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DISCUSSION PAPER

Trends in International Trade and FDI in Services

Note: this paper is based on and documents version 4 of the IIDE TSD dataset.

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Trends in International Trade and FDI in Services

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(this paper updates the 2008 draft)

Abstract

This paper builds upon an updated database of international trade and FDI in services (Trade in Services Database – TSD) to provide an overview of recent trends in volume and modes of trade in services. The database combines, through concordance to a common classification scheme, data from a number of sources on trade and FDI stocks and flows. The re-classification of these data into a broadly comparable BOPS-based classification scheme yields 15 individual service sectors (and 16 sectors for FDI data). The data sources include the OECD, the IMF, Eurostat, and UNCTAD. The time span ranges broadly from 1994-2006, with earlier data available for individual countries. Cross-border trade flows with the world are available for 188 countries, while bilateral data and FDI data are reported by a narrower set of countries. For countries that do not report bilateral trade directly, a partial dataset is included based on mirror flows from reporter countries. On this basis, while only 30 countries report bilateral flows directly, we have at least partial information on bilateral trade flows for 64 countries, and aggregate trade data for up to 188 countries.

Keywords: services trade data, services FDI data

JEL codes: F14, F21

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Building on a derived dataset that combines information from multiple sources, we provide an overview of recent trends in services trade volumes and in the modes of supply. The database of international trade and FDI in services (Trade in Services Database – TSD) combines, through concordance to a common classification scheme, data from a number of sources on trade and FDI stocks and flows. The re-classification of these data into a broadly comparable BOPS-based classification scheme yields 15 individual service sectors (16 sectors for FDI data). The resulting data for trade in services from various sources -- and covering multiple modes of delivery -- show that the importance of trade in services is much higher than suggested by balance of trade statistics alone. Indeed, international service transactions may be valued at up to 45% of total global cross-border transactions.¹

1. MODES OF SUPPLY IN INTERNATIONAL SERVICES TRANSACTIONS

As is well known, services have unique characteristics that greatly affect their tradability. The two most obvious characteristics include intangibility and non-storability, however typically they also require differentiation and joint production, with customers having to participate in the production process. In order to capture these aspects and to allow for trade in services that also require joint production (so-called “bound” services according to Bhagwati, 19xx) the WTO defines trade to span four modes of supply:

- Mode 1 – Cross-border: services supplied from the territory of one country into the territory of another.
- Mode 2 – Consumption abroad: services supplied in the territory of a nation to the consumers of another.
- Mode 3 – Commercial presence: services supplied through any type of business or professional establishment of one country in the territory of another (i.e., FDI).
- Mode 4 – Presence of natural persons: services supplied by nationals of a country in the territory of another.

In practice, FDI remains a major channel for foreign providers to supply services. About 60% of global FDI stock is in the service sector, with finance and trade being the most

¹ Because the data are meant for econometric modeling rather than computational modeling, the accompanying database reflects reported data (with an option for constructing mirror flows) without imputation or other data generation mechanisms applied to the raw data.

important sectors therein. Structural shifts within service sector FDI reveal that recently telecommunications, energy and business service become increasingly important. Some of the greatest cross-border mergers in history, on a value basis, have involved telecommunications firms. International telecommunications firms are forging global networks, while energy distribution companies are spreading their systems across borders as well. These real world changes in the ownership and structure of service-sector industries are driving a need for revamping the regulatory structures governing these sectors.²

Services are also traded through cross-border movement of persons. On the consumer side (GATS “mode 2” trade), this includes for example Germans and Irish going to Poland for dental work, as well as tourism. On the producer side (GATS “mode 4” trade) it includes the cross-border temporary movement of skilled labor, like accountants and software engineers who increasingly work across Europe. It also includes Polish construction workers relocating temporarily for jobs in the Netherlands and France. All of these raise sensitive policy issues not yet well understood.

This change in the global position of services is important, because the service sector – as mentioned above - is itself the largest and most dynamic part of most middle and high-income economies. Services are also the most dynamic sectors in recent growth in global trade and FDI. Table 1 reports the relative importance of different modes of supply for the international provision of services. Between 1996 and 2004 the volume of cross-border commercial service exports increased globally by 109 percent, while exports of travel and transport services expanded by 50 percent and 69 percent respectively. Over the same period, world merchandise exports expanded by only about 20 percent in value terms. The most dynamic type of services trade is trade in producer services. The share of service trade in total cross-border trade stands at about 20 percent, and this share continues to climb. It also accounts for a large and growing share of FDI flows. In addition, these sectors are important for employment, and are a critical input to industrial production. The producer service sectors alone account for roughly 25 percent of

² In a European context, they also raise important issues and tensions regarding management of the single market, as it is becoming increasingly clear that new rules need to be developed if the EU is to represent economic integration of service markets as well as goods markets. This has already led to tension within the EU over the setting of rules for the service sector.

employment in industrialized economies. This is more than the 18 percent represented by manufacturing workers.

2. THE DATABASE

This paper outlines a database combining multi-sourced data on trade and FDI in service sectors. We have organized data from several sources: Eurostat, IMF and OECD on trade flows in services (balance of payments data) on the one hand, and data from the OECD on FDI stock and flows on the other hand. The data can be found in the accompanying file.

2.1 COVERAGE AND DATA SOURCES

The database contains information on six indicators for international transactions on the service sector: services exports (credits), services imports (debits), FDI inward stock, FDI outward stock, FDI inflows, and FDI outflows.

The core time period covers 1994-2006, we have however left in the data for earlier years where we had collected them. The country coverage varies from data for 28 OECD members, Hong Kong and Russia (for cross border trade and FDI) to 66 countries (cross border trade only) with bilateral breakdown, and to 188 countries (again cross-border trade only) for which no dual breakdown is available. All data are given in million USD at current exchange rates and have been recoded into BOP sectors where necessary, thus allowing for direct comparisons between modes 1, 2 and 3. To our knowledge, this collection of data is the first attempt to give a comprehensive picture over these three modes of international service delivery in a unified data set for such a wide range of countries.

2.2 CROSS-BORDER TRADE IN SERVICES

Data for cross-border trade in services as well as for exports and imports of travel services are based on balance of payment statistics and correspond mainly to GATS modes 1 – cross border trade - and 2 – movement of consumers. Data are usually reported for total services trade flows on a bilateral basis or for trade flows to the world broken down by sectors. The OECD and Eurostat provide data on services trade flows on a dual breakdown, by partners and sectors at the same time. Thus, we use this source first and then augment our database by including additional reporters (not included by

the OECD and Eurostat data) in such a way that we fill in row and column sums (i.e. bilateral total flows as well as flows to the world by sector/activity) from the IMF BOP database.

The combined OECD and Eurostat data cover 66 reporting countries (see below) and more than 200 partner countries over a total period of 15 years (1992-2006). Bilateral services trade flows are classified into 15 economic activities according to the BOP Manual 5 classification. Table 3 summarizes the coverage of this data source. This core data can be extended by additional data on services trade flows from the IMF Balance of Payments Statistics. The trade data reported here is broken down by 11 economic activities or sectors.

2.3 FDI IN SERVICES

As for mode 3 trade we are constrained for the moment to use FDI stock data as a very crude proxy for the activities of foreign affiliates abroad. We have collected the inward and outward FDI stock and flow data from the OECD (for the OECD member countries) for the period 1982-2005. Though FDI flows provide in general a greater coverage and are more up to date, stock data are often preferred in the analysis, since they are less volatile. Another consideration relates to the fact that an FDI stock will generate continuous transactions abroad and so captures better the type of trade that we ideally want to measure more accurately (i.e. by FATS-statistics). In contrast FDI flow data, measuring only capital transactions in a given year, would greatly underestimate the longer lasting trade relationships established through foreign affiliates. The data are originally classified according to an OECD classification scheme based on ISIC, revision 3. For our purposes and in order to generate a consistent data set, we have re-classified these to corresponding BOP categories to match the trade data. The conversion key is given in Table 4. More details on the coverage for FDI data are reported in Table 5.

It should be mentioned that there are many missing values for the years at the beginning and end of the reporting period, especially for FDI in total services (sector 200). In addition, data on FDI in the communication sector sometimes appear to be inconsistent, as there are cases when value of FDI in sector 245 is lower than in its 247 subsector.

3. MAJOR TRENDS IN CROSS-BORDER TRADE IN SERVICES

In this section we provide an overview of major trends in the development of the world services trade as well as of the FDI in the OECD countries, on the basis of our combined dataset. Of course, a more comprehensive analysis could provide much more insights into the services trade and investment development.

First, we analyze the sectoral structure of the world trade in services. Travel, other business services and transport services have the biggest shares in the world trade. Together they account for more than 60% of the total trade (Fig. 1). However, the importance of travel and transport services has been decreasing over the last decade – their shares over 1994 -2005 have declined by 9.2 p.p. and 5.0 p.p. respectively. Other business services have almost not changed their shares; while there has been increase in the shares of financial services and computer and information services (Fig. 2). However, most of the changes in the sectoral structure of services trade are attributed to non-allocated services. The fact that the major increase in the share of other (981-286) services occurred one-time in 1998, allows us to suggest that it is the change in the methodology of foreign trade accounting (namely, switching to the 5th Edition of the IMF Balance of Payment Manual), which mostly explains the shift in the services trade structure.

The EU15³ has been by far the biggest services exporter accounting for about one third of the total services export; the second biggest exporter is the USA, with 13% share. However, the shares of the EU15 and the USA in services exports have been gradually decreasing, as services have been increasingly more exported by less economically developed countries.

Among the less economically advanced countries, the low and lower-middle income Asian countries stand out as the biggest services exporters in terms of value – together with China they account for 5.1% of total services exports. Russia and other transition countries have the lowest share in services exports among all the regions analyzed (Fig. 3 and 4).

³ For analysis of the geographical structure of services trade we used the UN classification of geographical regions, available at <http://unstats.un.org/unsd/methods/m49/m49regin.htm>.

With regard to services import, the situation is rather similar: the EU15 and the USA, the biggest players, account together for 48% of total services import. The low and lower-middle Asian countries account for 24% of the value of services imported by less developed country regions (Fig. 5 and 6).

Next we focus on the dynamics of trade in different sectors of services in the geographic dimension. The world travel services export growth was the lowest among all the sectors over 1994-2005 (6.4%), and most of the regions analyzed had rather low rates of growth of this sector export, only other transition countries managed to increase their export on average by 32% annually. Growth of the world transport services export was also sluggish (on average 7.5% per annum); the highest rate of growth was recorded in China (16%) and other transition economies (13%). Export of financial services, the most dynamic sector, grew the fastest in Japan and other high and higher-income Asian countries (32% and 45% respectively). Among the countries with low and lower-middle income, China increased the sector export the fastest, while there was decline in the sector export in transition countries. With regard to other business services export, higher than the average rate of growth was recorded in the EU15 and EU12 (among the high and upper-middle income countries), and in China, Russia, and other transition countries (among countries with low and lower-middle income). The EU12, as well as Russia and other transition countries stand out as the countries with the fastest growth of royalties and license fees export (46%, 50% and 52% per annum respectively) – the major reason behind this remarkable performance is the very low initial level of the sector export (Fig. 7 and 8).

On the imports side, other transition economies and also China were the most active importers of travel services over 1994-2005 (this sector import grew over this period on average by 34% and 20% per annum respectively); in all the other regions the rate of growth only slightly differed from the average one. A similar situation was observed in the transport services sector, where only other transition countries increased import rather fast (25% per annum). The leaders by the rate of the financial services import growth were high and upper-middle income Asian countries and Russia (26% and 19% per annum respectively), closely followed by Japan, the EU12, and Latina America. At the same time, in China import of the sector declined, and in other transition economies it grew only at 5% average annual rate. Instead, China and other transition economies

increased the fastest among all the regions import of other business services (by 16% and 18% per annum respectively). Other regions were not very active in importing other business services (in Japan this sector import even fell). The situation in import of royalties and license fees is similar to the one in export of this sector: Russia, other transition economies, the EU12, and also China increased import of royalties and license fees at rates which exceeded the average one by several times (by 5.5 times in the most extreme case of other transition economies) (Fig. 8 and 9).

A comparison of global trade flows in goods and in services point towards the much higher concentration of the latter type of trade flows (as measured through balance of payments statistics). While a few large trading hubs can be identified from Fig. 11, illustrating that the bulk of global merchandise trade takes place between the EU, NAFTA and Asia, the majority of the world services trade occurs inside the EU, in particular within the EU15, as well as between the US and the EU and the US and Japan (Fig. 12). Besides, the only other sizeable bilateral services flow comes from the nearby Latin American countries to the USA. This suggests that proximity does still play a greater role in services trade as compared to goods trade.

4. MAJOR TRENDS IN FDI IN SERVICES

Due to limitations of data availability, this sections deals with the smaller and more homogenous sample of 30 OECD countries.⁴

The structure of the outward FDI stock in the OECD has been dominated by financial services; however, their share decreased over 1992-2003 by 1 p.p. to 44%. Other structural changes included almost total elimination of transport services (their share decreased over the period studied by 4 p.p. to 0.1%) and significant increase in the share of other business services (by 16 p.p. to 35%); besides, there has been recorded increase in the shares of communications and insurance services in outward FDI (Fig. 13).

The similar trends have been also observed in the structure of the inward FDI in the OECD countries, which pretty much resembles the outward FDI structure (Fig. 14).

⁴ For discussion purposes here, and due to a high share of missing values for BOPS 200 in 1996 for both outward and inward FDI and in 2002-2003 for inward FDI, the values of total FDI in services here is estimated to be equal to the previous year level increased by 10%.

The fastest average growth rate of both inward and outward FDI stock over 1992-2003 was recorded in communications; the major reason for this was the very low initial level of FDI in this sector. In the structure of outward FDI stock tourism services have also demonstrated rather fast growth – on average 26% over the period covered, while this sector was among the slowest growing ones in the inward FDI structure. Other business services was the third sector in terms of growth rate in outward FDI and the second one in inward FDI. Negative growth of FDI stock (both inward and outward) was recorded in transport sector, where cross-border trade in services has been demonstrating sluggish dynamics as well. Outward and inward FDI stock in insurance services has been growing at much below the average rate; this may indicate existence of rather high barriers for investors' entry.

5. SUMMARY

We see dramatic changes, both, in the structure of FDI as well as of cross-border trade flows in services. Unfortunately, little is known to date on barriers to trade in services. Thus, a possible explanation of the relative decline in financial services and the corresponding rise of the same category in cross-border trade flows may be related to changes in the regulatory environment, which has up to recently impeded cross-border flows in certain service sectors. On the other hand, in particular public services have up to date been mostly closed to both forms of trade in most countries of the world. Therefore, more research is needed on the interactions between individual modes of supply, barriers to trade in services and the like.

However, not only conceptually, but also in terms of measurement there is still ample room for improvements. In particular with respect to modes 3 and 4, measurement is up to date difficult and incomplete. The revision and refinement of the BOP classification, incorporated in the BOP Manual 6, to become the new standard from 2009 onwards, will work towards reaching this goal. This new manual will implement many of the suggestions which have been made in 2002 in the Manual on Statistics of International Trade in Services (a joint publication by UN, EC, IMF, OECD, UNCTAD and WTO) leading to a more coherent and more detailed classification of service sectors worldwide. Further, FATS statistics will become available for more countries, which will greatly improve our knowledge of mode 3 trade.

The present database is a first attempt to provide a basis for researchers to deal with important questions concerning the developments in and implications of trade in services. As a word of caution we would like to add that the quality of trade data in services is still far away from being comparable to trade data for merchandise goods. Due to the long tradition of tariff revenues, trade data for goods have been collected with particular quality and accuracy. Due to the intangibility and non-storability of services, at-the-border-duties cannot be applied to services, thus having resulted in much weaker compilation practices with considerable less accuracy. Increasing awareness of the rising importance of trade in services and relatively strong fears of adverse implications (in particular on domestic employment) however lead to better compilation practices. The Trade in Services Database should be seen in this light as the best currently available approximation to a comprehensive picture of global trade flows in services. Data collection for this database will find continuation when more and better data become available.

Table 1:

INTERNATIONAL TRANSACTIONS, 1997 AND 2004.

GATS supply mode	1997		2004	
	Value USD Billion	Percentage of Total	Value USD Billion	Percentage of Total
Mode 1 cross-border trade	890	41.0	2,034	48.2
Mode 2 consumer movement	430	19.8	620	14.7
Mode 3 commercial presence	820	37.8	1,500	35.5
Mode 4 producer movement	30	1.4	70	1.7
Total services	2,170	100.0	4,225	100.0
Total merchandise exports	5,488		9,127	

Source: IMF BOP, 2007, own estimates.

Table 2:

COVERAGE OF THE TRADE IN SERVICES DATABASE:

variable name	description
Country_code	ISO 3-digit code for reporting country
Partner_code	ISO 3-digit code for partner country
sector_code	BOP Manual 5 3-digit code for service activity
year	year
sm	Services exports (credits)
sx	Services imports (debits)
fdi_inw	FDI inward stock
fdi_outw	FDI outward stock
fdi_inflow	Inflow of FDI
fdi_outflow	Outflow of FDI
sm_datasource	data source (credits)
sx_datasource	data source (debits)
fdi_inw_datasource	data source (FDI inward)
fdi_outw_datasource	data source (FDI outward)
fdi_inflow_datasource	data source (FDI inflow)
fdi_outflow_datasource	data source (FDI outflow)

Table 3:
SERVICES TRADE DATA - COVERAGE BY SOURCE

<i>Data Source</i>	<i>Data Coverage</i>			
	reporters	partners	time period	economic activities
			BOP code	description
Eurostat	EU27, ALB,	ALB, ARG, AUS, AUT,	1992 – 2005	200 total
	ARG, AUS,	BEL, BGR, BLR, BRA,		205 transport
	BLR, BRA,	CAN, CHE, CHL,		236 travel
	CAN, CHE,	CHN, COL, CYP,		245 ⁵ communication services
	CHL, CHN,	CZE, DEU, DNK,		249 construction services
	COL, EGY,	EGY, ESP, EST, FIN,		253 insurance services
	HKG, HRV,	FRA, GBR, GRC,		260 financial services
	IDN, IND,	HKG, HRV, HUN,		262 computer & inf. services
	IRN, ISL,	IDN, IND, IRL, IRN,		266 royalties and license fees
	ISR, JPN,	ISL, ISR, ITA, JPN,		268 other business services
	KOR, MAR,	KOR, LTU, LUX,		287 pers., cult. & recreation
	MEX, MYS,	LVA, MAR, MEX,		291 government services
	NGA, NOR,	MLT, MYS, NGA,		981 all services, not included in
	NZL, PHL,	NLD, NOR, NZL,		205 or 236
	RUS, SER,	PHL, POL, PRT, ROM,		
	SGP, THA,	RUS, SER, SGP, SVK,		
	TUR, TWN,	SVN, SWE, THA,		
	UKR, URY,	TUR, TWN, UKR,		
	USA, VEN,	URY, USA, VEN,		
	YUG, ZAF	WLD, YUG, ZAF		
OECD	AUS, AUT,	More than 200 countries	1999-2006	200 total
	BEL, CAN,			205 transport
	CZE, DEU,			236 travel
	DNK, ESP,			245 communication services
	FIN, FRA,			246 postal and courier services
	GBR, GRC,			247 telecommunications
	HKG, HUN,			249 construction services
	IRL, ITA,			253 insurance services
	JPN, KOR,			260 financial services
	LUX, MEX,			262 computer & inf. services
	NLD, NOR,			266 royalties and license fees
	NZL, POL,			268 other business services
	PRT, RUS,			269 ⁶ merchanting and other
	SVK, SWE,			trade related services
	TUR, USA			287 pers., cult. & recreation
				291 government services
				981 all services, not included in
				205 or 236

⁵ 246 and 247 are subsectors of 245.

⁶ 269, 272, 278, 279, and 284 are subsectors of 268 (other business services).

IMF	188 reporters World	1994 - 2006	200	total
			205	transport
			236	travel
			245	communication services
			249	construction services
			253	insurance services
			260	financial services
			262	computer & inf. services
			266	royalties and license fees
			268	other business services
			287	pers., cult. & recreat. serv.
			291	government services
			982	not allocated

Table 4:
CORRESPONDENCE KEY BETWEEN ISIC,
REVISION 3 SECTORS AND BOP, MANUAL 5 POSITIONS

bop_code	isic	INDUSTRIAL_SECTOR
200		SERVICE SECTOR
205	60_61_62	TOTAL land, sea and air transport
		Supporting and auxiliary transport activities; activities of travel
236	6300	agencies
245	64	Post and telecommunications
246	6410	Post and courier activities
247	6420	Telecommunications
249	45	CONSTRUCTION
253	6600	Insurance
253	672	Activities auxiliary to insurance and pension funding
260	65	FINANCIAL INTERMEDIATION
260	6700	Activities auxiliary to financial intermediation
263	7200	Computer activities
269	50_51_52	TRADE AND REPAIRS
		Renting of machinery and equipment without operator and of
272	7100	personal and household goods
		Legal, accounting, book-keeping and auditing activities; tax
		consultancy; market research and public opinion polling;
274	7410	business and management consultancy
278	7430	Advertising
279	7300	Research and development
284	7000	Real estate
	7400	–
	7410	–
284	7430	Other business activities
287	9200	Recreational, cultural and sporting activities

Table 5:
FDI Data - Coverage by Source

<i>Data Source</i>	<i>Data Coverage</i>				
	reporters	partners	time period	BOP code	economic activities description
OECD	all 30 OECD	World	1982 - 2005	200	total
				205	transport
				236	travel
				245	communication
				246	postal and courier
				247	telecom
				249	construction services
				253	insurance services
				260	financial services
				263	computer services
				269	trade & repair
				272	rental services
				274	legal, accounting, management consulting, and PR
					advertising
				278	R&D
				279	real estate
				284	personal, cultural and
				287	recreational services

Figure 1.
SECTOR STRUCTURE OF SERVICES EXPORTS

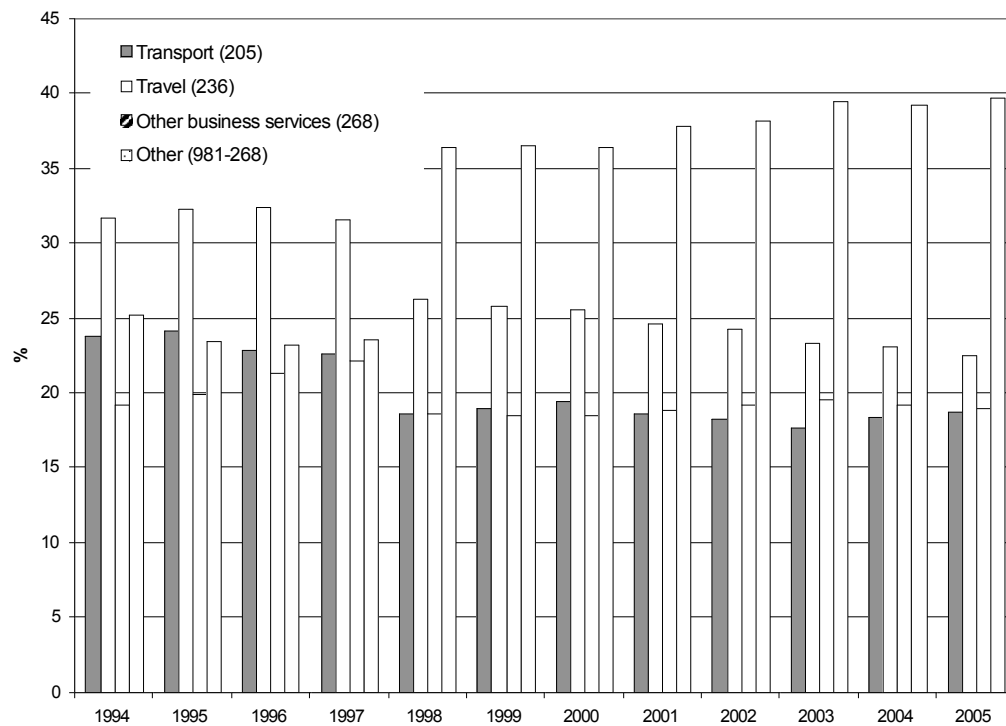


Figure 2.
SECTOR STRUCTURE OF PRODUCER RELATED SERVICES EXPORTS (APART FROM 268)

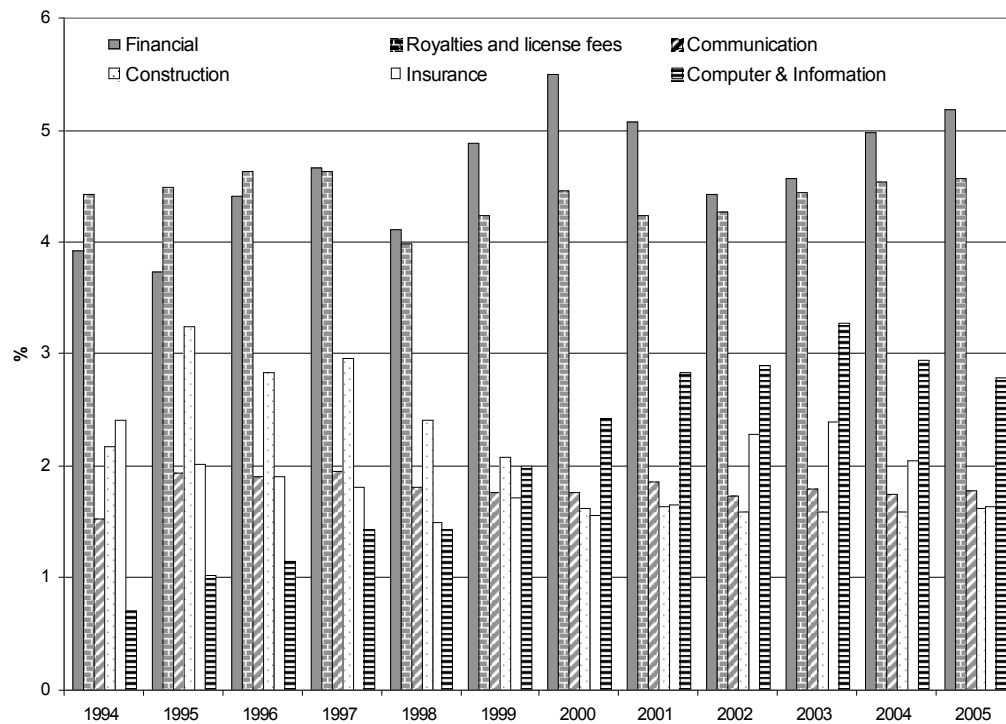


Figure 3.
GEOGRAPHICAL STRUCTURE OF SERVICES EXPORTS
(HIGH AND UPPER-MIDDLE INCOME COUNTRIES)

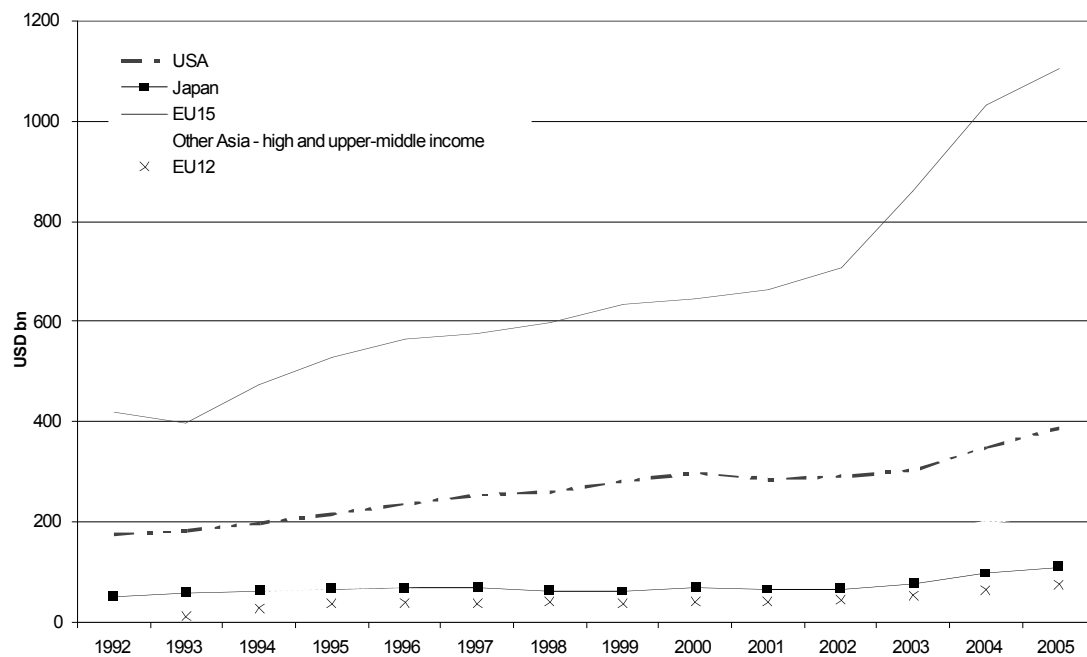


Figure 4.
GEOGRAPHICAL STRUCTURE OF SERVICES EXPORTS
(LOW AND LOWER-MIDDLE INCOME COUNTRIES)

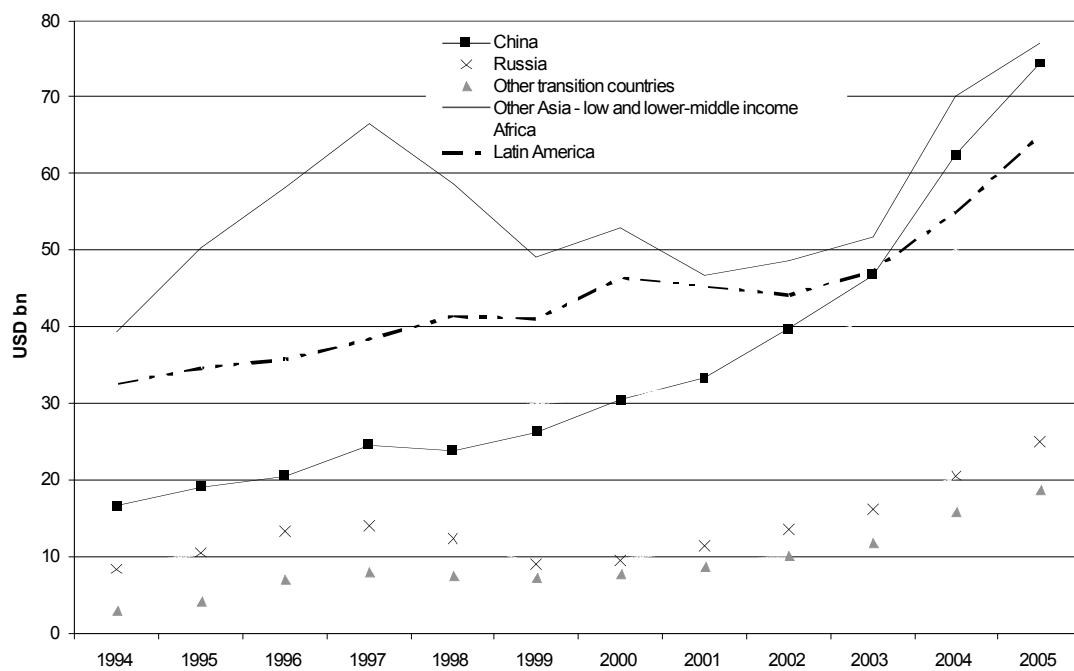


Figure 5.
GEOGRAPHICAL STRUCTURE OF SERVICES IMPORTS
(HIGH AND UPPER-MIDDLE INCOME COUNTRIES)

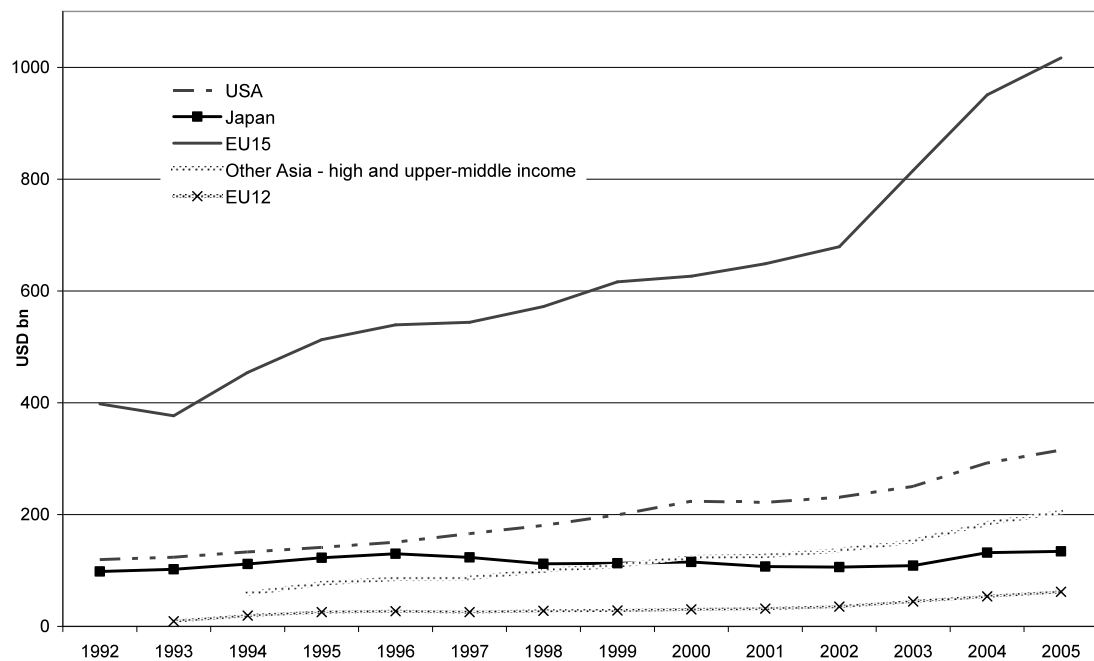


Figure 6.
GEOGRAPHICAL STRUCTURE OF SERVICES IMPORTS
(LOW AND LOWER-MIDDLE INCOME COUNTRIES)

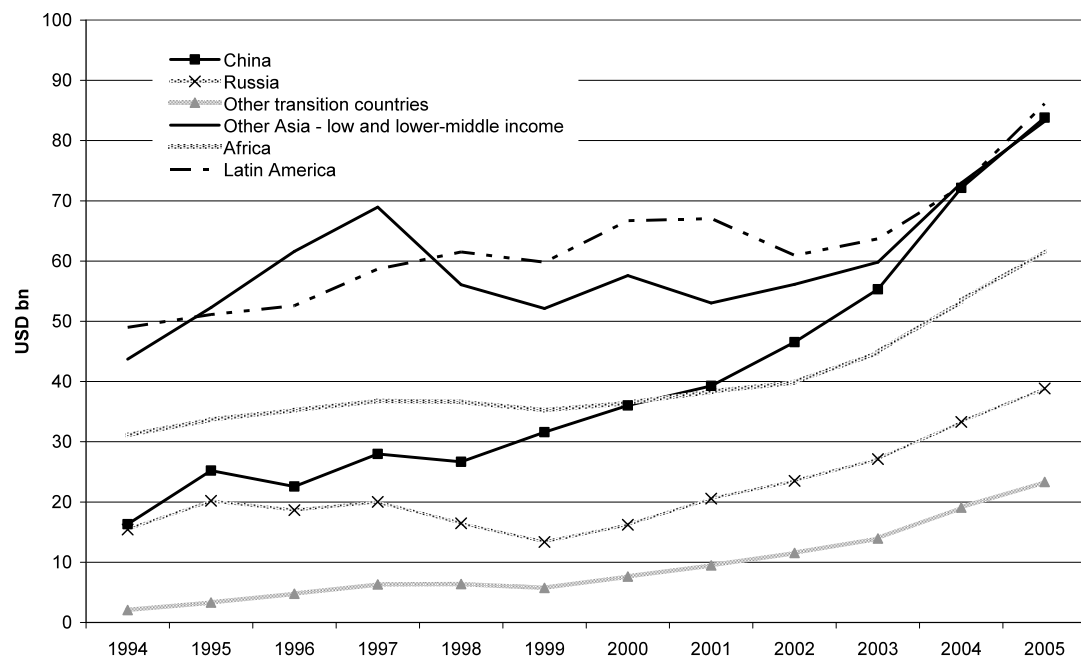


Figure 7.

AVERAGE ANNUAL GROWTH OF SERVICES EXPORT IN 1994-2005,
% (HIGH AND UPPER-MIDDLE INCOME COUNTRIES)

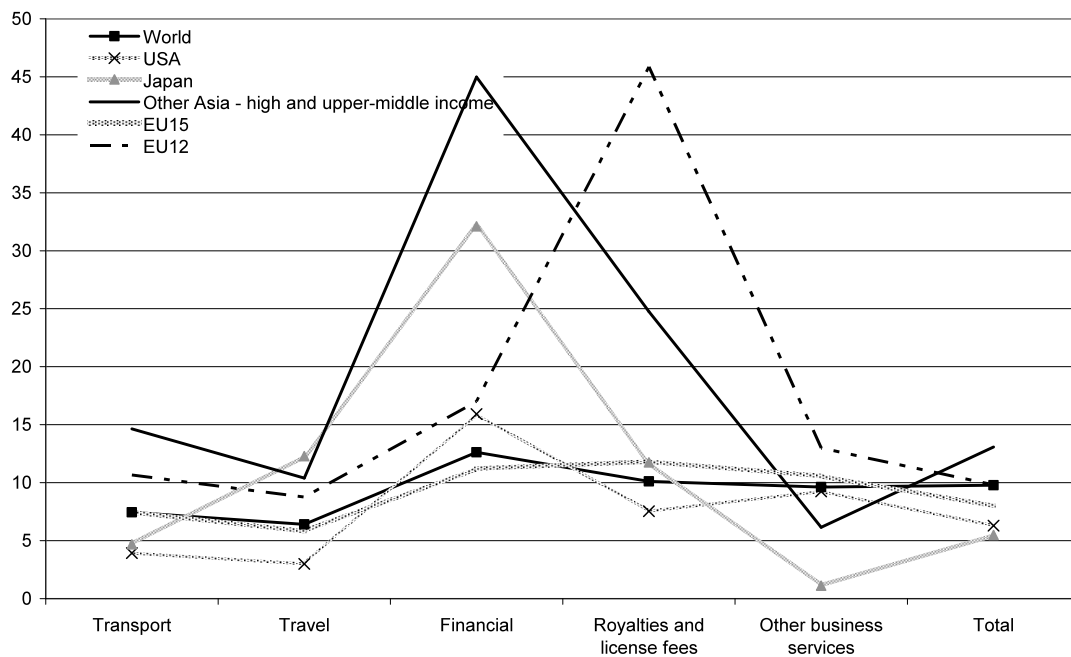


Figure 8.

AVERAGE ANNUAL GROWTH OF SERVICES EXPORT IN 1994-2005,
% (LOW AND LOWER-MIDDLE INCOME COUNTRIES)

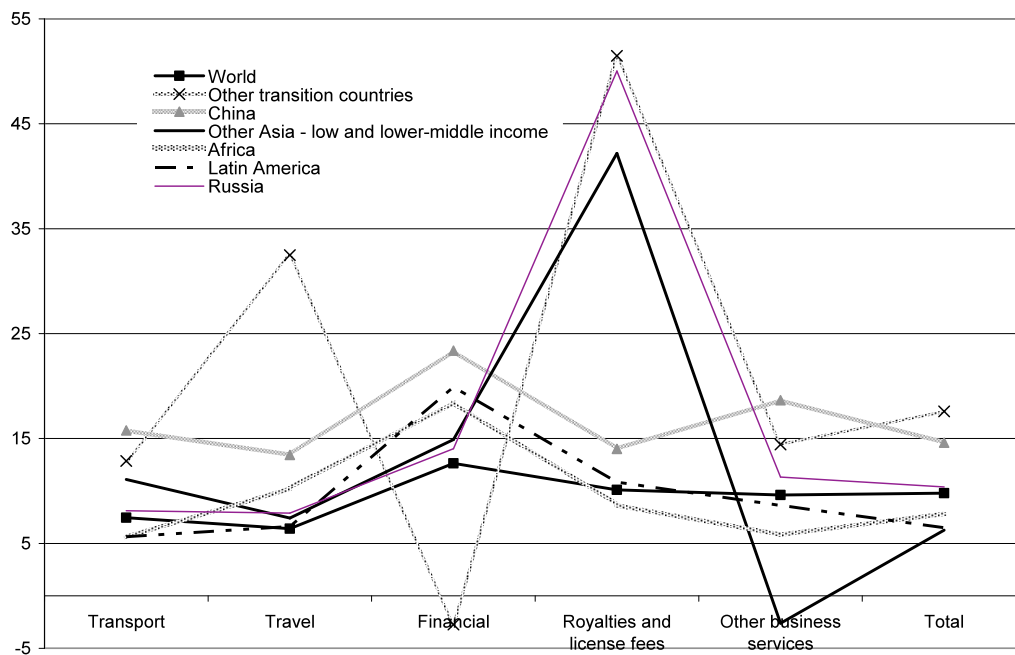


Figure 9.

AVERAGE ANNUAL GROWTH OF SERVICES IMPORT IN 1994-2005,
% (HIGH AND UPPER-MIDDLE INCOME COUNTRIES)

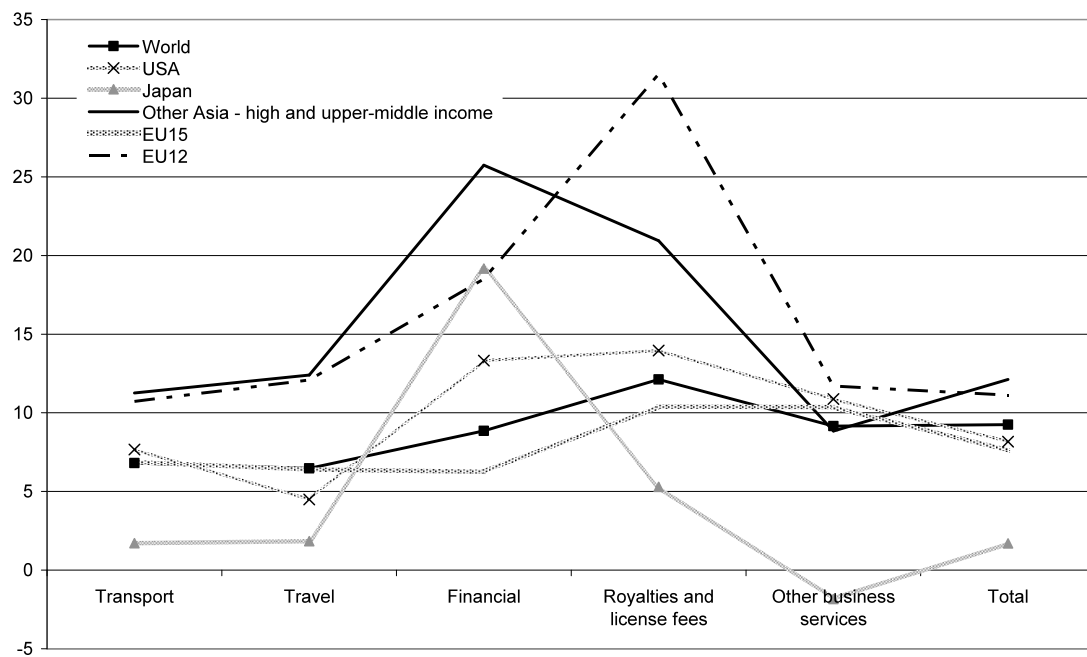


Figure 10.

AVERAGE ANNUAL GROWTH OF SERVICES IMPORT IN 1994-2005,
% (LOW AND LOWER-MIDDLE INCOME COUNTRIES)

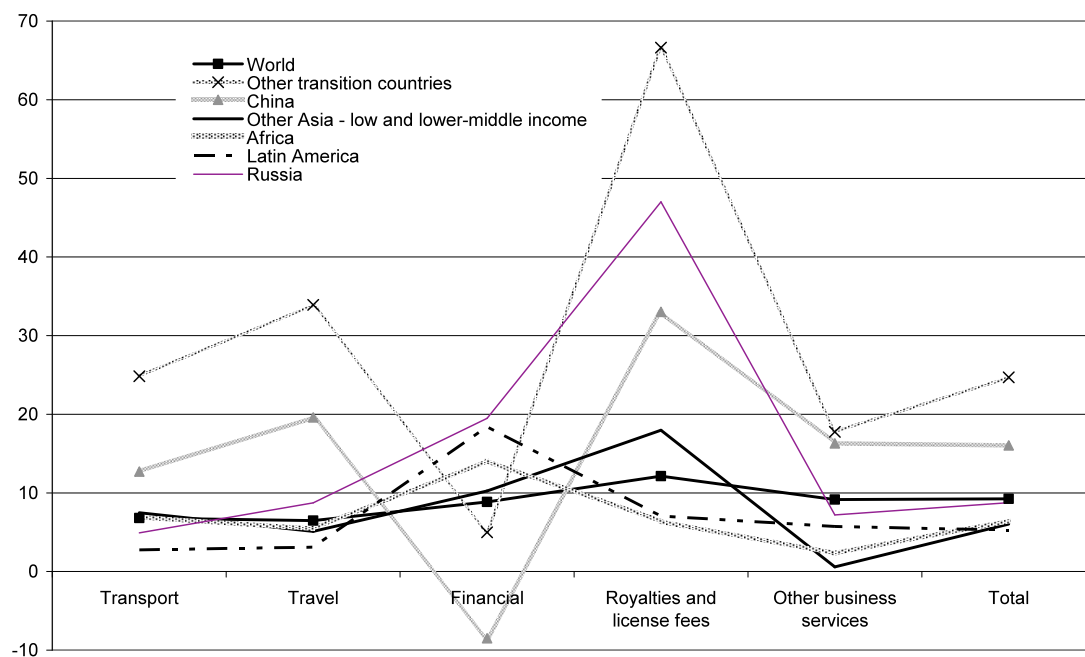
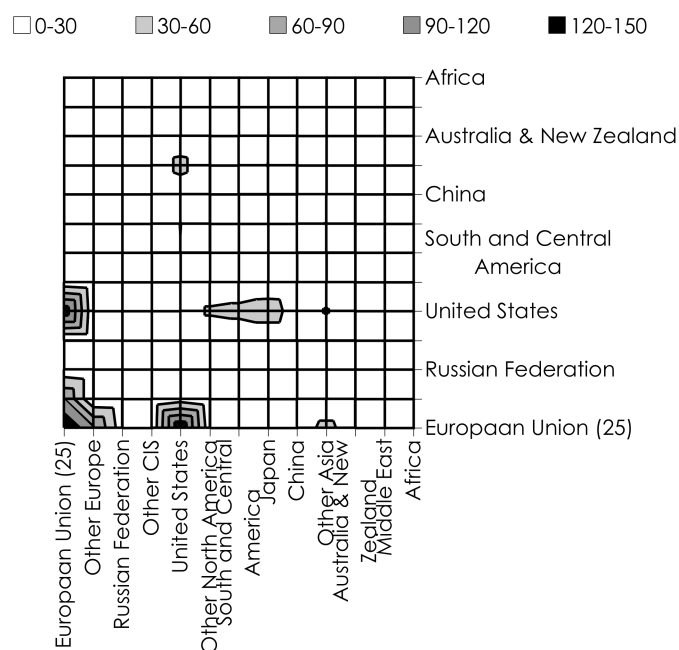


Figure 11.
 NETWORK OF WORLD MERCHANDISE TRADE BY REGION,
 2005 (IMPORTS IN BILLION USD)



Source: WTO International Trade Statistics 2006.

Figure 12.
 NETWORK OF WORLD SERVICES TRADE (CROSS-BORDER AND TRAVEL) BY REGION,
 2005 (IMPORTS IN BILLION USD)



Source: Eurostat and our own calculations.

Figure 13.
SECTOR STRUCTURE OF OUTWARD FDI STOCK IN THE OECD COUNTRIES, %

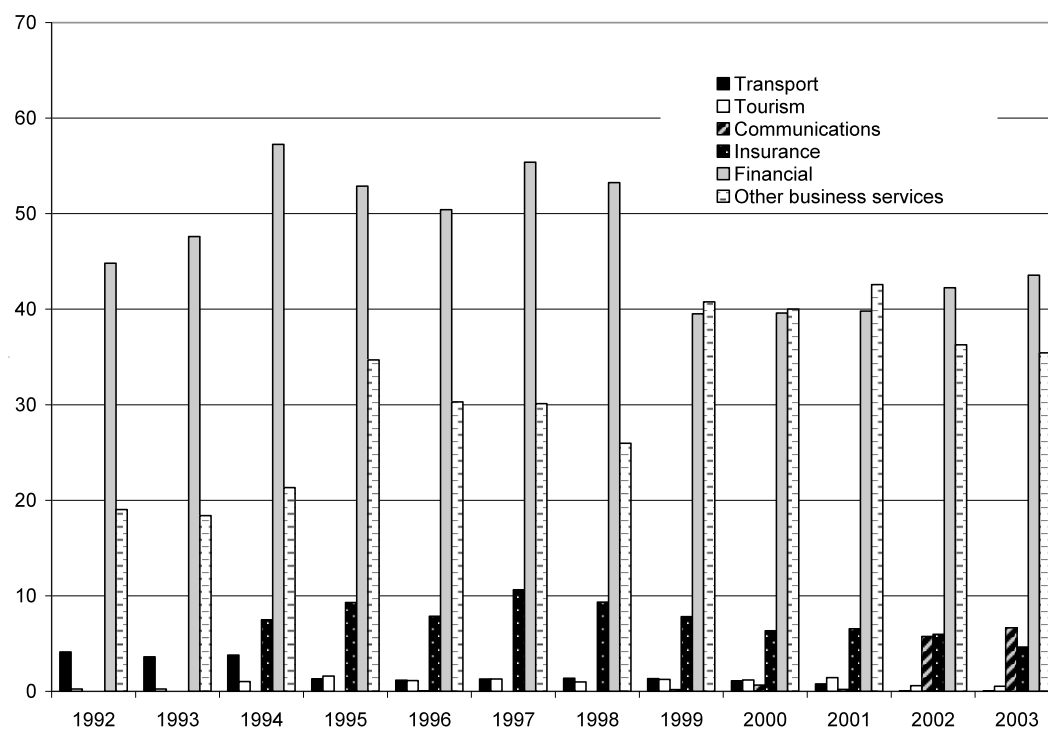


Figure 14.
SECTOR STRUCTURE OF INWARD FDI STOCK IN THE OECD COUNTRIES, %

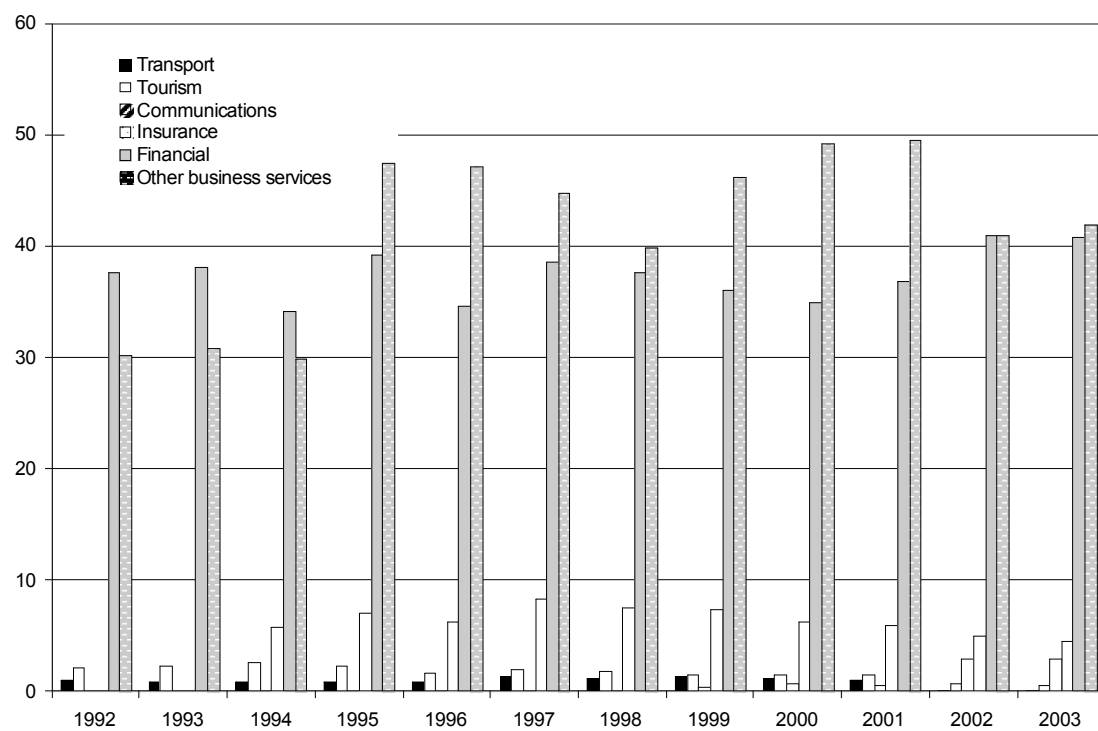


Figure 15.

AVERAGE ANNUAL GROWTH OF FDI STOCK IN THE OECD COUNTRIES IN 1992-2003, %

