Global Britain Briefing Note

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The Proper Definition of "Trade"

The word "trade" is often used, carelessly and wrongly, to mean "trade-in-goods" only.

The proper definition encompasses trade in Goods, Services, Income & Transfers

"Trade" between countries consists of exports & imports of Goods, Services, Income & Transfers. "Goods" are sometimes described as "visibles", while "Services, Income & Transfers" are sometimes described as "invisibles".

"Goods" are physical things such as commodities (e.g. oil or iron ore), agricultural produce, machinery, consumer goods & vehicles.

"Services" are services such as international transport, travel, financial & business services, engineering & legal & accountancy services, & royalties on intellectual property such as inventions or patents or music or literature.

"Income" comprises income flows such as dividends & interest earned by investors in one country on their investments in another country.

"Transfers" are financial flows such as payments by a country's government to international or supranational organisations, or remittances by workers in one country to their relatives in another country.

Internationally & nationally, the *Balance of Payments Current Account* is the set of statistics which contains trade data analysed by the main categories listed above, as well as by sub-categories, & geographically (by country-destination of exports and by country-of-origin of imports). In the statistical jargon, exports are "credits" & imports are "debits". The differences between credits & debits are "balances"; these represent countries' "trade surpluses" & "trade deficits" with one another.

The Importance of Income

The last twenty-five years have seen a massive increase in the amount of Foreign Direct Investment (FDI) worldwide. The UK's manufacturing, services & financial services industries are a major factor in global FDI, both as investors overseas and as recipients, usually ranking first or second in the world for both outward & inward transactions. During the same period, the "City", which accounts for around a fifth of the total GDP of the UK, has increased its share of the world market for financial services, and is currently the premier global financial centre.

The economic impact of FDI and the City is reflected as "Income" in the Current Account of the Balance of Payments. Table 1 shows that the value of UK earnings classified as "Income" now outstrips the earnings from exports of "Services", and is not far behind earnings from exports of "Goods"[1].

Table 1: UK Exports Worldwide by Category: 2009					
	Goods	Income	Services	Transfers	Total
Value £ bn	228	174	159	17	577
Percentage	*39%*	*30%*	*28%*	*3%*	*100%*
Source: UK Balance of Payments:The Pink Book 2010, Table 9.1 *www.statistics.gov.uk*					

The specific reasons for including "Income" in the definition of "trade" are:-

- Earnings on Foreign Direct Investment (FDI), a major component of "Income" [Table 2] are conceptually similar to earnings derived from trade in goods and trade in services. **FDI, exports of goods and exports of services are different ways of supplying foreign markets** – usually complementary: as much as half of all international trade in goods is between fellow-subsidiaries of multinational companies. A pound remitted in the form of dividends or interest (a receipt of income) from, say, a US subsidiary of Rolls-Royce is just as valuable to its British parent company as the proceeds of selling a jet engine to Boeing (an export of goods) or the proceeds of an engine-maintenance contract with an American airline (an export of services).

- At present, the earnings from UK FDI overseas account for around two-fifths (42% to be exact) of all "Income" on current account [Table 2]. **The remaining approximately three-fifths of "Income" on Current Account reflects, broadly speaking, the activities of the City of London** and other UK financial centres (notably Edinburgh) [Tables 2 & 3]. (Some of that activity is also "captured" in the Services category as well as in the Income category. For example, on a UK bank loan to an overseas customer, the associated arrangement fees would be classified as an export of “services”.) However, the much larger flows of loan interest would be classified as a receipt (i.e. an export) of “income”. A very small proportion of “Income” [Table 2] consists of “compensation of employees”, for which the trade justification might be argued to be tenuous: but for the sake of consistency with the UK and international Current Account statistics, it seems appropriate to regard them as “trade”.

Table 2: Breakdown of Income by Category: 2009		
	£ bn	*%*
Earnings on Direct Investment Abroad	73	*42*
Total Earnings on Portfolio Investm. Abroad	*55*	*32*
Earnings on other Investment Abroad*	*45*	*26*
Compensation of Employees	*1*	
Total Investment Income	**174**	*100*
**of which earnings on banking transactions*		
Source: UK Balance of Payments:The Pink Book 2010, Table 4.1 *www.statistics.gov.uk*		

Table 3: Breakdown of Investment Income by Type: 2009: £ bn	
Monetary financial institutions	*62*
Other [private] sector investors	*109*
Central govt. & public corps.	*2*
Total Investment Income	**173**
Source: UK Balance of Payments:The Pink Book 2010, Table 4.2 *www.statistics.gov.uk*	

Including "Transfers" in the definition of "trade" is, on the face of it, more difficult to justify, since in the case of the UK a large part of it consists of the outwards flow (an "import") of British residents' taxes to Brussels – the UK gross contribution – and the inwards flow from Brussels (an "export") of farming and structural subsidies.

However, to the extent that the resulting UK net contribution to Brussels is regarded as an "entrance fee" or "annual subscription" to the Single Market – in other words a cost of doing business with the EU - it is fair to classify "Transfers" as "trade"[2]. Other transfers consist of UK payments to bodies such as the UN or NATO and of bilateral aid, for which the trade justification is again tenuous: but in view of their small relative size, and for the sake of consistency with British and international Current Account statistics, it seems appropriate to regard them as "trade".

Notes

1 *For an analytical comparison of the German, French and British current accounts in 2009, see Global Britain Briefing Note No 66, Exports of Germany, France & the UK in 2009, 7th January 2011.*

2 *The British "entrance fee" or "annual subscription" to Brussels is often justified – quite wrongly - as the cost of exporting to the EU Single Market. So considered, it consists of a massive hidden tariff charged on British exports to EU-26.*

In 2009, the UK gross contribution to Brussels was £ 17.43 billion. In the same year, total UK exports (goods, services, receipts of income & transfers) to EU-26 were £227.01 billion. That works out at an average tariff of almost 8 per cent.

If, instead of the gross contribution, the UK net contribution (£ 6.72 bn) is taken as the value of the hidden tariff, the percentage tariff comes down to 3 per cent.

However, worldwide, developed countries do not charge tariffs on services, income or transfers. Tariffs are only charged on imports of goods. In 2009, EU-26 imported £124.33 bn of goods from the UK. Based on the UK's net contribution in 2009 of £6.72 bn, the implied average hidden tariff charged by the EU on UK exports to EU-26 was 5.4 per cent (6.72 divided by 124.33). That tariff is not borne directly by private British exporting companies but by British taxpayers and the economy as a whole; it is also a quite separate burden from the other costs imposed on the economy as a direct result of EU membership such as EU regulation.

Global Britain

Lord Stoddart of Swindon
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Lord Pearson of Rannoch
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