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Exporting financial services in Latin America and the Caribbean

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According to the World Trade Organization (WTO), trade in services has become the most dynamic segment of world trade, growing more quickly than trade in goods.[1] While travel remains the most exported service both worldwide and in Latin America and the Caribbean (LAC), other services are becoming relevant for both developed and developing economies. Among them, financial services is one of the most important categories in terms of value. Worldwide, the value of financial services exports rose by 15.2% in real terms between 2008 and 2017. Nevertheless, this global trend of rising exports of financial services was not reflected in LAC, where they contracted by 24.4% between 2008 and 2016.[2] In 2016 financial services accounted for just 2.2% of total services exports from the region, 91% of which was contributed by 10 countries.[3] Exporting more financial services could benefit LAC economies by improving the allocation of capital through enhancing competition between banks[4] and boosting economic growth.[5] The Inter-American Development Bank has highlighted exports of financial services as a major opportunity to add value and diversify the region's exports.[6] However, for economies to reap these benefits, adequate regulation needs to be put in place.[7]

What are exports of financial services and what are the general trends?

The WTO's General Agreement on Trade in Services (GATS) defines trade in services as the production, distribution, marketing, sale, and delivery of any service in any sector except services supplied in the exercise of governmental authority. In 2017, both globally and in LAC, the three most exported service categories[8] by value were travel, other business services,[9] and transport (figure 1). Worldwide, financial services rank fifth, representing 8.6% of all services exported. Overall, the value of exports for all sectors increased significantly over time, and the financial services segment is one of the most dynamic.

The GATS classifies financial services in 16 categories including banking, securities, asset or funds management, leasing, provision of financial information and consumer credit, and outlines four modes of exporting them:

1. Cross border delivery: financial services are delivered from the territory of one economy into the territory of another economy.
2. Onshore sales to non-residents: financial services are delivered from the territory of one economy to an international visitor.
3. Commercial presence offshore: a financial service provider sets up operations in a foreign country.
4. Fly-out to service customers offshore: an individual offers financial services while in the destination economy.

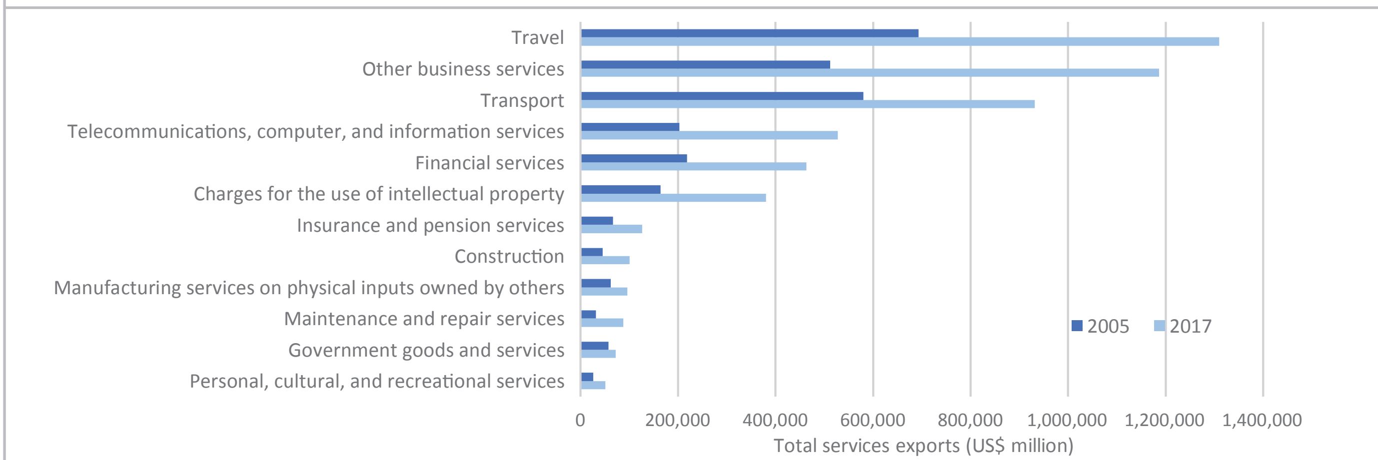
With $106 billion in receipts in 2017, the United States is the world's largest exporter of financial services. In the LAC region, Panama is the main exporter of financial services. Mexico leads trade in financial services within the Pacific Alliance, followed by Chile (table 1).

Table 1. Top 10 exporters of financial services and selected LAC economies

Economy	Value in 2017 (US$ million)	% of GDP in 2017
United States	106,423	0.55
United Kingdom	83,208	3.17
Luxembourg	60,593	97.10
Germany	23,484	0.64
Singapore	22,783	7.03
Switzerland	20,294	2.99
Hong Kong SAR, China	19,846	5.81
Ireland	16,563	4.96
France	11,562	0.45
Japan	10,356	0.21
Panama	1,222	1.96
Brazil	679	0.03
Mexico	262	0.02
Chile	136	0.05
Uruguay	130	0.23
Colombia	81	0.03
Peru 1/	56	0.03

Source: World Trade Organization statistics database (https://data.wto.org); World Development Indicators database (http://data.worldbank.org/data-catalog/world-development-indicators), World Bank.
1/ Data are for 2016.

Figure 1. Worldwide exports of services, by category



Source: World Trade Organization statistics database (https://data.wto.org).

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BOX 1. Exporting financial services in Ireland

Exports of services have become more prevalent in Ireland since the 2000s, increasing their value by 129% in real terms between 2007 and 2017. Financial services, together with computer and information services and insurance services, contributed significantly to this increase. Accounting for 5% of GDP in 2017, Ireland was ranked 8 worldwide in value terms for financial services exports.[a] Ireland mainly exports financial services to the European Union—the United Kingdom and Luxembourg were the main destinations in 2017.[b] To become a top exporter Ireland implemented a series of regulatory changes that promoted financial services exports.

In recent decades, Ireland developed a policy framework that promoted a competitive and open business environment as well as corporate tax rate certainty to support business confidence. Ireland ranked 23 of 190 economies on the ease of doing business and 4 on the ease of paying taxes in *Doing Business 2019*. Ireland also ranks 11 on the Forbes Best Countries for Business 2019 index and is a top destination for foreign direct investment.[c]

According to a 2018 report by PwC, Ireland has developed the expertise to make the country a successful financial hub. The study ranked Ireland first for labor productivity, attracting and retaining workers, investment incentives, flexibility and adaptability, attitude toward globalization, attracting high-value projects based on volume of job creation, and tax attractiveness for digital business models. Furthermore, investment in the economy is diversified. For example, Ireland hosts 20 of the top 25 financial services companies, 16 of the top 20 global software companies, and four of the top five IT services companies.[d]

Ireland's tax structure also contributes to its leading position. The country's corporate income tax rate is among the lowest worldwide (at 12.5% in 2018).[e] Ireland has a vast double taxation treaty network, with 73 signed treaties and several more under negotiation. Also, where a treaty does not cover a specific tax, Ireland provides unilateral tax relief. There are no financial transaction taxes and most financial instruments are not subject to stamp duty. The Irish tax regime also encourages the management and creation of intellectual property with an effective tax saving of 37.5% for expenditures on research and development.[f]

Several reforms were implemented in recent years to streamline the process of starting a business in Ireland. For example, the Companies Act of 2014—which applies to Irish registered companies and Irish branches of foreign companies—consolidated laws from 1963 and repealed more than two dozen statutes.[g] Ireland also implemented online business registration and, in 2016, the country removed the requirement that founders swear before a commissioner of oaths.[h]

Global talent is also a key asset for Ireland, which has one of the youngest populations in the European Union and whose workforce is adaptable, diverse, and well-educated. About 17% of the Irish population was born abroad, and the country ranks among the top 10 economies globally for education system quality and the transfer of knowledge between higher education institutions and companies.[i]

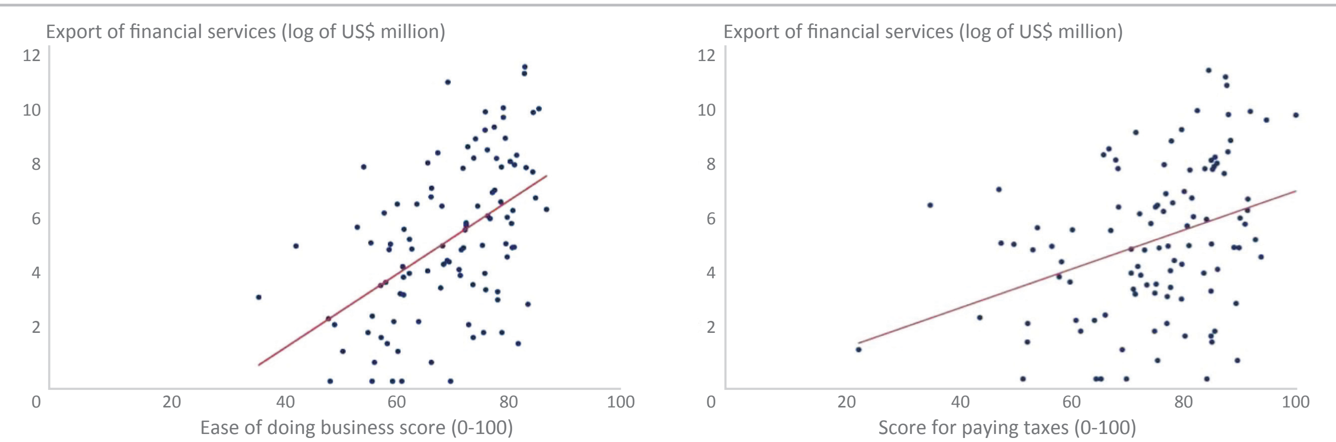
a. World Bank staff calculations using WTO data downloaded on February 28th, 2019, and WDI GDP deflator.
b. Ireland, Central Statistics Office 2017.
c. IBM Institute for Business Value 2018.
d. Asia Matters 2018.
e. The Tax Foundation 2018.
f. Asia Matters 2018.
g. Mason Hayes & Curran 2015.
h. *Doing Business* database.
i. Asia Matters 2018.

What are the drivers of financial services exports?

Several factors have been associated with an economy's potential to export financial services. These factors include taxation, financial markets sophistication, a competitive regulatory environment, transparency and absence of corruption, human talent, and ICT infrastructure (figure 3).[10,11]

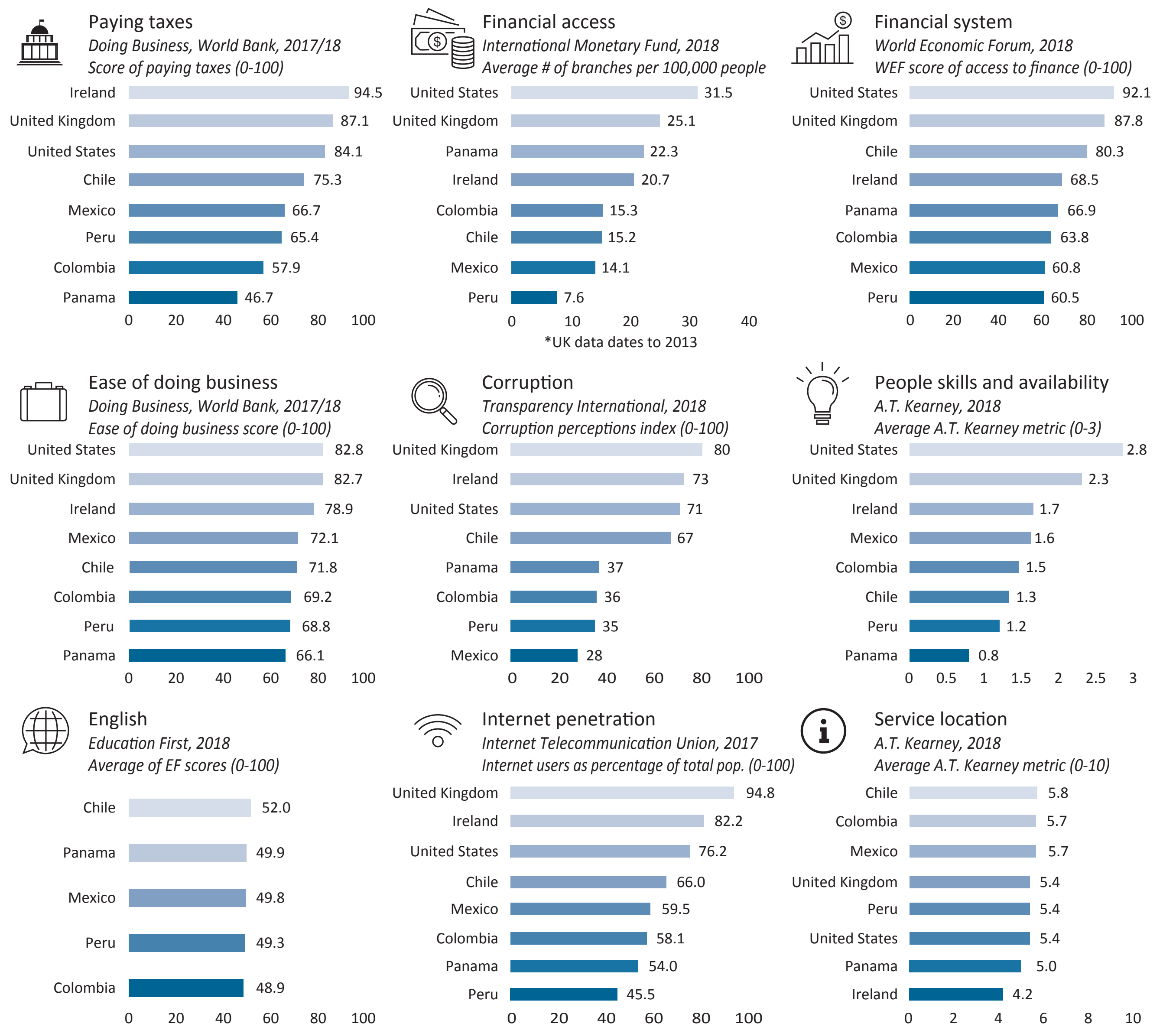
An economy's taxation system is important for exporting financial services. To boost exports of financial services, an economy's fiscal regime should be globally competitive and free of uncertainties and unnecessary complexities. Investors are more likely to import financial services from transparent, user-friendly, no-surprise jurisdictions.[12] A non-resident entrepreneur would be reluctant to contract financial services in an economy where those services are linked to heavy taxation or complicated tax regimes. By contrast, the tax regimes of some of the top financial services exporters—Ireland (box 1), Luxembourg, and Singapore—are examples of tax regime simplicity. Not surprisingly, there is a positive relationship between an economy's ease of paying taxes as measured by *Doing Business* and its exports of financial services (figure 2).

Figure 2. The biggest exporters of financial services are economies where regulation is business-friendly and paying taxes is relatively easy



Source: Doing Business 2019; World Trade Organization Statistics, 2017 (https://data.wto.org).
Note: Both relationships are statistically significant at the 1% level after controlling for income.

Figure 3. Selected economies' performance on drivers for exporting financial services



The local financial sector must also be developed enough to be chosen by non-residents. Economies with advanced financial systems are better integrated and can facilitate the delivery of services between one another. They also expand rapidly and attract foreign capital that serves to strengthen their positions as financial hubs, as in the case of the United Kingdom or the United States.[13] The size of an economy's financial institutions is increasingly important in attracting trade in financial services. For example, in 2017, Peru's largest bank was 2.4% the size of the largest U.S. bank.[14] Given the risks involved in financial transactions, a large Peruvian company might be more likely to trust its business to a bank in the United States than to a Peruvian bank, despite the Peruvian bank's local expertise. The sophistication of financial markets is also related to how investors are treated: most developed financial systems allow free movement of capital and foreign ownership of assets.[15]

A regulatory framework that enhances competition and discourages burdensome intervention from the government is also key when exporting financial services. Financial institutions should not be placed at a disadvantage by their home economy's business environment when competing for work offshore. The biggest exporters of financial services tend to be those economies whose regulatory framework is more business friendly (figure 2). Indeed, four of the world's top 10 exporters of financial services (the United States; the United Kingdom; Singapore; and Hong Kong SAR, China) also rank in the top 10 economies worldwide on the ease of doing business in 2017/18. A competitive regulatory framework does not mean deregulation. Economies must ensure that the rules governing financial services are up-to-date and consistent with global good practices[16] (such as the Basel III principles) and that the regulation protects intellectual property.[17]

Transparency is among the factors which exert the most influence on an economy's ability to successfully export financial services.[18] Transparency is particularly important as financial services is an industry prone to corruption and bribery when performing transactions offshore.[19] Because of this, governments must implement the highest standards of integrity, openness and transparency—together with strong judicial systems—to avoid becoming misused offshore jurisdictions.[20] One of the reasons importers of financial services tend to choose the United Kingdom, for example, is because it offers strong, clear and consistent regulations that keep corruption levels low. The country also has an independent judiciary and effective mechanisms for international commercial dispute resolution.[21]

Likewise, local expertise and talent contribute to an economy's competitiveness when exporting financial services.[22] There is a positive relationship between people skills and the availability of qualified professionals and the value of financial services exports.[23] To boost exports of financial services, an economy should provide specialized, skilled financial services workers that would be sought after from around the globe. To do so, an economy should have top-level academic institutions training people to become experts, as well as incentives to retain graduates in the country. Establishing a legal framework that retains university graduates of foreign origin and attracts skilled migration to fill shortages of qualified workers would also be important.[24]

A final critical element is ICT infrastructure, which must be sufficiently developed to sustain a vast flow of financial services information.[25] Technology is the backbone of financial services exports since it enables importers to access financial information at minimal cost in real time. Improvements in communications technologies enable importers to follow developments affecting foreign markets and companies more efficiently.[26]

Why is exporting financial services an area of opportunity for LAC?

Latin America and the Caribbean's focus on services exports has deepened and diversified over time. While travel remains the most important sector (generating almost $90 billion in 2017) and most economies have traditionally specialized in tourism, some others, such as Panama and Brazil, have a strong comparative advantage in financial services (box 2).[27] Between 2008 and 2016 LAC's real exports of financial services contracted by 24.4%.[28] In 2017, financial services exports totaled about $4 billion, compared to $383 billion in the OECD high-income economies and $6.5 billion in the Middle East.[29] The downward trend in LAC underscores the opportunity to consolidate the presence of exports of financial services in the region and capitalize on their potential benefits.

Generally speaking, there is a positive relationship between services exports and economic growth.[30] The UN Conference on Trade and Development (UNCTAD) points out that trade in services creates jobs, reduces unemployment and increases competitiveness.[31] The OECD further states that an increase in exports of services can result in an increase in productivity since services exports expand local service providers access to foreign markets, add value to their service chain and take advantage of knowledge spillovers.[32] Interestingly, those economies with the highest trade barriers—including developing economies—benefit the most from liberalizing trade in financial services.[33] Not surprisingly, a growing share of developing economies are exporting financial services; today they account for more than half of the world's total financial services exports.[34]

Trade in financial services leads to both short- and long-term economic growth. By developing exports of financial services, economies can deepen their foreign market base. Trade in services can boost competition and encourage innovation which, in turn, fuels economic growth.[35] According to UNCTAD, financial services (including exports of financial services) can be instrumental for economic development by securing and distributing financial resources more efficiently.[36] The liberalization of the financial sector enhances the distribution of capital by encouraging competition among banks, cutting down transaction costs for cross-border trade, and disseminating information and competencies.[37]

Exports of financial services represent a significant opportunity for economies in Latin America and the Caribbean to diversify, sophisticate and add value to exports.[38] Toward the end of 2017, the Inter-American Development Bank approved a $27 million loan to Chile to support the development of services exports with a focus on non-traditional services including finance and insurance.[39] Global service providers are establishing operations in Latin America and the Caribbean, especially in IT infrastructure, contact centers, and finance and accounting. And these firms are not only investing in traditional locations in the region—non-traditional markets, such as Colombia, are also considered viable locations for service centers.[40] The improving quality of the region's human resources (for example, the training of professionals in areas such as computer programming),[41] its proximity to the United States, the 12-hour time difference with Asia, the Spanish-speaking population, and competitive costs, contribute to the region's potential to gain a larger share of the world's service export market[42] implying a similar development in financial services in particular.

BOX 2. The case of Panama

Panama is currently Latin America and the Caribbean's biggest exporter of financial services, exporting almost twice the value of Brazil in 2016. However, in 2008 Panama only accounted for one-third of Brazil's exports of financial services.[a] One common misconception is that Panama was able to achieve this performance as a result of only amendments to its tax regulations.[b] However, this is not the case; in recent years, Panama has implemented broad-based reforms that facilitated its status as the regional leader in financial services exports.[c]

Panama's rise to the top was supported by reforms implemented between 2009 and 2014 in key sectors that established the country as a major global trade hub and with a particular focus on the banking sector.[d] New consumer banking products were introduced and promoted, from credit cards and mortgages to travelers checks and online banking. Corporate loans and commercial financing were also made available.

This transformation strengthened Panama's banking sector soundness. Today, capitalization and liquidity levels are relatively high, and a credit boom has taken place in recent years.[e] The financial sector provides a wide variety of products, and competition between providers ensures affordable rates. The sector also offers easy access to loans, high venture capital availability and adequate securities exchange regulation. Moreover, the government makes no distinction between foreign and domestic banks (foreign banks face the same establishment restrictions as national banks).[f]

To support the increasing sophistication of its banking system, Panama strengthened higher education in financial services and infrastructure.[g] The country sought to attract high value-added investment that promotes the strengthening of human capital and technology transfer.[h] Panama has also invested in energy projects to enhance the reliability of electricity and telecommunications.[i]

Tax reform also played a role in Panama's success. Over the last two decades, Panama established and enhanced its online system for filing and paying taxes. Both the corporate income tax rate and payment frequency were reduced, and tax returns were simplified.[j] Between 2014 and 2016, Panama took steps to enhance the credibility of its financial sector and amended its banking legislation to strengthen supervision and bring it in line with international standards, improve transparency, curb tax evasion and protect consumers. As a result of these efforts, in 2016 the Financial Action Task Force—an intergovernmental organization that combats money laundering—recognized Panama's progress and removed it from the agency's grey list.[k]

a. WTO data downloaded on February 28, 2019.
b. OECD 2019.
c. Hausmann, Espinoza, and Santos 2017.
d. See https://www.focus-economics.com/countries/panama.
e. IMF 2019.
f. Putnis 2018.
g. Republic of Panama, Ministry of Economy and Finance, Office of the Minister 2009.
h. UNCTAD 2017a.
i. IMF 2017.
j. *Doing Business* database.
k. CABEI 2017.

Conclusion

The economies of Latin America and the Caribbean have significant potential to export financial services. To take advantage of this opportunity, governments in the region can work on a variety of fronts to raise their economies' competitiveness in this area. Two specific challenges are the availability of human capital and electronic infrastructure.[43] The former refers to the limited number of professionals that, in addition to Spanish, speak the language of the importing economies and are adequately educated and experienced in the areas associated with services exports. The latter refers to the electronic infrastructure and digital systems that facilitate the export of financial services, but also the high cost to develop communication schemes in the region. Consequently, LAC's export dynamism in financial services will depend on long-term public policies and public-private strategies with clear objectives for promoting human capital and a competitive digital ecosystem.[44]

The World Economic Forum's Global Competitiveness Report identifies Chile, Jamaica and Panama as among the top 50 economies worldwide that enjoy a high level of financial system development. Nevertheless, the average score for Latin America and the Caribbean is 59.5 of 100, behind East Asia and the Pacific, Europe and North America, and the Middle East and North Africa, suggesting that the region has room to improve banking sector soundness while ensuring transparency and integrity.[45] Together with the Latin American Association of Service Exporters, the Inter-American Development Bank conducted research to identify the main determinants and challenges for companies exporting services in the region. Those companies highlighted taxation and training for young professionals as two of the main factors that governments in Latin America and the Caribbean should consider when implementing strategies to foster competitiveness for exporting services.[46] Interestingly, as discussed above, those are also two of the drivers of financial services exports.

NOTES

1 WTO 2015.
2 World Bank staff calculation using WTO data downloaded on February 28th, 2019, and WDI GDP deflator. Country-level 2016 data is used due to missing data for some LAC economies in 2017.
3 World Bank staff calculation using WTO data downloaded on February 28th, 2019. Country level 2016 data are used due to missing data for some LAC economies in 2017.
4 UNCTAD 2012.
5 Khatun 2016.
6 Giordano 2016.
7 UNCTAD 2017b.
8 From the 12 categories defined by the United Nation's Manual on Statistics of International Trade in Services (2010).
9 According to the UN Manual on Statistics of International Trade in Services (2010), "other business services" include research and development services, professional and management consulting services and technical, trade-related, and other business services; "Travel" covers goods and services for own use or to be given away, acquired from an economy by non-residents during visits to that economy.
10 Lindemane 2011.
11 UNECLAC 2017.
12 Prieto 2003.
13 Rousseau and Sylla 2003.
14 United States Federal Reserve Board 2017; Credicorp 2017.
15 Lindemane 2011.
16 Bouvatier 2012.
17 López and Ramos 2015.
18 Lindemane 2011.
19 PwC 2014.
20 Fenton 2016.
21 The City UK, PwC 2017.
22 López and Ramos 2015.
23 World Bank staff calculations using AT Kearney Global Services Location Index and the value of exports of financial services as measured by WTO. This relationship is significant at the 5% level after controlling for GNI per capita.
24 Australian Services Roundtable 2008.
25 UNECLAC 2007.
26 IMF 1999.
27 OECD, WTO 2017.
28 World Bank staff calculation using WTO data downloaded on February 28th, 2019, and WDI GDP deflator.
29 WTO data downloaded on February 28th, 2019.
30 Gabriele 2004.
31 UNCTAD 2017b.
32 Arbache 2016.
33 Verikios and Zhang 2003.
34 Loungani and others 2017.
35 Khatun 2016.
36 UNCTAD 2012.
37 Harms, Matto and Schuknecht 2003.
38 Giordano 2016.
39 IDB 2017.
40 Deloitte 2015.
41 UNELAC 2017.
42 IDB 2012.
43 López and Ramos 2013.
44 UNECLAC 2017.
45 WEF 2018.
46 López and Ramos 2015.

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