Moures Rowland Europe	200	3.500	-
Horwath Int.	150	3.000	75 %
Moore Stephens	140	2.000	-
Pannell Kerr Forster	140	2.500	95 %

With respect to the composition of fees, audit/accounting services still produce about one half of the total earnings of the Big Six, with management consulting and tax advice making up the bulk of the rest. Corporate finance and insolvency are of very minor significance. Fee income of the second group of accounting firms is on the whole much more dependent on audit/accounting services and hardly on consulting. In the EC, the national member firms of the leading Six are in fact also the largest accounting firms in the individual countries. As far as audit is concerned, the Big Six are the major accountancy service suppliers to Europe's top companies. They audit almost all of the top 200 businesses in Belgium, Italy and the Netherlands. They provide more than half the auditing work in Germany and Portugal; in France, they have a major position in audit and tax advice for large corporate clients. There are only two purely French firms in the same size bracket, Salustro-Reydel and Robert Mazars.

There seems to be little or no aggregate information on the many small and medium sized accounting practices operating in the EC. In France, however, overall figures about turnover of the accounting profession are available. They were reported at Ecu 4.7 bn in 1988.

In the UK, the larger accountancy firms collaborate each spring to reveal several useful and comparable figures on their financial performance for the year to March 31, which are published in early summer. They show fee income, broken down by increasingly diverse divisions within each firm: audit, management consultancy, insolvency and so on.

The major firms in the UK  
(estimates)

	Earnings in mn Ecu (1991/92)	Staff (professionals only)	Fee Income split %		
			audit acc	tax	cons
Coopers & Lybrand	800	7.700	48	20	24
KPMG Peat Marwick	690	7.500	52	21	17
Price Waterhouse	560	5.100	39	27	25
Ernst & Young	560	5.500	43	29	19
Touche Ross	490	4.800	48	23	17
Arthur Andersen	460	3.800	24	18	53
Grant Thornton	165	2.000	38	26	3
BDO Binder Hamlyn	160	2.000	56	29	4
Pannell Kerr Forster	120	1.800	50	24	5

Source: Accountancy, July 1992.

The other fee income comes partly from "insolvency" which represents 22% of total income for Grant Thornton, 15% for Pannell Kerr Forster, 12% for Ernst & Young and about 10% for the first four companies. A. Anderson, leader in consultancy, has only 5 % in insolvency.

At the world level, a survey based on more than 22.000 annual reports worldwide suggests that the Big Six audit two thirds of companies, representing 86% of assets or sales. One in four of the top 500 companies were still audited by firms outside them in 1990. On both criteria, Ernst & Young has the largest share, followed by KPMG, Deloitte Ross Tohmatsu and then Coopers & Lybrand.<sup>5</sup>

Revenues of the Big Six at world level in 1990  
(in Ecu mn)

KPMG	4.240	A. Andersen	3.260
Ernst & Young	3.930	Coopers & Lybrand	3.220
Deloitte & Touche	3.300	Price Waterhouse	2.770

Notes: A. Andersen includes Andersen Consulting  
For Coopers & Lybrand source is Accounting Report Estimate  
Source: Public Accounting Report, Feb 15, 1991.

### Employment

The figures reproduced in the above section include various estimates of variously defined staff in the major accountancy businesses (and include those engaged in consultancy and other work). Aggregate figures about qualified and recognized professional accountants raise all kinds of difficulties on account of the different professional qualifications requirements and regulations of the member states. The Federation des Experts Comptables Européens (FEE), the representative body for the accounting profession in Europe, produces some figures on professional accountants. The FEE groups together 35 professional bodies from 23 countries including the twelve member states. These bodies have a

<sup>5</sup>Centre for International Financial Analysis and Research, Princeton.

combined membership of 300.000 professional accountants, including some 270.000 in the EC. Less than half (115.000) in the EC work in private practice.

However, these data only register accountants with full qualifications and are not homogeneous for all member states as in most of them, membership of a professional body is limited to those individuals actually working in public accounting practices. In contrast in the UK for example where this is not the case, many accountants work in other activities or outside the home country<sup>6</sup>. In other member states the great majority, if not all, professional accountants are in public practice but not all are registered even if fully qualified because of the cost of registration. In Germany tax advisers (Steuerberater) form another body whereas in Italy they are part of the professional accountancy bodies. In France, in 1990 there were some 16.500 registered accountants and trainees. In sum, the available data do not represent a consistent measure throughout the Community and they do very much understate the numerical importance of the accountancy profession in the EC if only because accountants also employ plenty of non-professional staff.

#### Trade in accounting/tax consulting services

There seems to be little genuine cross-border trade in accounting and tax consulting services. Auditing is restricted to local provision by the logistical need to be located at least temporarily near the client and by legal requirements. For non-audit accounting services, various cultural, regulatory and practical barriers to cross-border supply hamper temporary movement of personnel and the provision of services from a distance. This is not to say that the "Big Six" do not deliver significant amounts of services cross-border as their activities go much beyond plain accounting services.

To serve foreign markets it is the delivery mode "establishment" which predominates. As experience has shown that collective ownership of practices tends to raise all kinds of difficulties the preferred formula for foreign expansion has been the development of network agreements. The precise importance of establishment trade (through branches and subsidiaries as opposed to affiliates) and of intra-firm "trade" is not known. With the foreign practices which they own, the more highly integrated networks (A.Andersen and Price Waterhouse) do have "establishment trade" which procures substantial foreign earnings. [In general, the major accounting firms supply services abroad through movement of personnel or directly cross-border only in special circumstances, for example when they have a specialised service which is unavailable in the foreign affiliated firm or subsidiary or for training purposes.]

The trade balance with the outside world at the EC level is unknown. According to US balance of payments figures the US has a positive balance with the EC (see below). It is likely that the EC has positive net flows with the rest of the world. In France, accounting/auditing (including management services<sup>7</sup>) (APE 7709) is itemized together with service activities called "financial documentation and analysis". Only about a dozen or so respondents had cumulative payments and receipts exceeding Ecu 1.44 mn in 1990. Total receipts were Ecu 11 mn and total payments Ecu 17 mn. A deficit concentration was reported vis-a-vis the US, the UK,

<sup>6</sup>In the UK, the holders of accounting degrees have sometimes been compared to professionals with an MBA.

<sup>7</sup>"Services de gestion"

Switzerland and Germany. Restraints on the access to the profession is advanced as a reason for the low levels of international activity of the accounting profession. In the EC the UK has an overall surplus both inside and outside. It is probably the only member state in that position.

Progress in harmonisation and the entry into force of the EC directive on mutual recognition of accountancy diplomas may gradually introduce greater accessibility of the national markets and more transborder supply. However, the greater freedom for individual European accountants to move around in the EC on the basis of the mutual recognition of diplomas directive, even when fully implemented, will not make it easier for firms to sell their services directly to other member states. Genuine cross-border trade can be expected to remain limited.

#### Data on the US accounting industry

According to the Census of Service Industries, in the US the income of the accounting, auditing and bookkeeping service industry was Ecu 27.5 bn in 1991 (+ 2.2%), with approximately 545.000 staff on the payroll<sup>8</sup>. In 1987 the US had 70.000 establishments in this service industry. In 1991-92 some of the Big Six reduced their numbers of partners by 5 to 15%. The US Bureau of Economic Analysis (Dept of Commerce) reports 1990 cross-border transactions in accounting, auditing and bookkeeping services as \$ 120 mn for receipts and \$ 37 mn for payments.

#### Market demand and prospects

During the last ten years, EC accounting and tax consulting services have grown faster than the economy and they are expected to continue to do so even if fee income growth seems to have slowed down since 1990. The major accounting businesses throughout the EC have experienced annual growth rates of between 20 and 40% throughout most of the 1980's, mainly through providing consultancy and other value-added advisory work in addition to the staple accounting services which have not progressed as fast as the other services. Part of the increase in fees in the accounting services sector is due to externalisation by business of accountancy functions, part also to the ever wider legal and business requirements for properly audited accounts. Increased use of high technology office equipment and integrated systems together with more sophisticated communications facilities has boosted productivity and will continue to do so.

The restructuring of European industry ahead of 1992 has called for growing sophisticated accountancy and tax consulting services. International companies need homogeneous standards of assurance about their operations across Western Europe and beyond. On the continent the profession is not developed to the same degree as in the UK which has a tradition in international accounting activity and where also every single one of the 950.000 British companies had until recently to be audited. In some countries such as Germany, Spain and Portugal the requirement of full audited accounts has only in recent years been extended to a larger number of companies. On the whole, the European continental markets are less saturated than the UK and US markets and they therefore offer more growth potential. Many companies in these two countries have been gaining access in Europe by buying out local firms or establishing joint ventures with them. This helps to explain the rapid growth of the accounting and tax adviser professions in Spain, Italy and France. The

<sup>8</sup>Source : US Industrial Outlook, 1992



most important recent development in western Europe has been the rising demand in eastern Europe for all types of accounting services including advice on privatisation. This has led the Big Six and many smaller companies to build up fast-growing practices in all leading east European cities. The clients are governments, state-owned enterprises and potential investors. Coopers & Lybrand, KPMG and Price Waterhouse as well as others, are engaged in assignments for privatisation. But even for them, these rapidly rising new markets still represent less than 5% of their total fee income and time. The unification of Germany with its tax driven approach to accountancy, is placing great demands on the small but highly expert profession there<sup>9</sup>. In France and several other member states, there is large growth potential in the public sector which has been slow to open up in comparison with their British and Dutch counterparts. In sum, like many other professional services, in the EC overall accountancy/tax consulting can be expected to maintain significant growth throughout the present decade but probably at a slower pace than during the second half of the 1980's. This encouraging perspective does not mean that this service sector altogether escapes from the consequences of the current economic downturn as several UK practices have recently experienced.

#### Other information

##### Type of market

Within each of the member states there seems to be intense competition between the various national accounting firms linked up with the Big Six and the group of other large and medium-size firms. Even if the Big Six are not anywhere near supplying the bulk of accounting services in the member states, they are by and large the main, if not the sole providers of auditing services to the large companies. In fact a separate market appears to exist within each member state for such large company audit needs. Indeed for firms other than the Big Six and the second tier group it seems difficult to enter that market. Among the reasons are the insufficiency of their resources. Also these smaller practices may not be legally authorized or may not even desire to depend on one or a few very large customers. Other factors are the strength and depth of expertise and broad service line capabilities of the international networks and finally a widely held perception that the other firms do not offer the same quality of service as the Big Six affiliates in all the member states. The peculiar inclination of the world's financial markets with their fondness for well-known signatures adds further strength to the privileged position of the major players.

As for accounting/tax consulting services, the member state markets remain largely insulated from one another by all the factors described above. At present cross-border trade in such services is very limited and there is in fact little competitive pressure from foreign suppliers. On the whole, the networking arrangements within the Big Six and some of the other firms may probably have some restraining effects on trans-border flows of accounting and tax advice services. But they do not seem to be a major element.

<sup>9</sup>In particular German Wirtschaftsprüfer.

#### Price elements

Fee rates charged by firms operating in the different member states markets vary considerably. Charges for partners from the Big Six and the second group of firms are above average in France, Germany, Denmark, Luxembourg and not least in the UK where they are the highest. In Belgium, Greece and Portugal charges tend to be lower than average. Throughout the EC hourly rates charged by accountancy firms in 1989 were on average roughly Ecu 175 for the big Six and Ecu 110 for the second group of firms. The average of fees in the most highest country (UK) was double that of the lowest (Greece). In Germany, yearly fees per employee in accounting firms were reportedly around Ecu 75.000 per person.

## Statistical Issues (tentative)

### The various nomenclatures

In the most recent draft CPA<sup>10</sup> nomenclature which classifies goods and services by activity, "accountancy services" coming under division 74 entitled "OTHER BUSINESS SERVICES", fall under item 74.1 covering also other services such as legal services; business and management consultancy and market research. The relevant heading reads "Accounting, book-keeping and auditing activities; tax consulting services" (74.12). This nomenclature is symmetrical with NACE/Rev 1, the EC nomenclature for activity classification. However, the proposed CPA nomenclature goes much further and subdivides the heading into three categories:

- (i) (74.12.1) accounting, book-keeping and auditing services
- (ii) (74.12.2) book-keeping services, except tax returns; and
- (iii) (74.12.3) tax consulting services.

Categories (i) and (iii) are further split up into several sub-categories as follows:

- 74.12.11 Financial auditing services
- 74.12.12 Accounting review services
- 74.12.13 Compilation of financial statement services
- 74.12.14 Other accounting services.
- 74.12.31 Corporate tax planning and consulting services
- 74.12.32 Corporate tax preparation and review services
- 74.12.33 Individual tax preparation and planning services
- 74.12.34 Other tax related services

The proposed joint OECD-Eurostat nomenclature for trade in services limits itself to a one-line item called "Accounting, auditing, bookkeeping and tax consulting services" which is part of the following structure:

- 8.4 Legal/accounting/management consulting services
  - 8.4.1 Legal services
  - 8.4.2 Accounting, auditing, bookkeeping and tax consulting services
  - 8.4.3 Management consulting services.

The explanatory notes indicate that accounting, auditing, bookkeeping and tax consulting services relate to the recording of commercial transactions for businesses or others, the certification of their accuracy, the preparation of personal and business income tax returns and advisory activities on accounting.

### Comments on the draft nomenclatures:

The two first classifications above are geared to domestic rather than to international transactions. The difference between item 74.12.1 and item 74.12.2 above is not clear with book-keeping appearing in both.

With regard to particularly these two types of accounting and book-keeping services, the nature of the services rendered varies from basic book-keeping for small clients, to detailed advice on the application of accounting principles and standards for large, sophisticated businesses. The assistance may also extend to giving advice on the organisation and design of accounting systems, the keeping of accounting records and the preparation of financial statements for different purposes. Auditing (74.12.11) however consists in an approved external auditor or firm of auditors expressing an

<sup>10</sup> The CPA (draft 0.6 of Dec 91), a classification of products by activity (CPA) is derived from the UN central product classification (CPC).

opinion as to whether the financial statements give a true and fair view of a company's activities and of its financial position, and whether they comply with the relevant legal provisions. There are in addition audit related services which involve the issuance of special-purpose reports on the application of certain defined procedures. This activity should not be referred to as only "financial auditing" (item 74.12.11 of the draft CPA) or is it meant to cover "auditing of financial statements"?

With respect to item 74.12.3, tax consulting services, it appears from contacts with the profession, that indeed a difference can be made between the following: tax planning consisting of advice on the application of taxation law so as to minimize tax liability, and tax compliance, relating to the preparation and presentation of the various returns and declarations required by law, and assistance to clients in their dealings with the relevant authorities.

### Classification issues

#### *Definition of activities:*

The classification of accounting services according to the highly articulated nomenclature of the draft CPA as reproduced above does not seem to correspond to the ways in which accounting/taxation practices actually subdivide their work and organize their staff. Except for auditing, much of the work for clients comprises a mixture of the various listed activities. What does appear in tables with data (often simply estimates), produced by professional associations and journals particularly of the UK, are distinctions such as between: "audit", "accounting", "tax", "management consultancy" (even sometimes "IT consultancy"), "insolvency", "corporate finance" and "other" which includes for instance "trustee and administration work". One also notes that in such tables the estimates about many firms do not follow the desired breakdown either because the figures do not exist or because they are not made available. With the exception of a few practices which specialize in narrow, well defined activities such as e.g. auditing, most accounting firms may not even be able, certainly not without going into great expense, to produce separate figures for the extensive list of activities described in the CPA draft nomenclature. It is highly doubtful for instance whether in their day to day operations accountancy firms in practice keep precise statistical records of their different types of tax related activities and, importantly, whether such data would be of particular significance or interest to users.

Difficulties also arise with the proposed classification of "insolvency and corporate recovery" work of accountants in their capacity of liquidator, receiver, administrator of companies or individuals in financial difficulties, as well as their trusteeship and administrative duties (fiduciary capacity, handling of investments and similar financial arrangements) for clients. Can all this be classified in "other accounting services" (74.12.14) when in several member states these activities are reserved to non-accountants i.e. in practice to the law profession? To this must be added the complication that many accountancy firms provide "other services" that do not fall under the broad heading "accounting and tax advice".

Thus, in conclusion, while technically it might be relatively easy to draft detailed definitions of the various disciplines within the accountancy/taxation service sector, in practice the distinction might be of little help in actually obtaining useful and accurate data and moreover rather costly to collect.

The description in this paper of the wide and diverse set of services that are provided by many accounting and tax consulting practices, especially by the larger ones, and the still very wide differences in the recognized scope of accounting professions and activities in the twelve member states show the difficulty of setting up a common nomenclature and obtaining comparable

statistics on this service industry, certainly at this stage of the harmonisation process in the EC. The industry segment made up by "statutory auditing" which has now become compulsory across the Community on a minimum requirements basis might form the nucleus for a modest beginning towards a common classification. If it is considered necessary and feasible to require from business detailed data on the different activities, segmentation might perhaps be envisaged along the following lines:

- auditing (statutory control of accounts: 4th & 7th EC directives);
- other accounting and book-keeping (including incidental tax advice);
- tax consulting (also widely provided by lawyers in several member states);
- management consulting (supplied mainly by consulting firms and the consulting arms of accounting firms):
  - information technology consulting (other major suppliers: software consultants)
  - other management consultancy;
- insolvency services, provided by accountants in the UK and mainly by the legal profession on the continent. However, under its recently passed Insolvency Act, both qualified accountants and lawyers are now authorized to register as Licensed Insolvency Practitioners (LIPs);
- corporate finance (mostly provided by merchant banks);
- other.

#### *Definition of practitioners:*

The international networks described in this paper are not stable. The composition of individual networks changes when, as often happens, new members are recruited either by taking them away from other networks or by buying out smaller independent firms.

#### *Trade nomenclature:*

With respect to the trade and balance of payments statistics, for which the suggested nomenclature is the most simple, and taking account of the relatively small cross-border flows of trade, the most practical way would be to collect data from firms which are mainly in "accounting and tax consultancy services". The question then arises what the percentage of gross earnings of companies would have to come from "accounting, book-keeping, auditing" and from "tax services" for the firm to become a respondent under the 8.4.2 classification. It is clear that for instance A.Anderson Consulting's activities would have to be reported under "management consulting" and not under "accounting" but it is not clear to what extent the other Big Six, which with a relatively small number of other companies, would for the time being, likely be the only respondents in surveys of trade in accounting services, have also distinct operational units for their consulting activities within their worldwide groups.

#### Production of statistical data

##### *Gathering of data:*

- collect data directly from the major operators, periodically for instance every year or two, on the basis of voluntary collaboration. As this is not likely to produce satisfactory results compulsory replies to questionnaires would probably be the only efficient way to proceed. Confidential treatment by Eurostat of data notified by individual respondents would have to be legally ensured 11.

-use the FEE as a basis and conduit for the periodic collection of data if they were to be voluntary. Call upon FEE's assistance to help produce framework and definitions for a questionnaire.

establish a list of respondents which, at least for the collection of trade and balance of payments figures, would probably, at EC level, not exceed much one dozen firms and groups.

*Type of data:*

It would be relatively straightforward to collect the following figures on accounting firms once defined how much of the activity is to pertain to the accounting/auditing range to qualify as respondent:

- number of accounting firms and of their local offices in member states,

- numbers of staff: partners, professional staff, supporting and administrative staff, total numbers.

Other data such as the following would meet with considerable resistance and be extremely difficult to obtain:

- earnings of practices : fee income, chargeable hours,

- fee income split: audit, accounting, tax consultancy, corporate finance, management consultancy<sup>12</sup>, other,

- notional fee income per partner (total fee income divided by total number of partners or by fee earners)<sup>13</sup>

With respect to trade the respondents might be called to report :

- cross-border transactions : outflows and inflows;

- broken down into main geographical zones: EFTA, North America, Japan, rest of the world.

Cross-border services should be recorded on a gross basis (i.e. exports separately from imports). In reality intra-firm compensation takes place between units of the same company and net amounts only are transferred between firms or units of the same group in different countries without much information on the nature of the transactions behind the payment.

As regards income from establishment abroad it would be necessary to look into the current system for investment surveys and to collect data on worldwide sales of accounting services by majority-owned EC affiliates outside the EC and on worldwide sales by majority-owned EC affiliates of foreign companies in the EC. It would have to be kept in mind that in the professional services sector the origin of a firm is less important than the structure (modus operandi) of the network it may belong to.

*Choice of index:*

- feasibility of an employment index accountants, auditors? + supporting staff? Is it true that this is a service with high added value and that therefore the employment indicator would be more significant than earnings?

- a volume index could be based on earnings of firms if, what is doubtful, such data could be obtained;

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<sup>11</sup> Confidentiality also vis-a-vis other parts of the EC institutions.

<sup>12</sup> Often called MAS, management assistance services.

<sup>13</sup> As stated before such figures could be misleading as for example in France fully qualified accountants do not all register because of the high cost and the lack of benefits from registration.

PS. The English term "accountancy" covers rather more than the corresponding French term "expertise comptable". A list of often used terms follows:

Comptabilité	Accounting
Certification des comptes	Auditing
Conseil fiscal	Taxation service
Liquidation	Insolvency
Gestion de patrimoines	Trustee and administration work
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