

# comercio internacional

## **B**razil's emergence as the regional export leader in services: A case of specialization in business services

Lia Valls Pereira  
Ricardo Sennes  
Nanno Mulder



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Division of International Trade and Integration

Santiago, Chile, October 2009

This document has been prepared by Lia Valls Pereira, Fundação Getulio Vargas and UERJ, Ricardo Sennes, Prospective Consulting and PUC - São Paulo and Nanno Mulder, Economics Affairs Officer of the Division of International Trade and Integration, ECLAC.

The authors wish to thank Fernando Lemos of the Central Bank of Brazil for providing us with data on bilateral trade in services of Brazil and Eduardo Raupp de Vargas for his useful comments and suggestions. A previous version of this study was prepared as a background document for an ECLAC study entitled Structural Change and Productivity Growth: Twenty Years Later, presented at the thirty second session of ECLAC in Santo Domingo, Dominican Republic (9-13 June 2008).

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United Nations Publication  
ISSN printed version 1680-869x ISSN online version 1680-872x  
ISBN: 978-92-1-121721-6  
LC/L.3124-P  
Sales No.: E.09.II.G.102  
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Printed in United Nations, Santiago, Chile

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## Abstract

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Brazil has been the most dynamic country of Latin America and the Caribbean in global services trade in the 1990s and 2000s, but compared to other emerging economies elsewhere it is outperformed by China and India. Brazil's rising share in global services trade reflects mostly its increase in the world trade of "other services", which include all services except transport and tourism. Brazilian exports of "other services" are concentrated in architectural-engineering and real estate services. In terms of destinations, the US market accounts for about one half and the European Union for one quarter in total exports, while Latin America is a small but growing export destination. New types of exports are gaining importance, for example financial and legal services. Brazil's dynamic performance is associated with three, interrelated, trends. The first is the internationalization of Brazilian companies, which increases the demand for integrated support services such as finance, information technology and logistics. The second is the rise of inward foreign direct investment in the service sector, which expands Brazil's export capacity. Third, Brazilian investment abroad (in particular within the region) in the service sector has also grown rapidly. The future expansion of service exports requires above all a set of horizontal policies directed at enhancing the qualification of workers, the telecom infrastructure and a legal and regulatory system that favors investment and international trade.



## Introduction

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Brazil has been the most dynamic exporter of services of Latin America and the Caribbean in the 1990s and 2000s. Brazil's global trade share grew 60%, overtaking Mexico as the main service exporter of the region. Brazil's rising share in global services trade reflects mostly its rising participation in the world trade of "other services", which equals total services minus transport and international travel. Nowadays, "other services" account for about two thirds of total Brazilian services exports, compared to only one fourth in Latin America and the Caribbean as a whole.

This category of services exports has received special attention in several studies, as it contains many non-traditional services, which are often sold to other businesses and in many cases highly knowledge intensive (for example, finance, insurance, advisory services, services related to information technology, engineering services and research and development services). As such they are strategic inputs that increase the productivity and competitiveness of businesses and the economy as a whole. These services have a greater potential to incorporate value added and technology than "traditional services" (transport and travel).

This study's purpose is to analyse in more detail Brazil's dynamic trade performance in "other services". Which categories of "other services" have expanded most? What factors may explain their fast growth? What are the main destination markets for Brazilian service exports? Which policies have been important in the expansion of service exports?

"Other services" play a major role in world trade for three reasons. Accounting for about 10% of world trade of goods and services, according to balance of payments data, their true importance is understated. This is because a substantial share of these cross-border transactions does not go through a centralized system as is the case for



Goods trade that passes through customs administrations. Only few countries have developed special surveys to grasp cross-border activities of these services. Moreover, many “other services” are exported through local sales by foreign affiliates, which are not registered for most developing countries and not reported as part of international trade in services.

Second, a country’s competitiveness in “other services” is a major determinant of a country’s performance in global goods trade. In general, the world’s major exporters of goods are also the main exporters of services, except for some countries with very specific comparative and competitive advantages in goods or services.<sup>1</sup> Innovative countries with a good physical infrastructure and qualified workers not only export technology, transport services and professional services, but are also competitive goods exporters as they incorporate these services into their products. In 2007, Brazil was the 24th major goods exporter (with a 1.1% share) and 32nd major exporter of services (with a 0.7% share) (WTO, 2009).

Third, “other services” are becoming increasingly tradable, and offer increasing opportunities for developing countries. Until recently, services were considered mostly nontradable. But due to the rapid spread of information and communication technologies (ICT), more and more types of services can be digitalised and sold across borders.<sup>2</sup> Moreover, the convergence of national regulations combined with international commitments through multilateral, region and bilateral agreements and specific policies are contributing to maximise the effect of ICT on services trade. Firms are increasingly contracting services overseas or purchase services from local providers (off shoring). This offers many new opportunities for developing countries (UNCTAD, 1999). India is a showcase in this context: through targeted investment and labour training in the ICT sector, this country has become the world’s second largest exporter of computer services (NASSCOM-McKinsey, 2005; WTO, 2009). Moreover, India is one of the largest providers of call centre services for multinationals worldwide.

This paper has four sections. The first presents a descriptive analysis of Brazil’s performance in global trade of “other services”. In section 2, we discuss how the expansion of other services was shaped by the internationalization of integrated support services in and the expansion of sectors with a competitive advantage (within the region). The third section describes export promotion policies of services. Section 4 concludes.

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<sup>1</sup> Five countries (Ireland, India, Sweden, Denmark and Luxembourg) were part of the 20 major exporters of services in 2007, but not within the list of 20 major exporters of goods. Ireland and India have implemented specific policies to promote new types of services exports such as computer and BPO services. Luxembourg is a major exporter of financial services. In similar vein, five countries were part of the major exporters of goods (Russia, Mexico, Chinese Taipei, Saudi Arabia and Malaysia), but are not part of the major service exporters. Russia and Saudi Arabia are major energy exporters, whereas Mexico, Chinese Taipei and Malaysia are major exporters of manufactures. In 2007, the 20 largest exporters of services represented three fourths of global services exports, while the 20 largest exporters of goods represented 72% of global goods exports (WTO, 2009).

<sup>2</sup> See Mulder et al. (2008) for an overview of the impact of new technologies on trade in services.

## **I. Brazil's performance in global services trade**

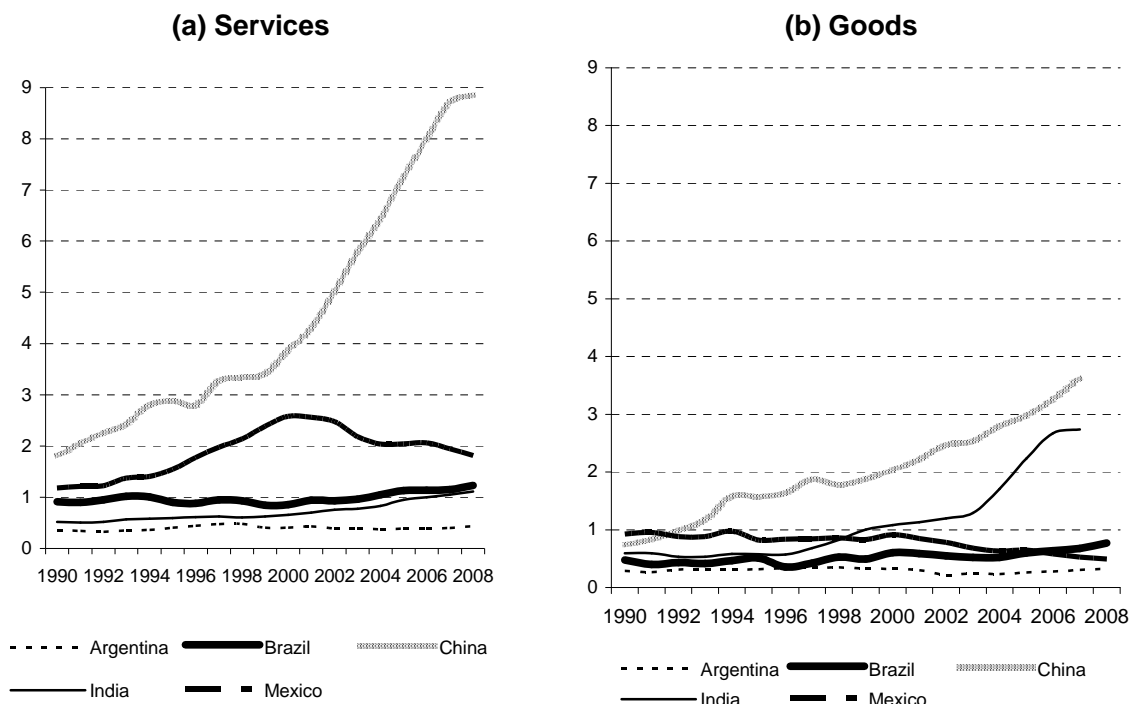
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### **A. Brazil's role in global services trade**

In the analysis of trends in service trade, it should be kept in mind that available statistics in this area are incomplete and less reliable than data on goods trade. This is not only true for Brazil but a general phenomenon. The data used here are from the balance of payments, which are incomplete because they do not register services provided through foreign affiliates established abroad, as well other service transactions that are not registered by the statistical authorities because they are difficult to capture. Moreover, there are major discrepancies between trade values declared by Brazil and its trading partners for the same trade flows (see Box 1 for more details). Nevertheless, the data available are deemed reliable enough to illustrate trends and orders of magnitude.

Brazil was the most dynamic country of Latin America and the Caribbean in global services trade in the 1990s and 2000s, but compared to other emerging economies elsewhere it was outperformed by China and India (Figure 1). In this period, Brazil's global trade share grew by 60%, overtaking Mexico as the main service exporter of the region. In contrast, Mexico's global trade share was cut by half. The third major provider in the region, Argentina, saw its market share increase only marginally. The relatively good performance of Brazil was modest compared to China and India, whose share in world services trade was multiplied by almost five.

**FIGURE 1**  
**SHARES OF BRAZIL AND OTHER EMERGING MARKETS IN GLOBAL SERVICES AND**  
**GOODS TRADE 1990-2008**  
*(percentages)*



Source: Authors' calculations based on WTO (2009), World Trade International Trade Statistics 2008.

**BOX 1**  
**DATA CHALLENGES IN TRADE IN SERVICES AND COMPARISON OF TRADE DECLARATIONS**

The main difference between trade in services and trade in goods lies in the need of direct contact between the producer and consumer in the case of the former. Many services are “non-transportable and non-storable”, and cannot be exported like goods. Instead, the consumer must visit the supplier, or the supplier must come to the consumer. To reflect this reality, international trade in services includes services provided through foreign affiliates established abroad. Services can also be provided by individuals located (temporarily) abroad. As such, services can be exported through four modes: (a) cross-border supply, takes place when both the consumer and the provider of a service remain in their respective countries, while the service crosses the border (Mode 1); (b) consumption abroad, takes place when a consumer moves to the country of the producer (Mode 2); (c) permanent commercial presence of the producer in the home territory of the consumer, which facilitates close contact between both in various stages of production, delivery, and after sales (Mode 3); and (d) temporary presence of natural persons, occurs when an individual has moved into the territory of the consumer to provide a service (Mode 4).

This study employs data recorded in the balance of payments of Brazil and OECD countries, which adhere to the extended definition of services. During recent years, Brazil and other countries of the region have improved the breakdown of their service trade in accordance with the fifth edition of the Balance of Payments Manual (see Annex 1). These data cover trade in modes 1 and 2, and partially trade arising from the temporary movement of persons (mode 4), but not exports through mode 3.

A comparison of trade declarations of “other services” between Brazil and its main trading partners shows major discrepancies, which fell over time. For Brazil, this paper uses unpublished export data by trading partner from the Central Bank for the period 2001 to 2006, distinguishing 25 types of “other services” and fifteen trading partners, including six OECD members (France, Germany, Italy, Japan, Portugal and the United States). These export data are compared with import declarations of these six OECD members, drawn from OECD’s Statistics on International Trade in Services: Detailed Tables by Partner Country (Box Table 1). Five out of six (four in 2005) OECD trading partners reported non-zero import values of “other services” from Brazil (column 3). Double trade declarations (by both Brazil and its partner) as a share of the total number of declarations (by Brazil, its partner or both) increased from 2001 to 2004 (column 4). For example, in 2001 out of 108 trading possibilities (6 countries times 18 types of “other services”), both Brazil and its partner declared a trade value in 13 cases, while in 77 cases either Brazil or its partner declared a non-zero trade value. The ratio of 13 to 77 equals 17%. When both Brazil and its partner declared a trade value, the former was always higher than the latter (column 5). Brazilian

(Continues)

Box 1 (concluded)

export values were almost 6 times the import values of its trading partners in 2001, but this ratio fell to 1.9 in 2005. The standard deviation of between both declarations also fell over time (column 6).

BOX TABLE 1  
DISCREPANCIES BETWEEN BRAZILIAN EXPORT DECLARATIONS VS.  
OECD MEMBER IMPORT DECLARATIONS OF "OTHER SERVICES", 2001 TO 2005

	Partners Brazil	Partners i	% non 0	Ratio Brazil X to partner M	Standard Deviation
2001	6	5	17%	5,9	9,7
2002	6	5	16%	3,5	4,3
2003	6	5	20%	3,8	4,1
2004	6	5	24%	3,1	4,0
2005	6	4	20%	1,9	2,3

Source: Central Bank of Brazil and OECD.

Some interesting differences can be noted among these five countries when their performance in world services trade is compared with their dynamics in world goods trade. Three countries show similar trends in both markets: an initial rise in the 1990s followed by a decline after 2000 (Mexico), a minor increase in both over time (Argentina), or a spectacular rise during both decades (China). The other two countries show a faster increase in their share in world trade in services compared to world trade in goods: India followed by Brazil. In 2008, the share of these five emerging markets in global goods trade was above that in global services trade, except for India.

Brazil's rising share in global services trade reflects mostly its rising trend in the world trade of "other services", which equals total services exports minus transport and international travel (Figure 2). Over the two decades its global trade share almost tripled, similar to that of Argentina although the latter country's initial share was very small. This performance contrasts with that of Mexico, which share increased in the 1990s but dropped rapidly in the 2000s. China and India's initial market shares were similar to those of Brazil and Mexico, but their boom has been much more spectacular. India's expansion is concentrated in computer and information services, where it has become the global leader (Arora et al. 2001).

Among these five emerging economies, China is the only one that matched its performance of "other services" in transport and international travel. India also expanded its market share in the latter two, but much less than in the former. Brazil's market shares in both transport and international travel stagnated, whereas those of Argentina and Mexico fell over the 1990s and 2000s.

Although its world market share has increased, Brazil remains a small player in world trade of "other services".<sup>3</sup> In 2007, it was the 14th biggest exporter, accounting for 0.8% of world trade, and the tenth largest importer with a 1.3% share of global imports. Considering the 15 major exporters in eight categories of "other services" in 2006, Brazil was present in only two: financial services (14th; 0.3% world market share) and other business services (13th; 1.2% share).<sup>4</sup> Brazil is part of the 15 main importers of all types of "other services", except for communication and construction services.<sup>5</sup> In the

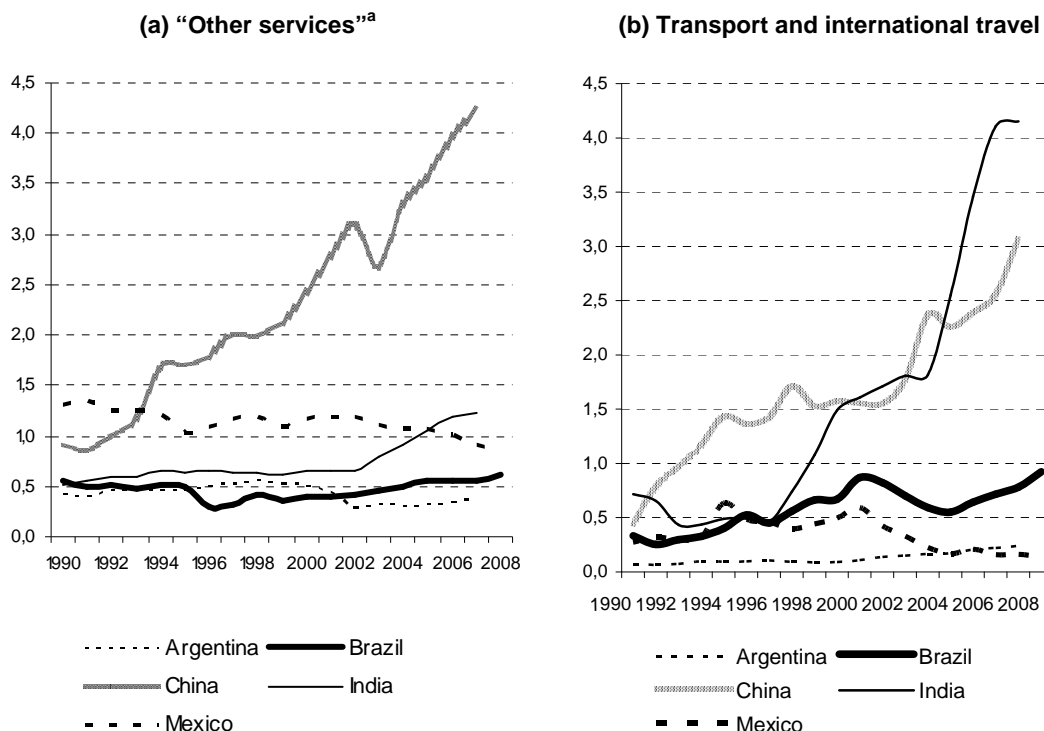
<sup>3</sup> The predominant exporters of "other services" are the European Union, the United States, Japan, India, China and Switzerland.

<sup>4</sup> Other South-American countries were also among the world's main exporters of certain types of services in 2006: Argentina and Uruguay are part of the largest exporters of computer services; Argentina, Colombia and Ecuador were among the main exporters of audiovisual services; and Ecuador was the 13th largest exporter of royalties and licenses.

<sup>5</sup> Brazil's position among the main importers in 2006 was: insurance (14°); finance (12°); computer and information services (5°); royalties and licenses (12°); other business services (12°); and cultural and recreational services (8°).

latter category, Brazil has several large firms which expanded due to large public infrastructure investments in the 1970s.<sup>6</sup>

**FIGURE 2**  
**BRAZIL AND OTHER EMERGING MARKETS SHARES IN WORLD TRADE**  
**OF “OTHER SERVICES” AND TRANSPORT-INTERNATIONAL TRAVEL 1990-2008**  
*(percentages)*



Source: Authors' calculations based on WTO (2009), World Trade International Trade Statistics 2008.

<sup>a</sup> Other services equals total services exports minus transport and international travel.

## B. Sectoral dynamics in “other services” exports

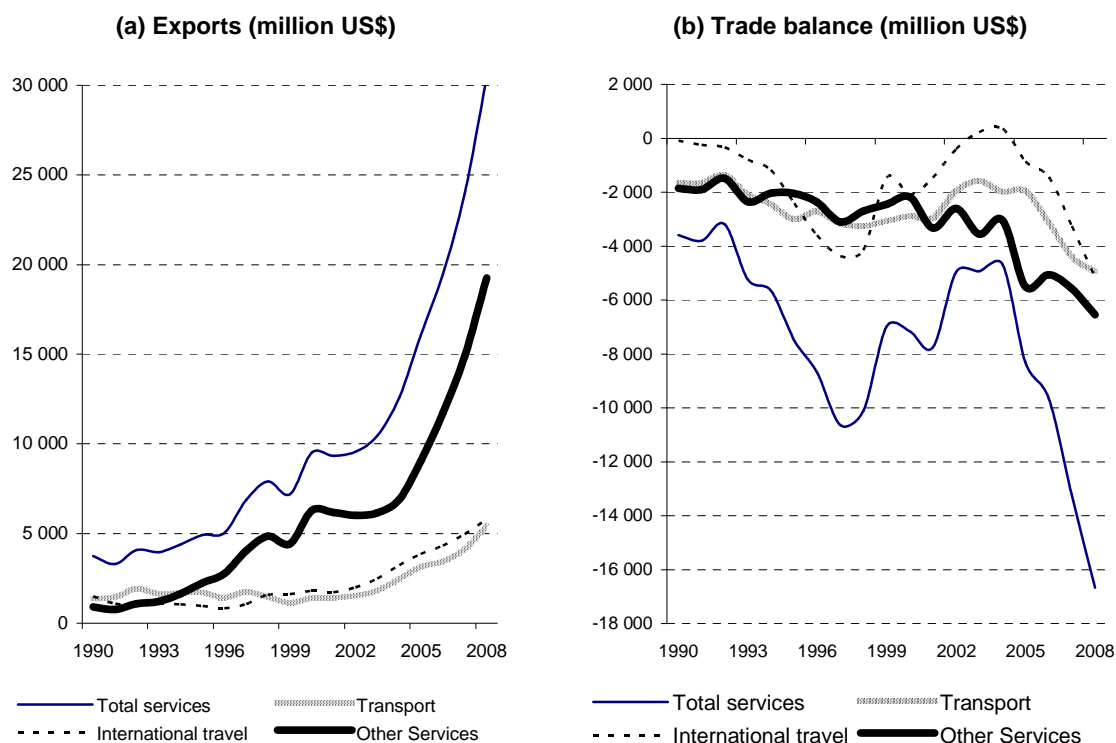
“Other services” has been the main and fastest growing component of Brazilian services exports for most of the present and previous decade (Figure 3). From the first to the second half of the 1990s, the share of “other services” in total services exports rose from 47% to 61%. Moreover, this category accounted for 74% and 81% of the growth of total services exports in 1990-94 and 1995-99, respectively. After a deceleration in the early 2000s, “other services” exports regained their fast growth from 2004 to 2008.

However, imports of these services grew even faster than exports, and also above the rate of imports of transport and international travel. As a consequence, Brazil has always had a deficit in its trade of “other services”, reaching almost US\$ 7 billion in 2008. Brazil also marked a quasi permanent

<sup>6</sup> According to the revealed comparative index indicator (RCA), Brazil had a comparative disadvantage in financial services (0.44), but a comparative advantage in other business services (1.66) in 2005, according to WTO data. When this indicator is above one, the country has a comparative advantage in a particular sector. The RCA indicator is the ratio of (a) the share of a service category in Brazilian exports of “other services” and (b) the share of that category in global exports of “other services”.

deficit in the other two categories and trade in services as a whole. The trend in the trade balance is explained in part by movements in the real exchange rate: the deficit grew in parallel with the real appreciation of the currency from 1994 to 1998, but fell after the devaluation in 1999. From 2004 onwards, the trend was again reversed in a context of a new period of real appreciation.

**FIGURE 3**  
**BRAZIL'S EXPORTS AND TRADE BALANCE OF MAIN CATEGORIES OF SERVICES, 1990 TO 2008**



Source: Authors' calculations based on Central Bank, [www.bcb.gov.br](http://www.bcb.gov.br).

Within “other services”, the category “Business, professional and technical services” explains more than two thirds of its expansion in the 1990s and 2000s (Table 1). As such, its participation in “other services” increased 46 percentage points to 75%. Within this category of several services, office installation and maintenance was the major contributor (61%) to the total growth of “other services” in the first half of the 1990s, while architecture and engineering services (42%) was a major contributor in the second half of that decade and the 2000s. Another fast expanding category in the 2000s was services of independent professionals, which participation in total service exports rose from 1% in 2000-04 to 12% in 2005-08. Other services that increased their share over time were athlete’s transfer fees, publicity and computer and information services (1.6, 1 and 0.9 percentage points, respectively). In contrast, several subcategories reduced their share between 1990-94 and 2005-08, like Financial Services (from 15% to 7%), Insurance (from 11% to 3%), and Merchanting (from 19% to 8%).

In 2005-2008, the predominant subcategories in “other services” were Architectural and Engineering services (37% of total of “other services”), followed by Installations of offices (22%) and Self-employment remunerations (12%).

The deteriorating trade balance of “other services” over the past decade hides contrasting trends within underlying categories. The category marking the largest deficit has been operational leasing services, increasing from minus US\$ 1.3 to US\$ 7.8 billion in the period 2001 to 2008, probably on the

account large oil exploitation companies. Other categories with a growing deficit were computer and information services (minus US\$ 2.6 billion in 2008) and royalties and license fees (minus US\$ 2.2 billion). In contrast, the category business, professional and technical services accumulated a trade surplus of US\$ 8.1 billion in 2008, with the most important subcategories contributing each about a quarter being architectural and engineering services, installation and maintenance of offices, and services of independent professionals.<sup>7</sup>

**TABLE 1**  
**EXPORTS OF "OTHER COMMERCIAL SERVICES": 1990 TO 2008**

Items	1990/1994			1995/1999			2000/2004			2005/2008		
	(a)	(b)	(c)	(a)	(b)	(c)	(a)	(b)	(c)	(a)	(b)	(c)
TOTAL	100	15	100	100	18	100	100	1	100	100	31	100
Insurance	11	5	4	9	-3	-1	3	-24	-106	3	83	7
Financial services	15	9	11	12	4	2	7	3	24	7	35	7
Computer-information services	0	26	0	1	-23	-1	1	12	10	1	29	1
Royalties and license fees	2	2	0	3	43	5	2	-3	-6	2	66	4
Operational leasing services	0	53	2	1	-34	-1	2	-10	-16	1	-11	0
Communication services	5	-21	-9	2	-5	0	4	62	106	2	25	2
Construction services	1	...	6	1	16	0	1	-73	-116	0	42	0
Merchanting, other trade-related	19	10	11	13	18	15	8	-10	-108	8	31	8
Business, professional, technical	46	28	74	60	24	81	72	4	320	75	29	70
Mail orders	...	...	0	0	31	0	0	40	1	0	-38	0
Self-employed remuneration	...	...	1	1	30	2	1	4	5	12	81	23
Installation of offices	31	37	61	32	14	27	30	2	64	22	27	20
Participation in fairs-exhibits	0	90	0	0	13	0	0	-10	-2	0	16	0
Athlete's transfer fees	...	...	2	2	59	4	2	-6	-14	2	14	1
Publicity	1	40	1	3	66	5	2	-10	-29	2	38	2
Architectural, engineering	14	9	7	21	42	42	37	7	296	37	19	23
Technical - economic services	...	...	0	0	24	0	0	...	0	0	140	1
Personal, cultural, recreational	0	38	1	1	7	0	1	-7	-8	1	16	0
Audiovisual	0	43	0	0	-25	-1	0	-4	-1	0	18	0
Cultural and sports events	0	37	1	1	44	1	1	-9	-7	0	15	0

Source: Authors' calculations based on Central Bank, [www.bcb.gov.br](http://www.bcb.gov.br).

Notes: (a) share in total exports of "other services", average for period; (b) annual average growth rate, (c) contribution to total growth of exports of "other services" during subperiod.

### C. Geographical dimensions of "other services" exports

The main destination markets of Brazilian exports of "other services" are the United States and the European Union. This can be concluded on the basis of a special database from the Central Bank that registers cross-border services transactions (mostly mode 1 and 2) by main destination markets for the period 2001 to 2006.<sup>8</sup> These data show that the United States absorbed about half of Brazilian exports,

<sup>7</sup> See Annex 2 for trade balances of individual categories of "other services trade".

<sup>8</sup> The following caveat should be kept in mind when using the Brazilian bilateral trade data: the destination and origin countries in this database are not always the countries that host the service provider (in the case of Brazilian imports) or service purchaser (in the case of

and the European Union about a quarter (Table 2). The participation of Asia was slightly higher than that of South America, with the share of Mercosur being surprisingly small. This geographical pattern was similar to the import profile of “other services”.<sup>9</sup> But it is totally different from the pattern observed in goods exports.<sup>10</sup>

**TABLE 2**  
**GEOGRAPHICAL BREAKDOWN OF EXPORTS OF “OTHER SERVICES”, 2001-03 AND 2006**  
(percentages)

Regions/countries	2001-03	2006	Difference in % points
<i>Americas</i>	60.6	62.0	1.4
United States	50.8	51.0	0.1
Mexico and Canada	0.8	1.4	0.6
Central America – Caribbean	4.0	3.8	-0.2
Mercosur	2.7	2.0	-0.7
Other South America	1.6	3.1	1.5
<i>European Union</i>	30.5	26.6	-3.9
<i>Asia</i>	4.9	5.9	1.0
China	0.1	0.2	0.1
Japan	3.3	2.2	-1.0
India	0.1	0.1	0.0
<i>Africa</i>	0.3	0.7	0.4
<i>Other</i>	3.8	4.7	1.0
<i>Total</i>	100.0	100.0	0.0

Source: Authors' calculations based on Central Bank, [www.bcb.gov.br](http://www.bcb.gov.br).

It should also be noted that the above data refer to cross-border exports, including mode 1 and mode 2, but excluding exports through local sales abroad by foreign affiliates of Brazilian companies (mode 3). Even though no data is available on exports by mode 3, indirect evidence of stocks and flows of Brazilian investment abroad suggests that the Latin American market is proportionally more important for this mode than modes 1 and 2.

At the more detailed level of subcategories of services, the geographical distribution varies in some cases from the general picture. This is illustrated by the market composition of the seven main categories accounting for 92% of total exports of “other services” in 2005-06 (Figure 4).<sup>11</sup> The United States had a higher than average weight in affiliated professional and technical services and telecommunications, while the European Union played a proportionally more important role in other professional-technical services and legal-accounting-public relations services. The South American market was relatively important for the exports of architectural-engineering services, accounting for one

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Brazilian exports). Instead, the registered countries are those that make or receive the payment of the services. In some cases, payments are made through third countries, in which case the host/destination country differs from the country doing/receiving the payment.

<sup>9</sup> Almost four fifths of imports of “other services” were from the United States and the European Union in 2006. The share of South America in imports was bigger than that in exports.

<sup>10</sup> The geographical distribution of Brazilian goods exports is much more diversified. In 2007, one quarter of all exports went to the Latin America and Caribbean (Mercosur 11%), another quarter to the European Union, 16% to the United States and 16% to Asia. The product composition differs considerably according to destination markets: agricultural and mineral commodities dominate Brazilian exports to Asia and the European Union, whereas manufactures account for most exports to the rest of South America and the United States.

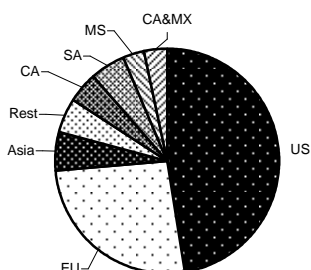
<sup>11</sup> The Central Bank statistics by geographical destination distinguish 22 categories, with 7 accounted for more than 90% of total exports in 2005-06.



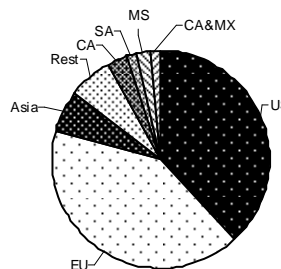
tenth of total exports. For exports of financial services and affiliated professional-technical services, the Asian market had a non-negligible share.

**FIGURE 4**  
**GEOGRAPHICAL DISTRIBUTION OF EXPORTS OF EIGHT CATEGORIES OF "OTHER SERVICES", 2005-06**

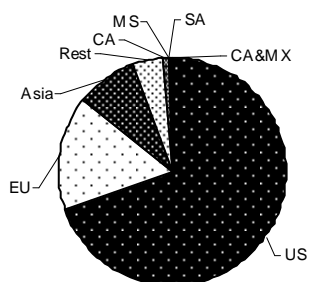
**(a) Architectural-engineering (35%)**



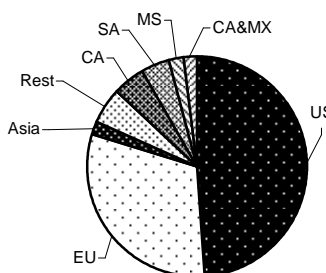
**(b) Other professional technical (21%)**



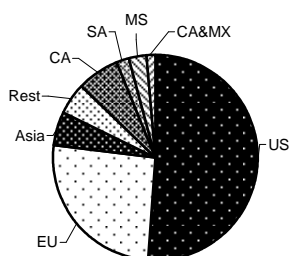
**(c) Affiliated professional -technical (13%)**



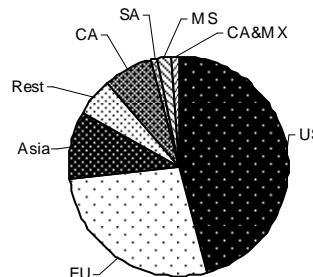
**(d) Legal-accounting-public relations (12%)**



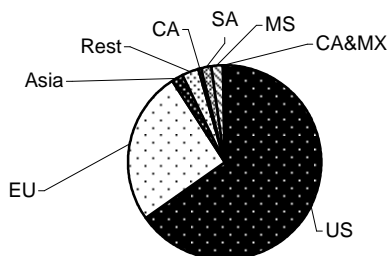
**(e) Merchandising & trade (10%)**



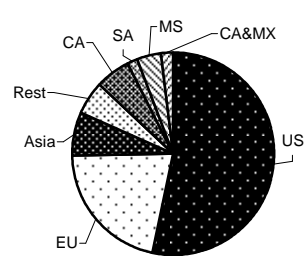
**(f) Finance (8%)**



**(g) Telecom (2%)**



**(h) Other (8%)**



Source: Authors' calculations based on Central Bank, [www.bcb.gov.br](http://www.bcb.gov.br).

Notes: (a) numbers in parentheses are shares in total exports of "other services" in 2005-06; (b) CA&MX = Canada and Mexico, SA = rest of South America, MS = Mercosur, CA = Central America and the Caribbean. Panel (h) of other services includes: Computer, Information, Post & mail orders, Construction, Operational leasing, Agricultural-mining-processing, Other direct insurance, Re-insurance, Freight insurance, Auxillary insurance, Audiovisual, Other personal-cultural.-recreational., Research & development, Publicity, market research, and Royalties and licenses.

A breakdown by the other dimension is shown in Table 3: that is the composition of trade flows to the major destination markets by subcategories of “other services” in 2005-06. Exports to the United States, the European Union, Central America and the Caribbean and the Rest of the world were most diversified, whereas those to Mercosur and the rest of South America seemed more concentrated. In South America, architectural and engineering services were the major source of exports.

**TABLE 3**  
**SHARE OF EACH SUBCATEGORY IN EXPORTS TO MAIN DESTINATION MARKETS, 2005-06**  
(percentages)

	US	EU	Asia	CA	SA	MS	Ca&Mx	Rest
Architectural-engineering	34	32	33	39	62	49	59	34
Other professional and technical	16	30	22	16	9	18	17	25
Affiliated professional technical	18	8	19	3	1	1	2	10
Legal-accounting-public relations	11	12	4	13	17	12	11	12
Merchanting & trade	10	9	9	16	7	12	6	9
Finance	7	7	13	13	3	6	4	8
Telecom	3	2	1	0	1	2	0	1
Other	9	6	10	11	6	14	8	8
<b>TOTAL</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>
Memorandum: share of each country in total exports of “other services” (in %):								
	49	29	6	4	3	2	2	5

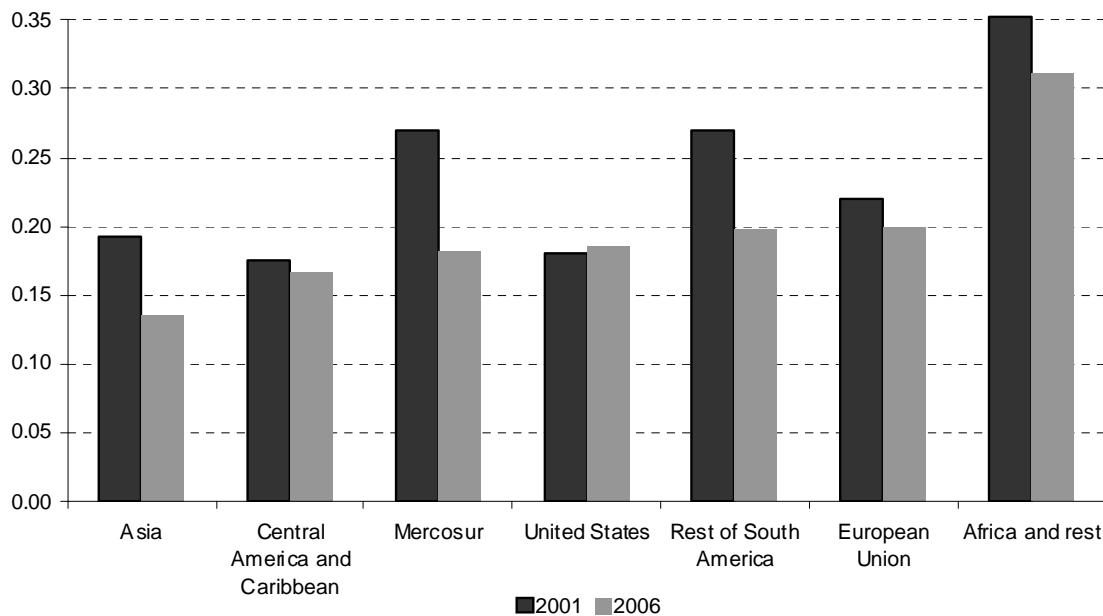
Source: Authors' calculations based on Central Bank, [www.bcb.gov.br](http://www.bcb.gov.br).

Notes: USA = United States, EU = European Union, CA = Central America and the Caribbean, SA = Rest of South America, MS = Mercosur, and Ca&Mx = Canada and Mexico.

To get a better understanding of the real concentration of Brazilian exports by destination markets, the Herfindal-Hirschman (HH) was used: the higher the index, the lower the diversification or the higher the concentration.<sup>12</sup> The overall index fell only marginally from 0.18 to 0.17 from 2001 to 2006. In comparative terms, the most diversified exports were those to Asia and Central America and the Caribbean, while the largest drops in concentration levels were observed in Mercosur and the rest of South America.

<sup>12</sup> The index is obtained by dividing a flow of the export sector by the sum of total exports, increased to the power of two. The outcome depends on the number of sectors considered its shares. In this case, a breakdown was available for 21 sub-categories sectors of “other services”.

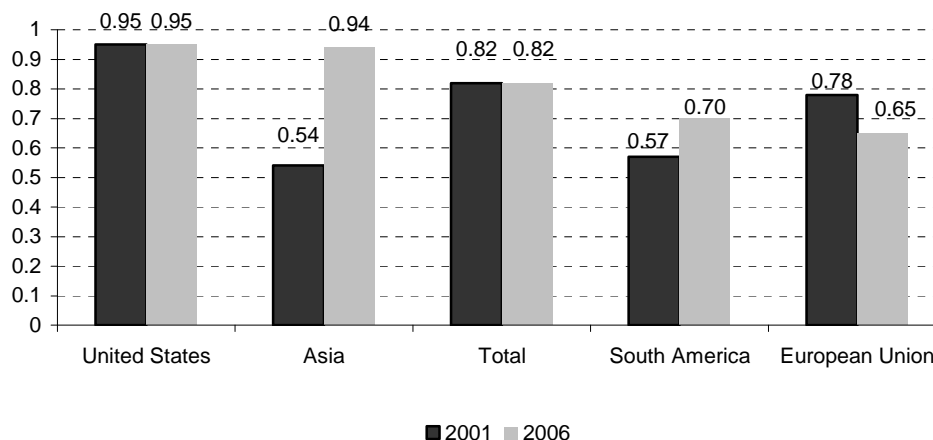
**FIGURE 5**  
**CONCENTRATION INDEX OF EXPORTS BY DESTINATION MARKET, 2001 AND 2006**  
*(Herfindahl Hirschman index)*



Source: Authors' calculations based on Central Bank, [www.bcb.gov.br](http://www.bcb.gov.br).

The degree to which Brazil participates in international networks that drive the differentiation of services, increase productivity and generate economies of scale depends in part on the degree of intra-industry character of its trade (Mulder et al., 2008). This can be approximated by the Grubel-Lloyd index: the higher the value of the index, the larger the degree of intra-industry trade. Intra-sector trade was highest for trade with the United States, followed by Asia. The jump in the case of the latter region between 2001 and 2006 is remarkable.

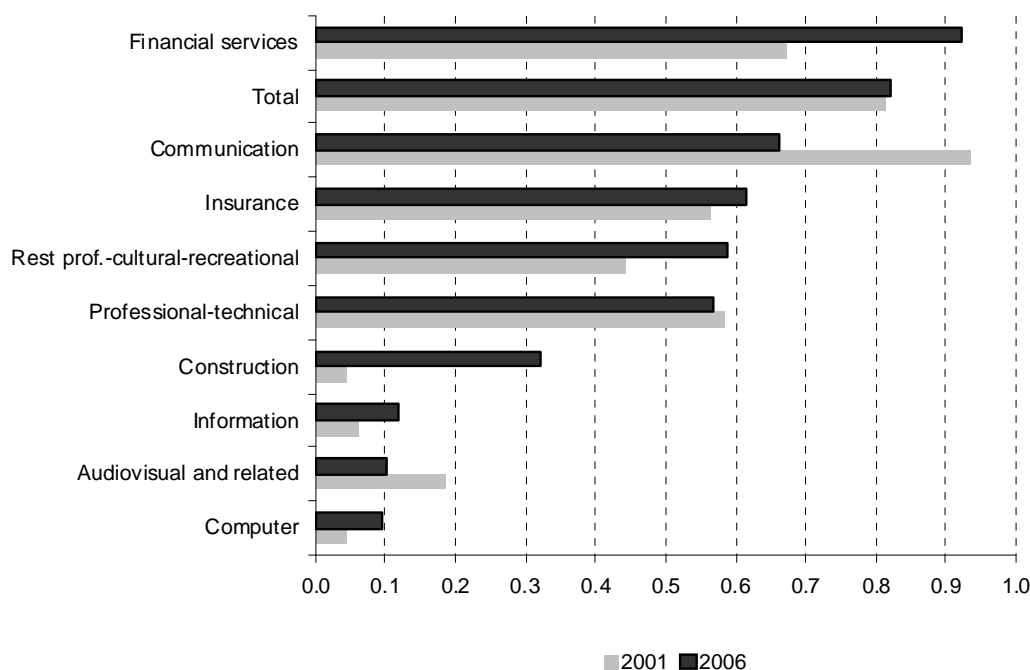
**FIGURE 6**  
**INDEX OF INTRA-SECTOR TRADE PER REGIONS, 2001 AND 2006**  
*(Herfindahl Hirschman index)*



Source: Authors' calculations based on Central Bank, [www.bcb.gov.br](http://www.bcb.gov.br).

From a sectoral perspective, the degree of intra-sector trade was low in computer, information, audiovisual and construction services but high for financial services, insurance and professional services. Over time, most progress was made in finance and construction, whereas in communication there was a drop.

**FIGURE 7**  
**INDEX OF INTRA-SECTOR TRADE BY CATEGORIES OF EXPORTS OF "OTHER SERVICES",**  
**2001 AND 2006**



Source: Authors' calculations based on Central Bank, [www.bcb.gov.br](http://www.bcb.gov.br).

A breakdown by regions and sectors shows that finance and communication were the sectors with the highest shares of intra-sectoral trade (see Annex 3). In finance, the index was above 0.8 in all four markets. The lowest shares were in audiovisual, computer and information services. From 2001 to 2006, major jumps were observed in information services in trade with Asia, the European Union and South America, insurance in trade with the United States, and four other categories in trade with South America (audiovisual, communication, computer and financial services)



## II. New trends in exports of “other services”

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In 2007, Brazil was the 14th major global exporter of “other services”. Within “other services”, the most dynamic segment is that of “other business services”, in particular architectural and engineering services, installation and maintenance of offices, and services of independent professionals. The main markets for Brazilian exports are the United States and the European Union, while South America is also gaining importance.

The above analysis based on balance of payments statistics does not capture, however, some new trends in services exports. In particular, the development of new internationalization strategies —whether of exports or foreign direct investment— of non-traditional services can only be detected on the basis of information from interviews, meetings of industry associations, seminars and debates.<sup>13</sup>

More in depth analysis on Brazilian services exports suggests that recent trends are shaped by three separate processes.<sup>14</sup> First, the internationalization of Brazilian enterprises and the related demand for support services, which create incentives for the expansion of cross-border sales of services. This category covers financial services, ICT, logistics and consulting. Second, Brazil has some segments with a competitive edge derived from specific aspects of recent developments within the Brazilian economy. Several segments of information technology (government management, payment operations and finance, games, etc.),

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<sup>13</sup> This issue has also been analyzed by authors dealing with innovation in services, see Djellal and Gallouj (1999 and 2000) and Drejer (2004).

<sup>14</sup> For example, Prospectiva Consultoria (2006) uses private data from company reports, business associations, media announces of foreign investments, and information collected from 64 interviews with service companies that participate in internationalization programs.

engineering and construction, aeronautical engineering and bio-technology, medical services and franchise sales fall in this second category. A third trend refers to niche markets where Brazil has developed skills for risk control and design with more profitable business models than its competitors from developed countries. Examples of these are projects and infrastructure development services, air transport, and even software and IT services, among others. These three trends sometimes overlap, as discussed in more detail below.

## A. Integrated support services

Multiple service companies in Brazil have internationalized their activities to follow their clients. Several services are essential inputs into production, as they increase their efficiency and improve the quality of products and services. Examples include electricity, finance, logistics and telecommunication. Services also connect activities within and between multinational corporations worldwide by facilitating the flow of information, goods, and people. As many Brazilian companies have increased the scale of their foreign operations, both by investment abroad and exports, Brazilian service providers followed suit by offering their services in an increasing number of countries.

Also linked to this trend are new forms of organization and management based on the allocation, in different countries, of different stages of the production process. The success of these vertical production networks depends in part on the efficiency of logistics services. These facilitate productive activities that are technology-intensive and just-in-time. As such, the investment by multinationals in a country depends in part on the presence of efficient infrastructure services. In this case, the causality seems to run the other way: the internationalization of services is not a result from the internationalization of client enterprises, but acts as a precondition to attract parts of production chains of global companies.

Some of these services are “incorporated services” or indirect service exports, i.e. these services are part of the good or service exported as they are used for design, market research, legal assistance, marketing, etc. The boundary between the production of goods and services is more and more blurred and mobile (Almeida, 2006). Services account for about one quarter of the total value of manufactures (IBM, 2006). Goods with the highest services-contents are the high-tech ones: electric-electronic goods and devices, telecom equipment and hardware. The value of the latter incorporates an increasing share of software. In some high-tech sectors —such as pharmaceuticals—, the value of the medicine depends more on the amounts spent on research and development than its actual production.

There is an intense debate about the following causality: (i) Does a country need an international competitive environment to attract global service exporters, or (ii) Is the development of a cluster of global competitive services a necessary precondition to create an international competitive environment?<sup>15</sup> UNCTAD (2004) discussed this issue in the context of several developing countries.

Below four examples of integrated support services are discussed: (a) Finance: banks, insurance companies and stock market institutions; (b) information and communication technology (ICT) services: telecommunication, information technology and other communication services (wideband transmission, satellite transmissions, telephony); (c) Logistics services including air and maritime freight shipping, (d) Professional services: legal, accounting, audit, consulting, marketing, environmental, events, and media services, among others.

### 1. Financial services

Banks and other financial operators are essential to international operations of companies, including financial planning and cross-border trade. Multinationals organize their finances according to the tax system and regulation in each country (taxes, credit etc.), as well as the local supply of financial services.

<sup>15</sup> See Gallouj et al. (eds.) (2006), and Moulaert and Gallouj (1993).

Export and import operations require credit products in local and foreign currency, guarantees, letters of credit, project financing and accounting products.

Brazilian banks greatly increased the provision of cross-border financial services, in parallel to the internationalization of many companies. Public and private banks have established several offices abroad and foreign banks have better integrated their Brazilian offices into their global network. While some banks (e.g. Banco do Brasil) mainly focus on corporate clients, others (Banco Itaú and Caixa Economica Federal, CEF) also offer services to Brazilian expatriates living in Europe, Japan and some countries in Latin America. Foreign banks (e.g. HSBC and Santander) have been accredited to carry out more complex financial operations to assist Brazilian and foreign multinationals.

Nevertheless, the expansion of cross-border banking services in South America has been very slow, which in turn seem to have hindered regional integration (Prospectiva, 2006). Until recently, only few banks operated at the regional level. Moreover, credit for region-wide (trade) operations was scarce and expensive. Bank lending was concentrated in big loans, and often rendered regional operations difficult.

However, the strong growth of Latin American multinationals (the so-called *translatinas*) with activities throughout the continent over the past couple of years has intensified the demand for region-wide banking services. This latent demand has in turn pushed financial institutions in Brazil to implement regionalization strategies, in particular Banco Itaú.<sup>16</sup> After concentrating its efforts on the regional wholesale market, Itaú has started to penetrate the retail market as well. Moreover, some foreign banks based in Brazil have established a strong presence throughout South America, which gives them a competitive edge offering regional products and services.

Other financial mediators that have internationalized their operations rapidly, with a focus on Latin America, are the stock exchange of Sao Paulo (BOVESPA) and the Stock Exchange and Commodity Futures (BM & F). In 2008, both institutions merged for two reasons: (a) to avoid a possible hostile takeover by an international competitor, and (b) to reinforce its internationalization with a focus on the Latin America market. In 2008, BOVESPA was the eighth largest stock exchange worldwide, with only Hong Kong and Shanghai being larger in emerging economies. Also in 2008, BM&F was the 6th largest futures and commodities exchange in the world. It operates a network of about 70 banks in Brazil and several abroad and is mediated by five clearings banks in the United States. BM&F is certified by the IMF in terms of risk management and is considered a global technological leader in its activity.

Two factors characterized Brazil's competitive conditions when compared to the rest of the region for these services (Pereira, 2007). First, both exchanges have exceptional technological capabilities that allowed the entire trading system to be essentially electronic and online, as a result from the reform of the Brazilian system of payments in 2002. Second, the consolidation of corporate governance rules that set a high standard among emerging economies.

## 2. ICT services

Brazilian exports of information and communication technology (ICT) services also have grown in parallel with the internationalization process of other companies. Firms expanding abroad have a growing demand for the development and maintenance of software to implement and integrate their systems, processing and storage of data, support, applications, business intelligence, network services, and security needs, among others. Specialized IT firms responded to these demands providing so-called BPO (Business Process Outsourcing) services, including customer support (e.g. telemarketing and research), back-office services (e.g. processing of financial information and processing of payroll.) and

<sup>16</sup> After a negative experience with the purchase of Banco Buenos Ayres in Argentina (1998) – an investment that remained frozen until the crisis of 2001-2002 -, Itaú exchanged shares with Bank of Boston in which it switched participation of the latter with the capital of Itaú Brazil (about 8%), for its assets in Uruguay and Chile. Thus, Itaú became the 12th bank in assets in Chile and 3rd in Uruguay. In Argentina, it plans to triple the number of customers from 170 to 400 thousand customers by 2010 (Itaú News, year 6, #57, June 07). Recently, Bank Itaú merged with Bank Unibanco and became the largest financial institution of Latin America, reinforcing its internationalization strategy.



miscellaneous services such as human resources, financial planning and accounting, marketing, design, among others. The expansion of international outsourcing and off shoring has been facilitated by the drop in communication rates and expansion of digital networks (UNCTAD, 2004).

In Brazil, several medium and large domestic companies are competing with multinationals, both in domestic sales and exports of services. In addition to their exports, several IT companies internationalized through the establishment of subsidiaries in several countries in the region, mainly Argentina and Mexico. According to the leading business associations of IT in Brazil (BRASSCOM): "Brazil takes advantage of a growth potential of 40% to 50% per year of global sourcing and establishes itself among the five largest of the market by 2010, generating US\$ 5 billion per year in exports of software and IT services."<sup>17</sup> "According to the same source, "several aspects make the country attractive to international demand. We have one of the largest markets in the world. We are global leaders in the use of IT in retail banks and one of the most sophisticated and efficient in terms of bank automation, especially in the clearance of checks and documents". For example, the Brazilian Payment System (SPB) is considered as one of the most efficient systems in the world, through the network that connects financial institutions to the Central Bank, and most of the transactions occurring in real time and with high safety standards. Brazil has also advanced in the use of Internet banking (about 14% of the population).

Both Brazilian (e.g. CPM, Datasul and Microsiga) and foreign companies (EDS, IBM and Tata) with subsidiaries in Brazil, have specialized in support services for international operations of Brazilian and foreign companies. These services include financial back office, management of payroll and human resources, help-desk and call-centers. A recent example is a consortium of foreign and national firms led by IBM – that signed a long term contract, managed from Brazil, for the outsourcing of payroll services, career management and benefits of ABN-Amro Bank which has a global presence (Prospectiva, 2006).<sup>18</sup>

Some positive features of the Brazilian IT sector stand out. For example, several IT service companies with a global presence have included Brazil in their priority list of countries to host part of their offshore operations, including EDS, IBM, and some Indian companies such as Tata Consulting. The country has a potential base for exports of IT services, as it hosts 450 of the 500 largest multinational companies in the world, and has a large domestic market for corporate IT.<sup>19</sup> For many multinationals, Brazil is the main market and key regional player in the region. In 2006, About 40% of all multinationals had their regional headquarters in Brazil, while 14% had main offices in both Brazil and Argentina (Prospectiva, 2006).

Some countries stand out as exporters of IT and BPO services, including India, China, Mexico, the Philippines and Brazil. According to a consultancy AT Kearney (2007), Brazil appears just behind India in the ranking of attractiveness. The Brazilian balance of payments does not record exports of IT and BPO services separately.<sup>20</sup>

### 3. Logistics services

Brazilian and foreign logistics companies have followed the trend of expanding goods exports, albeit slowly. Some companies have prioritized the regional market —mainly the southern cone of South America, while others have focused on extraregional operations, including the China, the United States and Africa. The supply of multimodal and international logistics is still well below that of other countries with a longer export tradition. The high cost of freight, low availability and low frequency of maritime routes, and recurrent bottlenecks of both infrastructure and logistics services suggests that there

<sup>17</sup> Testimony from Rego Gil (2007), president of Brasscom, which represents most IT exporters in Brazil.

<sup>18</sup> The ABN-AMRO (Banco Real) branches in Brazil were transferred to Banco Santander in 2008.

<sup>19</sup> One example of the size of the Brazilian market is an announcement by one of the largest Brazilian banks (Bradesco) to invest US\$ 600 million in IT projects in 2007 (Valor Economico, 03/08/2007).

<sup>20</sup> Each type of service is recorded under a different heading of the balance of payments. For example, some BPO operations are registered under the heading "professional services", others under "communication" and many under "computing and information".

is a huge market potential.<sup>21</sup> The shortage of logistics services to meet business demand in Brazil, particularly to the rest of South America, hinders regional trade.<sup>22</sup>

Some logistics companies have strongly internationalized their activities. Examples in rail and air transport are America Latina Logistica (ALL); TAM (Air Transport Mercosur) cargo services and Varilog.<sup>23</sup> About one quarter of all cargo shipped abroad goes to the rest of South America, but this region only represents 12% of total revenues from international operations. Important barriers seem to hinder the development of express cargo services, such as excessive red tape, customs delays, poor infrastructure at airports and ports and heterogeneity in air regulation.

#### 4. Other professional and technical services

Another sector which internationalization process paralleled that of its customers is professional services. From 1990 to 2008, this sector generated more than half of total revenues of “other services”. Professional services also stand out worldwide, contributing about a quarter of world exports of “other services” in 2004. Professional services include legal services, business consulting, projects and counseling, among others.

Several Brazilian law firms established a significant international presence, either through partnership networks, associations with firms in other countries, or in some cases with independent offices. These law firms basically follow the internationalization process of their customers. This internationalization process explains the increased participation of legal services in the exports of other business services from 1% to 14% between 2001/02 and 2005/06.<sup>24</sup> South America is the main market for the export of Brazilian legal services.

Exports of consultancy services (in audit, accounting, environmental issues, management) take multiple forms. Most are exported via cross-border trade (mode 1), but sometimes these companies establish commercial presence in other countries through partnerships with a local consultancy (mode 3). As consultancy services are usually contracted on a project basis, they tend to be developed in Brazil (mode 1) in combination with the temporary movement of consultants abroad during the development and implementation of the project (mode 4).

Another example of booming professional services exports is design. The main export markets are the United States and the European countries, and to a lesser extent South America. The latter exports are primarily oriented towards Brazilian companies that have business presence in several countries in the region, and want the same service design provider. Although exports of these services to the region are still small, they are growing rapidly. In addition to many medium and small design firms, several large industrial companies (e.g. Brastemp, Embraer, General Motors) created specialized design agencies. The latter also export services, both directly and indirectly.<sup>25</sup>

The franchising sector in Brazil began its internationalization process only recently, through the establishment of trade representation in third countries via Mode 3. These companies are expanding abroad to improve their international competitiveness and reduce their dependence on the home market. Moreover, they feel that owning franchises abroad strengthens their position in the Brazilian market through the improvement of the valuation of their brand at home. As such, international brands have become part of domestic marketing strategies. Examples are: China in Box and Habib's (food industry), Chili Beans (sunglasses) and O Boticário (cosmetics). Out of 400 companies that are part of the Brazilian Franchise Association (ABF), only 35 had gone international by 2007. According to ABF,

<sup>21</sup> Based on interviews with executives from logistics, air transport, rail and road companies in 2006-07.

<sup>22</sup> A study by Propsectiva (2006) showed that 57% of all multinationals consider poor logistic services (low supply and high cost of regional flights and maritime shipping) as a major obstacle to the integration of their activities in the region.

<sup>23</sup> This company was created after the restructuring of Brazilian biggest airline - VARIG.

<sup>24</sup> Although there are no official data on the number of law offices and their activities abroad, information published in newspapers (showing openings of offices abroad and partnership with foreign offices), and interviews suggest they are rapidly increasing their exports.

<sup>25</sup> A recent example was the export of the design of the Autosport Ford by the engineering department of GM Brazil to GM's subsidiary in Germany.

Latin America accounts for almost all international billing, but represents less than 5% of total turnover of the industry. According to business leaders of this segment, as Brazilian franchises are in their initial phase of globalization, they concentrate on neighboring countries (Argentina, Chile, Colombia, Peru, Ecuador, Uruguay and Paraguay) for the ease of cultural and physical proximity. It should be noted that in the case of franchising, companies export a business model related to the product concept and marketing strategy rather than products.

## **B. Sectors with a competitive advantage**

Another group of fast growing service exporters base their strength on a competitive advantage in niche markets, including medicine, engineering and construction, and some areas of finance and IT. Exports of medical services mainly consist of two types of remote diagnoses performed in Brazil (mode 1) and health tourism (mode 2). The first is clinical analysis of medical samples (part of the end stages of manufacturing and marketing of drugs). South America has developed into an important market for these clinical laboratory testing services. The second is teleradiology services sold mainly to European countries. Although no hard data are available to assess the importance of these services, some evidence points to the growing importance of these service exports. In addition, Brazil also exports medical services through mode 2 (movement of consumers), referred to as "health tourism". These consist of medical services related to check ups and surgery (including plastic surgery and heart transplants) for foreigners, including the travel from their home country to Brazil and vice versa. Some Brazilian top level hospitals already have a third of this capacity allocated to foreign clients, with service provides by Spanish and English-speaking staff.

Another niche market penetrated by Brazilian companies is engineering and construction, which is the main revenue generator of exports of "other professional services". In this industry, Brazil has several large companies with a strong international presence, built up mainly in the 1980s. These activities also increase the foreign sales of Brazilian building materials as Brazilian constructors decide which inputs are required. In this case, the opposite occurs of what is observed in other parts of services, which are exported in indirect form or shipped "within" the goods. Here it is the export of services that generates an export flow of goods. Brazil has important technical capabilities to compete in international markets. However, Brazil's participation in global trade of construction services remains small (1.4% of total market turnover in 2007). In 2007, three Brazilian companies were among the 225 largest construction exporters in the world: Norberto Odebrecht (21st) and Construtora Andrade GUTIÉRREZ (82nd), and Camargo Correa Construction and Trade (203rd) (ENR Engineering News Record, 2007).

## **C. Sectors with "advantages" in developing countries**

A third type of successful export activities in Brazil is those with specific advantages relative to companies in developed countries. The experience of Brazilian companies in the domestic market gives them an advantage in managing risks and designing appropriate business models in other developing countries, in particular in Latin America.

One example is engineering services. Brazilian firms are successful in project financing, as they attach less risk to neighboring countries than large construction companies from developed countries. This attitude stems from a better understanding of the operation of the institutions in the Latin countries. Moreover, Brazil's official relationships with other governments in Latin America may be decisive in the contract process of major engineering projects.

A second example is IT services administering political elections. The 100% automated electronic ballot box used in the 2004 elections in Brazil was developed by a Brazilian company (OMNITECH Services) between 1995 and 1996. In 2004, these electronic ballot boxes were exported for the first time abroad and used in the 2006 elections of the Dominican Republic.

A third example is regional logistics services, both land and air transport. For political, cultural and historical reasons, the provision of transport services connecting Brazil to its neighbors has been dominated by Brazilians companies that extended their domestic market strategy to neighboring countries.



### **III. Export promotion of services**

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The heterogeneity of Brazilian exports of services demands different types of promotion policies. According to the Brazilian Foreign Trade Association (Fonseca Moreira, 2007), the formulation of an export policy for services needs to account for different demands of exporters ranging from tax exemptions on payments associated with trade in services to policies to improve the infrastructure for transport, tourism, as well as investment in technology and education.

This section shows the policy framework for trade promotion in the service sector, and illustrates the issue of specific policies for specific needs in the cases of information technology services and engineering services. Also, this section highlights the importance of inward foreign and outward Brazilian investment, as well as the role of regional trade agreements in services.

#### **A. Policies to encourage services exports**

The Department of Trade and Services (SCS) in the Ministry of Development was created in 2005. This department monitors the exports of services, participates in international negotiations and proposes policies for the development of the sector. In addition, the SCS disseminates the culture of “services exports” through for example training courses for companies and interested individuals.

Other agencies from the federal government also promote service exports. Their main credit instruments are:<sup>26</sup>

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<sup>26</sup> [www.desenvolvimento.gov.br](http://www.desenvolvimento.gov.br). in services, credit facilities and financing for exports.

- Export Financing Program (PROEX) allocates funds for goods and services exports to micro, small and medium Brazilian companies.
- Export Credit Insurance protects Brazilian exports of goods and services against commercial, political and extraordinary risks.
- Export Guarantee Fund (FGE): cover guarantees in operations of credit insurance for export.

Export financing operations (PROEX and FGE) need approval and are monitored by the Committee on Finance and Guarantee of Exports (COFIG), which is a board of the Chamber of Foreign Trade (CAMEX).<sup>27</sup> These instruments apply to trade in goods and services. There are no special privileges for the exports of services, despite requests from the Foreign Trade Association to allocate more resources to this area.

In addition, the National Bank for Economic and Social Development (BNDES) offers credit lines for investments in fixed and working capital and purchases of capital goods, aimed at the production of goods and services for export. There are programs for specific types of services, such as tourism, information technology (PROSOFT, see below) and audiovisual services (PROCULT, both for domestic market and exports).

The BNDES also promotes the internationalization of Brazilian companies, by providing them credit through the subscription of securities. This support can be used for the following operations: investment (construction, acquisition, expansion or modernization of units installed and corporate participation), and working capital associated with investments liable for financial support.

To illustrate the role of policy incentives for exports, two sectors are analyzed in more detail below: engineering and information technology services.

## 1. Engineering services<sup>28</sup>

Financing and the provision of guarantees is a key determinant for the competitiveness of engineering services. In advanced economies, the private sector and governments often participate in the financing and provision of guarantees for overseas projects in the construction industry. In Brazil, such guarantees are available only from a public entity called FGE-COFIG, but are deemed insufficient by Brazilian construction companies.

In 1982, the Convention of Reciprocal Credit (CCR) was set up - an agreement signed among the central banks of 12 Latin countries.<sup>29</sup> The objective was to stimulate intra-regional trade, at a time when foreign exchange restrictions (crisis of external debt) existed in most Latin countries. The CCR operates as a mechanism to compensate of payments on a quarterly basis. Operations approved under the CCR were guaranteed by Central Banks, only related to convertibility, transfer and payment risks. Transactions under the CCR accounted for 90% of intra-regional trade of member countries of the agreement in 1989 (ALADI, 2002).

In the 1990s, new guidelines on the management of central banks restricted the role of the CCR. In 2001, operations backed by CCR represented only 3% of intra-regional trade. Nevertheless, the CCR continues to be an important facilitator in markets with a high degree of risk, for example for long-term operations in engineering and construction services. The private market offers no guarantees for these projects.

At the First Summit of Presidents of South America in 2000, the heads of state recognized that physical integration in the region is a decisive factor for regional economic integration. In this context, they approved the IIRSA Project (Integration of Regional Infrastructure in South America). Although

<sup>27</sup> The board of COFIG consists of members from ministries, the President's chief of staff ("casa civil"), National Treasury Secretariat (with voting rights) and representatives of the BNDES, Banco do Brasil and Credit Insurance to Brazilian exports (without voting rights).

<sup>28</sup> The comments are extracted from the Schechtman Report and Costa Pereira (2005).

<sup>29</sup> These countries are Argentina, Plurinational State of Bolivia, Brazil, Colombia, Chile, Dominican Republic, Ecuador, Mexico, Paraguay, Peru, Uruguay and Bolivarian Republic of Venezuela.

Brazilian companies have expertise and technical skills, their expansion in Latin America is restrained by insufficient supply of securities. Some recent proposals include the establishment of a regional fund for guarantees.

Nevertheless, Brazilian companies have several projects under way in various Latin countries. This suggests the companies have solved, at least partially, the issue of guarantees. Broader government support in the area of guarantees would contribute to the expansion of its foreign operations.

## 2. IT services

In recent years Brazil implemented several policies to promote the internationalization of IT service companies. In 2004, the software and related services were selected as a priority sector for the Industrial Policy, Technology and Foreign Trade (PITCE) policy. A first set of policies was implemented under the Law No. 11,196 22/11/2005 in 2005. In addition to promoting technological innovation, this Act stimulated investment and software development. This was done through special arrangements for the Platform for Export Services Information Technology (REPES), which aimed at expanding Brazil's exports of IT services through the elimination of PIS / PASEP and COFINS charges on purchases of computers in the domestic market and imports of goods and services related to software development and services for export.<sup>30</sup>

A second measure was the 2005 Law of Technological Innovation (Law 10,973 02/12/2004). This tool encouraged interaction between companies, research centers and universities, stimulating the development of new ideas and innovative products.

A third tool was the creation by BNDES of a credit facility called PROSOFT (Program for the Development of the National Software and Related Services Industry). This credit line provides financing for the purchase of equipment and machinery, spending on training, expansion of companies abroad and exports.<sup>31</sup>

Another policy initiative is the promotion of a safe environment for the IT industry by the protection of intellectual property. For this purpose, a National Council to Combat Piracy was created.

To accelerate PITCE's goals, President Lula renamed the initiative Productive Development Program (PDP) in May 2008. PROSOFT continues to be part of it.

## B. Investment and services negotiations

Export competitiveness in services also depends on investment and (regulatory) trade barriers. Both affect the potential for expanding exports through trade diversion and creation.<sup>32</sup>

<sup>30</sup> PIS / PASEP and COFINS are taxes paid by companies on their revenues and profits intended to finance social programs, including the unemployment-insurance. As companies also pay social security contributions on wages, they would like to be exempted from the other taxes.

<sup>31</sup> Two interesting examples can be mentioned in this regard. The first is the support to the internationalization of a firm called Itaotec. The BNDES disbursed US\$ 142 million in July 2007 to support and facilitate the acquisition of a US company Tallard, to strengthen the company's subsidiaries in Miami and Lisbon. A second relates to Microsiga, a Brazilian company with strong presence in Argentina and Mexico, which acquired Logocenter with financial support from BNDES.

<sup>32</sup> The concepts of creation and diversion of trade are used in the economic literature to assess the effects of preferential free trade agreements and customs unions. There is trade creation, when a country starts to import from the partner's agreement, a commodity that was previously only supplied by the domestic industry. The partner, even if it is not the most efficient in world trade, has comparative advantages in relation to the country. Without the agreement, the country would not have imported the commodity. There is trade diversion, when as a result of preferential access a partner country replaces another more efficient source country in the imports of the partner of the trade agreement. In this case, the allocation of global resources worsens. However, an analysis of the benefits of a dynamic integration shows that the gap may favor the development of regional industries (Pomfret, 1997). The same conceptual approach can be applied in the area of services. The difficulty, however, is to quantify the costs and benefits.



## 1. Foreign investment

Investment and exports of services are strongly linked. Investment can facilitate foreign sales of services exports in two ways. First, in addition to cross-border transactions, Brazil can also export services through the establishment (investment) of affiliates in other countries and use those to sell services locally. Second, Brazil can attract foreign companies to establish (invest) affiliates in Brazil, which in turn can export services to other countries. The data on foreign investment by Brazilian companies abroad as well as FDI by foreigners in Brazil are used as a proxy for both sales by Brazilian affiliates abroad and exports by multinationals based in Brazil, as the latter data do not yet exist.

Brazilian investment abroad grew steadily from 2001 and 2007 from US\$ 42 to 75 billion, while investment in service industries rose from US\$ 38 to 69 billion (Central Bank). As such, about 90% of Brazilian investment abroad was in services over the past few years. About half of the investment abroad was in financial services, a share that is probably upward biased because part of these funds are only intermediated by banks and invested in other parts of the economy.<sup>33</sup> Investment abroad in business services accounted for about one quarter to one third of the total in recent years. Unlike financial services, investment in this segment is more closely linked to the internationalization of Brazilian firms. That is, the fact that business, professional and technical services accounted for half of total exports seems consistent with the share of investment abroad in this sector.

The second contribution of investment to foreign sales of services is through the establishment (investment) of affiliates in Brazil by foreign multinationals, which in turn can export services to other countries. The most recent data on the stock of inward FDI are for 2000. These data illustrate that in the 1990s, multinationals invested heavily in Brazil taking advantage of (i) a large wave of privatization of public utilities (telecommunications, electricity, roads and railroads), and (ii) deregulations easing the entry of foreign capital. As a result, the share of services in the stock of inward FDI increased from one third in 1995 to 81% in 2000, with posts and telecommunications representing 37%, and finance (excluding insurance and pension) 21%. The main foreign investors in the 2000 FDI stock were Spain (32%) and the United States (18%).

The service sector share in inward FDI flows has fallen over the past decade. Its share was about 80% from 1998 to 2000, after which it fell to 55% from 2001 to 2006, 47% in 2007 and 39% in 2008. In the last few years, the predominant recipient sectors were finance, retail, construction-real estate, and transport.

A comparison of Brazilian direct investment abroad and foreign direct investment in Brazil shows the large share of financial services. This finding is consistent with the high level of intra-industry noted in section I. Moreover, the data show that that the massive inward FDI in some sectors has contributed to Brazil's export performance in these areas. One example is telecommunications, where foreign companies invested heavily in this sector following the privatization in the 1990s. This contributed to boost service exports, as illustrated by the fact that this sector posts a surplus since 1997.

## 2. Agreements on trade in services

Preferential trade arrangements are essential for Brazilian exports of goods and services. For example, 41% of Brazilian exports of capital goods and 38% of total exports of manufactures went to members of ALADI (Latin American Integration Association) in 2007.<sup>34</sup> However, in its free trade negotiations, Brazil has prioritized the goods sector over the service sector. This is partly the result from a more active participation of the private sector in discussions with the government on goods trade than on services trade. In turn, this weak public-private dialogue on services originates in part from its heterogeneous

<sup>33</sup> That is, according to these data about half of all funds were invested in affiliates of Brazilian banks and other financial institutions abroad. However, in many cases these funds do not stay in the financial sector but are passed on to Brazilian companies in other sectors of the host economy. Therefore, the financial services share as well as the overall service sector share in investment abroad is probably inflated, without knowing by how much.

<sup>34</sup> For more information and data, see the Secretariat of Foreign Trade, [www.desenvolvimento.gov.br](http://www.desenvolvimento.gov.br).

character, with different segments having different demands and interests, which complicate the formulation of a strategic agenda with clear objectives.

Brazil has signed more than ten trade agreements on goods and has ratified the multilateral agreement GATS (General Agreement on Trade in Services) on services. As part of Mercosur, it has signed one bilateral agreement on services with Chile in 2008. Currently, it is negotiating several other agreements (all via Mercosur).<sup>35 36</sup> Brazil's stance in multilateral negotiations in services has been basically defensive. It took on few commitments in GATS, except for some in Mode 3 (commercial presence), and a couple in telecommunications in mode 1 (cross-border trade) and 2 (consumption in exporting country). Despite its few commitments in GATS, the Brazilian service sector is relatively open, offering few restrictions on trade in services, in particular in mode 3. Examples of open sectors are distribution and telecommunications.

Brazil has not a clear regional trade strategy for services, which runs counter the growing interest of the private services sector in South America, as shown by the survey of Foresight Consulting (2006).<sup>37</sup> Several service providers have put emphasis on the South American market. However, this business expansion in the region has received little public support.

One exception to the prior finding is that Brazil, a member of Mercosur, signed, together with other States Parties, the Protocol of Montevideo on Trade in Services of Mercosur in 1997.<sup>38</sup> So far, six lists have been negotiated.<sup>39</sup> The seventh round of negotiations began in 2007 and has not yet been completed. The first protocol only came into force in December 2005. Also in 2005 the list of initial commitments, and a second complementary list, was ratified by the Brazilian National Congress.<sup>40</sup> The Treaty of Montevideo, despite its limited coverage, is being implemented slowly.

A worrisome trend is that countries in South America have advanced little to better integrate their services markets, whereas some countries have been increasingly establishing such commitments with third countries, notably the United States and the European Union.

The main impediment to exports services to other South American countries is not market access, but issues related to trade facilitation, including vague and divergent regulatory standards, and costs related to cross border financial flows (e.g. high fees and double taxation). Another impediment is the lack of agreements between Mercosur and other countries in the region on the temporary movement of workers.<sup>41</sup>

Some Brazilian service sectors, like the IT sector, indicate they can focus their internationalization directly on developed countries. There is a clearly room to develop more effective support policies for this purpose and create a demand for it. The main business association in this sector, BRASSCOM, has been pushing for a more aggressive strategy both in multilateral and bilateral negotiations.

However, it appears that the best opportunities for the export and internationalization of service companies in Brazil are within South America. Sectors such as air transport, banking, stock markets, engineering, construction, distribution, franchising, tourism and remote medical services seem to have a great potential to expand their regional business.

<sup>35</sup> They are: Regional Tariff Preference between countries of ALADI (NTP-04); Agreement of seeds between countries of ALADI (AG-02); Agreement on Cultural Property between countries of ALADI (AR-07), Brazil - Uruguay (ACE-02), Brazil - Argentina (ACE-14); Mercosur - Chile (ACE-35); Mercosur - Bolivia (ACE-36), Brazil - Cuba (ACE-43), Brazil - Mexico (ACE-53); Mercosur - Mexico (ACE-54); Automotive Mercosur - Mexico (ACE-55), Mercosur - Peru (ACE-58); Mercosur - Colombia, Ecuador and Venezuela (ACE-59) Brazil - Guyana (ACE-38) Brazil - Suriname (ACE-41). Brazil also signed ACE-18, which led to the Mercosur.

<sup>36</sup> Mercosur is currently negotiating agreements with many countries/regions, including the Central American Common Market, European Union (EU), Gulf Cooperation Council, Jordan, Morocco, Pakistan, Republic of Korea and Turkey (INTAL-IADB, 2009).

<sup>37</sup> See also Prospectiva Consulting (2006).

<sup>38</sup> The Montevideo Protocol has the same structure (rules & disciplines) as GATS. Its aims for free trade area in services, instead of a common market with common external barriers. It works with a positive list.

<sup>39</sup> Lists are ratified sequentially: the sixth list is not yet ratified before that of all former ones is completed.

<sup>40</sup> Source: Central Bank of Brazil, see [www.bcb.gov.br](http://www.bcb.gov.br).

<sup>41</sup> Despite agreements on the temporary movement of staff in Mercosur, in practice this is hindered by a lack of knowledge of the necessary documentation and long administrative procedures.

The expansion of the “other services” also depends on international passenger transport. Surprisingly, South America does not yet have a flexible network of low-cost flights between capitals and cities in the periphery. While airlines have increased the number of routes, there is still room for expansion. The current network of flights seems irrational, in part because the region lacks consolidated hubs that connect intra-regional flights with extra-regional flights. On other continents these hubs do exist and take away part of the value chain from the region.<sup>42</sup>

The development of a regional system of financial transactions is another factor that could boost Brazil's overall competitiveness in services. The Brazilian experience in this segment could be used to develop a region-wide program for payment settlements and risk management. The program requires agreements with neighboring countries and participation of public and private institutions, such as the BM&F-BOVESPA (Securities, Commodities and Futures Exchange of São Paulo). Expected future benefits from this initiative are speedier transactions, fewer risks related to the settlement of transactions in regional trade, lower costs for foreign exchange contracts, fewer difficulties for countries in the region to obtain hard currency, and a stronger participation of small and medium enterprises (SMEs) in regional trade. So far many SMEs are excluded because of high costs and risks involved in these operations.

A third example of a service that could facilitate intra-regional trade is telecommunications. More cooperation among national regulators and telecom companies should bring about lower prices. The strong presence of foreign companies in several countries in the region, of which several offer VoIP (voice over Internet protocol) services, should provide an impetus for the convergence of national regulatory frameworks to reduce operating costs and in turn communication charges. Moreover, regulators should push towards lower roaming tariffs.

The competitiveness of the previously described sectors depends in part on preferential trade agreements in services between countries (Mulder et al., 2008). One message is that the convergence of regulatory frameworks within Mercosur and South America at large may boost trade in services in the region. This, in turn, will benefit consumers. The agreements should include provisions for consumer protection, for example in the cases of telecommunications and aviation.

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<sup>42</sup> The National Civil Aviation Agency (ANAC) has mentioned this issue, without expressing an opinion.

## IV. Final considerations

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Brazil's recent dynamic performance in global trade of "other services" has been remarkable. But, the much faster expansion of China and India in this segment suggests that Brazil could do even better. The diversification of Brazilian exports of "other commercial services" is still low in terms of types of services and destination markets, but new types of exports and markets are emerging. Exports are concentrated in architectural-engineering and real estate services. In terms of destinations, the US market accounts for about one half and the European Union for one quarter in total exports. New types of exports are gaining importance, for example financial services (where Brazil is the 14th largest exporter worldwide) and legal services, which are part of technical professional services. Intra-sectoral trade with Brazil's main export markets is important. In the case of professional technical services, the highest index is registered in the South American market, suggesting an important potential to increase trade in this area in the region.

The recent dynamism of Brazilian services exports and their incipient diversification is associated with three, interrelated, trends. The first is the internationalization of Brazilian companies, which increases the demand for integrated support services such as finance, information technology and logistics. The second is the rise of inward foreign direct investment in the service sector, which expands Brazil's export capacity. Third, Brazilian investments abroad in the service sector have also grown rapidly.

The expansion of service exports requires a set of common, horizontal policies. These should be directed at enhancing the qualification of workers, the telecom infrastructure and a legal-regulatory system that favors investment. In the latter case, the convergence of regulatory frameworks in South America would boost not only the exports of Brazil but also those of its regional trading partners. Even though

Brazil, as a member of Mercosur, has free trade agreements with all countries in the region, they only apply to trade in goods (except for a recent agreement with Chile). In addition, the dissemination of information and participation in international events is important. The APEX (Brazilian Agency for the Promotion Exports and Investments), which supports small and micro enterprises, does important work in this direction.

In addition to horizontal policies, specific policies are also needed. Brazil has a revealed comparative advantage in "other business services", consisting mostly of technical and professional services. This segment includes a variety of specialties ranging from traditional engineering services to design services, and technical consultancy, amongst others. The type of support needed for export development differs from one service sector to the other. For example, engineering services require a system of state guarantees to expand their foreign sales directed towards the physical integration in South American. In the case of information technology exports, the best incentives seem tax incentives and credits.

To further improve the country's potential, this paper highlights the following policy recommendations:

- More work is needed to improve the statistics in services trade. An effort in this direction is under way, which includes a register of sales abroad by affiliates of Brazilian multinationals (FATS statistics).
- After its agreement with Chile in 2008, MERCOSUR should step up its efforts to include services in the other regional agreements. Moreover, services should be part of the extraregional trade negotiations.
- Brazil's private service sector branch organizations and coalitions should be better organized to intensify its dialogue with the government on what are its needs and what policies seem most appropriate to boost its competitiveness.
- The country needs to step up its efforts to improve and adapt its (higher) education system and labor training to the needs of the service exporters, as adding value to "other services" depends strongly on the qualification of the workforce. Additional efforts are needed to improve primary and secondary education, in particular improved mathematical, logical and reading-comprehension skills, as well as early English-language education. Also, more interaction is needed between the public and private sectors and academia in the design and deployment of technical and university curricula (ECLAC, 2009).

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## **Annexes**

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## Annex 1

### Trade classifications of “other services”

<u>Bilateral trade database 2001-06</u>	<u>Balance of payments database 1980-2008</u>
1 Computer	1 Insurance
2 Information	2 Financial services
3 Post & mail orders	3 Computer and information services
4 Telecom	4 Royalties and license fees
5 Construction	5 Operational leasing services
6 Operational leasing	6 Government services
7 Other profes.-technical	7 Communication services
8 Legal-accounting-public r.	8 Construction services
9 Research & development	9 Merchating and other trade-related services
10 Publicity, market research	<b>Business, professional and technical services</b>
11 Agricult.-mining-processing	10 Mail orders
12 Architectural-engineering	11 Self-employed remuneration
	Installation and maintainance of administrative offices and
13 Affiliated profes.-technical	12 real-state rental
14 Merchating & trade	13 Participation in fairs and exhibits
15 Royalties and licenses	14 Professional athlete's transfer fees
16 Other direct insurance	15 Publicity
17 Re-insurance	16 Architectural, engineering and other
18 Freight insurance	17 Installation/implementation of technical and economic services
19 Auxiliary insurance	<b>Personal, cultural and recreational services</b>
20 Finance	18 Audiovisual
21 Embassies	19 Cultural and sports events
22 Other governmental	
23 Military units-agencies	
24 Audiovisual	
25 Other pers.-cult.-recreat.	

Source: Central Bank of Brazil.

## Annex 2

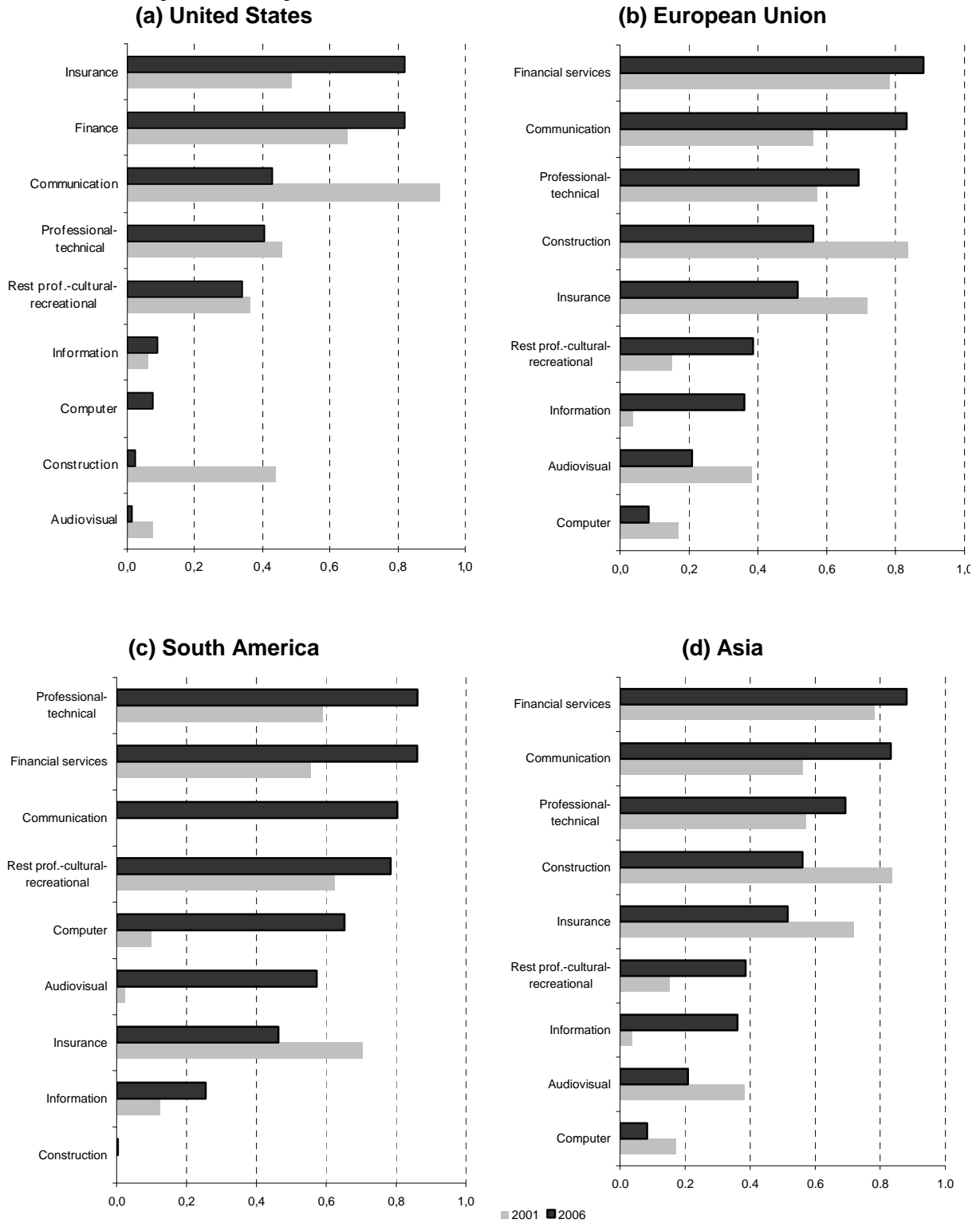
### Trade balances of categories in “other services trade”, 1990-2008

	1990	1995	2000	2001	2002	2003	2004	2005	2006	2007	2008
<i>Total services</i>	-3 596	-7 483	-7 162	-7 759	-4 957	-4 931	-4 678	-8 309	-9 640	-13 219	-16 672
Transportation	-1 644	-3 011	-2 896	-2 966	-1 959	-1 590	-1 986	-1 950	-3 126	-4 384	-4 944
Travel	-90	-2 420	-2 084	-1 468	-398	218	351	-858	-1 448	-3 258	-5 177
<i>Total "other services"</i>	-1 863	-2 052	-2 182	-3 325	-2 601	-3 558	-3 041	-5 500	-5 067	-5 576	-6 551
Insurance	-68	-122	-4	-275	-420	-436	-544	-568	-430	-766	-837
Financial services	-608	-152	-294	-307	-232	-383	-77	-230	-110	283	93
Computer and information services	-51	-249	-1 111	-1 106	-1 118	-1 034	-1 228	-1 626	-1 903	-2 112	-2 598
Royalties and license fees	-75	-497	-1 289	-1 132	-1 129	-1 120	-792	-1 303	-1 513	-1 940	-2 232
Operational leasing services	-513	-769	-1 311	-1 867	-1 672	-2 312	-2 166	-4 130	-4 887	-5 771	-7 808
Government services	-328	-339	-549	-652	-252	-151	-192	-755	-450	-1 134	-1 116
Communication services	70	-10	4	29	14	84	174	127	104	180	167
Construction services	0	6	227	17	12	10	1	8	18	12	14
Merchanting and other trade-related services	-77	-90	194	-23	-12	-92	-235	-279	1	18	440
Business, professional and technical services	-122	372	2 251	2 300	2 460	2 158	2 378	3 651	4 556	6 230	8 110
Mail orders	0	-6	-25	-30	-30	-26	-30	-34	-37	-33	-14
Self-employed remuneration	0	11	44	32	42	7	61	308	1 034	1 423	2 167
Installation and maintenance of administrative offices and real-state rental	-99	378	1 174	1 348	1 403	1 294	1 359	1 528	1 572	2 254	2 921
Participation in fairs and exhibits	0	-6	-9	-8	-14	-83	-30	-29	-35	-37	-43
Professional athlete's transfer fees	0	14	107	121	62	68	98	151	117	203	192
Publicity	-5	-11	51	69	69	45	-53	58	64	83	85
Architectural, engineering and other	-19	-6	911	768	927	853	975	1 665	1 800	2 267	2 691
Installation/implementation of technical and economic services	0	0	0	0	1	0	0	4	42	70	111
Personal, cultural and recreational services	-91	-202	-300	-307	-251	-283	-362	-396	-452	-578	-783
Audiovisual	-42	-68	-242	-230	-187	-221	-285	-298	-366	-439	-563
Cultural and sports events	-48	-134	-57	-78	-64	-62	-77	-98	-85	-139	-220

Source: Authors' calculations based on data from Central Bank.

### Annex 3

### Intra-industry trade by destination, "other services", 2001-06







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