Contents

Highlights

- After reaching an estimated $2.4 trillion in 2005, world services exports are forecast to grow 6% to $2.6 trillion in 2006, and 4.5% to $2.7 trillion in 2007.
- World services trade is expanding in tandem with strong economic growth of 5.1% in 2004, slowing to 4.5% both in 2005 and 2006, and to 4.1% in 2007. Economic growth is most robust in Asia, with large spillover to growth in the region's services trade.
- Export growth was very strong in all major geographic areas in 2004 and 2005. Asia recorded the fastest growth in services exports in 2004 (+26%), although in 2005 this distinction went to Africa with services export growth of 25%. Still, Asia remains a key destination for outsourcing of services from North America and the UK, as well as growing popularity as a tourist destination. After Africa, export growth in 2005 was strongest in CIS countries (+20%), followed by the Middle East (+15%), Asia (+12%), Europe (+10%), North America (+9%), and finally South America (+7%). These trends are expected to continue in the foreseeable future.
- By volume, Europe accounts for the largest share of world services exports ($1.104 trillion), followed by Asia ($543 billion), North America ($420 billion), South-Central America ($68 billion); Africa ($57 billion), Middle East ($54 billion), and the CIS ($40 billion).
- By sub-sector, the largest segment was commercial services ($1.15 trillion), followed by travel – largely tourism – ($698 billion), and transportation ($563 billion). Growth in export receipts was strongest worldwide in transport (+11%, down from 24% in 2004), followed by travel (+10% in 2005, down from 18% in 2004) and commercial services (+11% in 2005, down from 17% in 2004). On a country basis, latest data show growth in travel receipts in 2004 was particularly high in China (+48%), while India's commercial services receipts nearly doubled in 2004, from $23 billion to $40 billion.
- Growth in tourism was particularly strong in 2005, with world arrivals (the key measure of tourism) exceeding 800 million for the first time. This is a direct result of the robust global economic recovery.
- Canada's services exports increased by 1.7% in 2005 to C$65.0 billion. Thus, the level of services exports is higher than forestry (C$43.4 billion) but lower than energy (C$86.9 billion). The relatively

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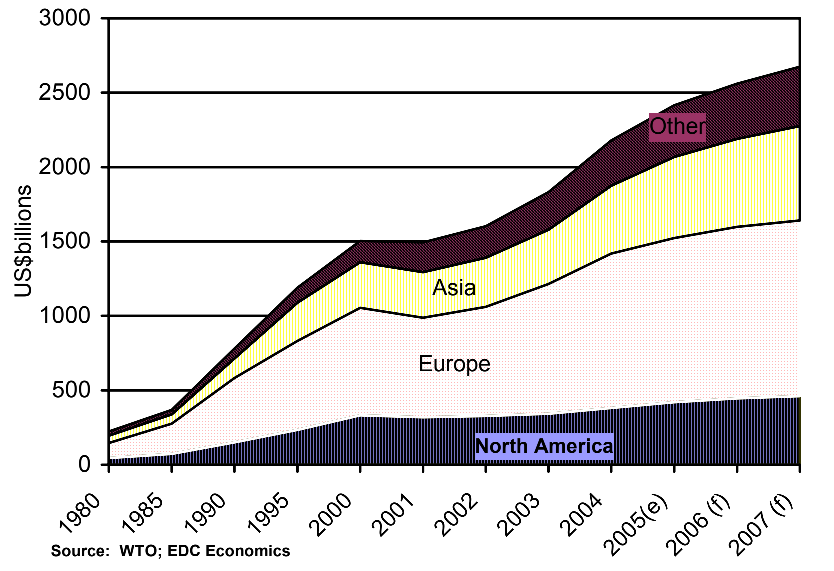
lackluster services growth rate relative to goods (1.7% versus 5.9%) was caused by some significant stresses in tourism and specific commercial services sub-sectors. For example: travel (i.e. tourism) services declined by 1%; commercial services rose by 1.8%; and transportation receipts by 5.5%.

- Growth in Canada's service exports is forecast at 2.6% to $66.7 billion in 2006, with performances varying substantially across sub-sectors.

I. Recent Developments in World Services Exports - Highlights

Chart 1 – World Services Exports, 1980-2007



After rebounding by 15% to US$1.8 trillion in 2003, global service exports increased by 19% in 2004 to $2.2 trillion and 11% in 2005 to $2.4 trillion (chart 1). As stunning as this increase appears, it is still 2% below the nominal rise in goods exports in 2004 and 2005 (Tables 1 and 6). Looking ahead, we expect world services exports to reach $2.6 trillion in 2006, and $2.7 trillion in 2007.

While growth in services exports is difficult to estimate due to insufficient price information, a good part of the growth may be attributed to higher **prices** and currency fluctuations rather than higher **volumes**. But based partly on the nature of the sub-sector (i.e. the energy-intensive transportation and travel sectors versus the less energy-intensive commercial services sub-sector); and world GDP growth, inferences can be made about how much real growth occurred. In particular, one of the defining events in 2003-2005 was the rapid rise in fuel costs, which as a result of the fuel surcharges on both passenger and goods transport exaggerated growth in the travel and transportation sub-sectors. Accordingly, the 24% growth in the fuel-intensive transportation services sub-sector and 18% growth in travel services (mostly tourism) in 2004 are much more plausible. Commercial services, which are less energy-intensive, increased by 17% that year (see Table 6).

Table 1: World GDP Growth, Merchandise Exports, and Merchandise & Commercial Services (% Growth)

	2001	2002	2003	2004	2005(e)
World GDP Growth	2.5	3.0	4.1	5.3	4.5
Goods Trade					
Total Growth (Nominal)	-4	5	17	21	13
(Volume)	(-0.5)	(3.5)	(5.0)	(9.0)	(6.0)
Services Trade (Nominal)	0	**7**	**15**	**19**	**11**

Source: WTO; EDC estimates

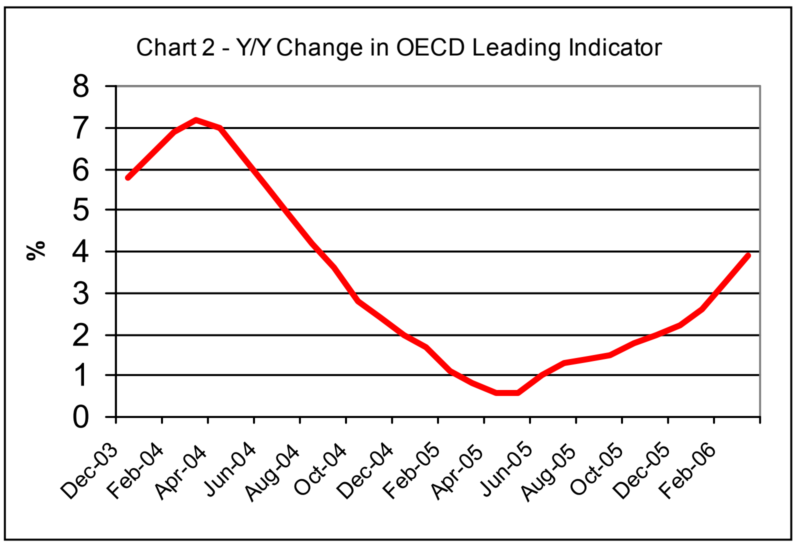
II. Recent Economic Developments

After peaking in 2004 at an unsustainably high rate of 5.1%, a slowdown in world economic growth in 2005 was both inevitable and desirable. 2005 world economic growth is estimated at 4.5%, off the 2004 pace, but still well ahead of the global long-term average of 3.7%. Momentum has continued into 2006 with growth still forecast at 4.5%. The slowing expansion is expected to take growth to 4.1% in 2007.

While the headline growth numbers thus far in 2006 are comforting, the best news is already behind us. Higher interest rates, ongoing inflation concerns and capacity constraints are weighing on global growth, and reining it in to a more sustainable path. And as global growth slows, repercussions are being felt in financial markets, as seen in recent stock market volatility, rising long term interest rates and rising spreads in more risky developing markets. Commodity prices have also been volatile, again a sign of a global economy trying to find a new footing.

In addition, the global economy faces structural headwinds. Political unrest in some of the world's developing economies, particularly some of the oil exporters of the Middle East, Venezuela, and sub-Saharan Africa is also an issue. Trade protectionism is on the rise, a trend that will likely be encouraged by slowing global growth. Moreover, rumblings from the US and EU with regard to their trading relationship with China have intensified from their usual level.

The United States remains the global growth locomotive, racking up an above-par 3.5% expansion in 2005. A strong start to 2006 has the economy well on its way to a repeat performance this year. Even so, the second half of the year will be slower, setting up for a more moderate 2.7% expansion in 2007. Two years of monetary tightening have seen short-term rates rise 425 basis points, and the effects are now being felt in the economy, notably in the housing market. Growth in the Eurozone is expected to pick up modestly to 1.7% in 2006 -– not a great outcome, but still better than last year's 1.3%. The acceleration reflects an economy that is generally on the mend, although the incipient storm warnings regarding the political future of the Union are becoming more persistent. The Japanese economy has largely recovered from the woes of the 1990s, having expanded by 2.7% in 2005, enough to bring the years of the zero interest rate policy to an end. Modestly slower growth of 2.5% is forecast for 2006, on account of forthcoming tax increases which will act as a drag on consumer spending. Japan is expected to slow further to 2.2% in 2007.



The OECD's leading indicator – which charts economic sentiment for its 30 member countries – has been edging higher in recent months, supporting the notion of slowing but steady growth. The index peaked in March 2004, but then decelerated steadily through April 2005. It has since steadily increased, with the March 2006 data showing continued expectation of growth (Chart 2).

As concerns emerging markets, the forecast points to some important differences across regions of the world. Non-Japan Asia is expected to continue setting the pace for economic growth, with regional growth projected at over 7.7% in 2006 compared with an estimated 7.8% in 2005. China is again forecast to be the world growth leader expanding by 9.5% this year. India is expected to be following closely behind with growth of 7.5 % this year slowing to 7.0% in 2007. The rest of Asia is also expected to turn in solid growth. Latin America is also performing well, although growth in the region is forecast to decline from last year's outturn due to emerging capacity constraints in the region's three largest economies: Brazil, Argentina, and Venezuela. Nevertheless, 2006 represents the second year in a row in which economic growth remains above 4%. Even though East-Central Europe has turned in a solid economic performance in the last several years, the regional numbers are skewed upward by the oil-fuelled exports of Russia and Kazakhstan which have capitalized on their positions, selling to the world's largest oil consumers. This boost was further driven by strong investment spending associated with EU accession for ten countries (the Baltics, Poland, Czech, Hungary, Slovakia, Slovenia, Malta, and Cyprus). As a result, Central and Eastern Europe are expected to register growth of 4.4% this year, down slightly from 5.0% last year, slowing to 4.3% in 2007. Oil revenues are fueling Middle East and North African output growth to over 5% this year and next. Sub-Saharan Africa is enjoying buoyant GDP growth of 5.3% this year fueled by oil and other commodity revenues. Growth in the region is forecast to slow slightly to 5.2% next year.

III. Trends in Global Services Trade

Table 2: World Service Exports by Principal Region (US$ billions)

Region	1990-2000	2001	2002	2003	2004	2005 (e)	2006 (f)	2007 (f)
World Total	**n/a**	**1,492**	**1,601**	**1,834**	**2,180**	**2,415**	**2,560**	**2,675**
(Annual % change)	***9.3***	***-0.6***	***7.2***	***14.5***	***18.8***	***10.8***	***6.0***	***4.5***
North America	n/a	319	327	343	382	420	445	461
(Annual % change)	***10.9***	***-3.7***	***2.4***	***5.0***	***11.3***	***9.0***	***6***	***4***
South & Central America	n/a	46	45	49	57	68	73	77
(Annual % change)	***11.0***	***-1.9***	***-2.8***	***9.8***	***15.4***	***7.0***	***7.0***	***6***
Europe	n/a	669	733	873	1,036	1,104	1,154	1,180
(Annual % change)	***n/a***	***-9.7***	***9.5***	***19.1***	***18.7***	***10***	***5***	***2***
CIS	n/a	20	23	27	33	40	48	55
(Annual % change)	***n/a***	***13.4***	***18.5***	***16.4***	***23.4***	***19.5***	***20***	***14***
Middle East	*n/a*	*31*	*34*	*43*	*49*	*54*	*65*	*74*
(Annual % change)	***n/a***	***6.2***	***9.4***	***26.6***	***13.6***	***15.0***	***20***	***14***
Africa	n/a	31	33	42	51	57	68	79
(Annual % change)	***6.4***	***2.6***	***6.4***	***26.4***	***20.4***	***25.0***	***20***	***15***
Asia	n/a	306	331	363	458	543	592	633
(Annual % change)	***9.0***	***-0.6***	***8.1***	***9.9***	***26.0***	***12.0***	***9***	***7***
Unallocated		***59***	***75***	***94***	***114***	***129***	***115***	***116***

Table 3: Europe Services Export by Sector and % of World Total, 2001-2005 (US$ blns and %)

Sector	2001	2003	2004	2005
Transport	169.6	206.2	257.3	280.8
Percent of World Total	49.2	50.4	50.9	49.9
Travel	215.7	274.0	315.8	338.1
Percent of World Total	46.2	51.0	49.8	48.5
Commercial Services	356.1	485.9	577.0	614.6
Percent of World Total	52.2	54.7	55.5	53.3
Total	**741.3**	**966.0**	**1,150.2**	**1,233.4**
Percent of World Total	49.6	52.7	52.8	51.1

Source: WTO.

Despite the data difficulties involved in compiling services trade, some useful insights can be obtained from the analysis of what data there is. Estimates by the WTO show that in 2004 the volume growth of goods was only 9%, with the remainder of the 21% growth consisting of price hikes (Table 1). For 2005 the WTO estimates total nominal growth in goods at 13%, with volume growth at 6%, implying price hikes of 5%. While no such breakdowns are available for trade in services, the data still offers compelling insights. Following is an analysis of the data by region and sector.

1. Regional Trends

A close examination of world services export data (Table 2) shows that Europe is the world's largest single exporter of services, accounting for nearly half of total global exports, followed by Asia (one fifth of the total), North America (17% of total), and the rest of the world. Europe's preponderance in services exports is likely symptomatic of the extremely high level of economic integration within the EU. Indeed, exports to non-EU countries of €395 billion (Table 4) – or US$490 billion – represent just 40% of total services that year from Europe estimated at US$1.2 trillion (Table 2). The remainder – roughly three fifths of all EU services exports – are intra-EU. Moreover, a sectoral breakdown of Europe's services exports shows the area is responsible for about half of the world total, across all three sub-sectors. This suggests that Europe's preponderance in services exports is broad-based, and not limited to tourism or travel.

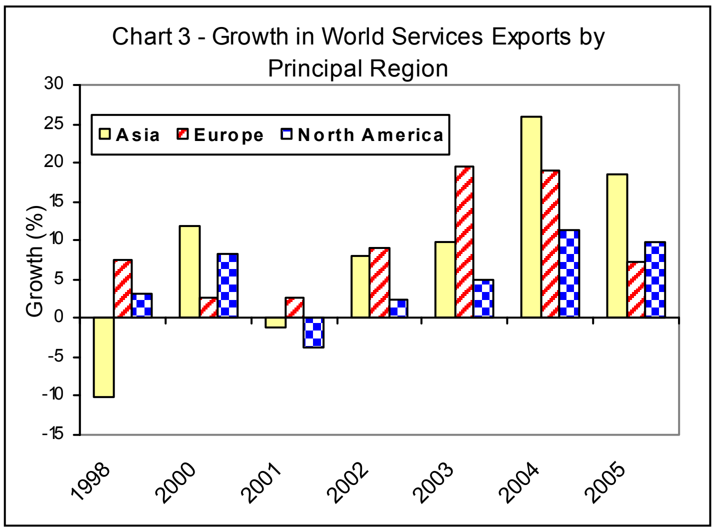
Table 4: Principal World Services Exports, 2003-2005

Exporting Country	2003	2004	2005(e)	% Δ, 2004/2005
Canada ($Can millions)	59,521	61,811	62,991	1.9
European Union§ (bln €)	331.8	362.1	395.5	9.2
Japan	89,926	105,552	108,824	3.0
United Kingdom (£ mlns)	93,616	103,010	105,732	2.6
United States (US$ mlns)	309,146	343,912	379,604	10.4

Source: EDC Economics, Source : Statistics Canada ; ECB ; UK Balance of Payments
§ EU – Exports to non-EU countries only
Data ; Japan Services Trade

Further, WTO data shows that European countries (i.e. EU-25) typically accounts for half of all world services exports in all sectors. Adding Japan and the United States (which individually account for 5% and 15% of world total exports, respectively) to Europe means that over 70% of all services exports are from three countries or country blocs: Europe, the US, and Japan.

On an individual country-by-country reporting basis, the individual country statistics published by these countries' own statistical agencies show that services exports by the US showed the highest growth in 2005 (+10%), followed by the EU (+9%), Japan (+3%), and finally Canada (+1.9%) (Table 4).



Source: WTO

2. Asia's Emergence as a Services Exporter

While Asia accounts for only 20% of total world service exports, export growth in services from the region outpaced the rest of the world by a wide margin during the 1990s – 15% versus 9%. Moreover, the region's total exports of services rose by a considerable 26% in 2004 and 19% in 2005 (chart 3), and forecasts show Asia continuing to outpace the global average. While offshoring certainly explains part of this growth, it is a much more complex process than commonly thought. In reality, off shoring encompasses all economic activities, from the very lowest value-added to the high-expertise high-value-added function. For example, Boeing has off shored some R&D work on its new aircraft design(s) to engineering firms in Russia; while Intel has offshored R&D microchip design functions to India. Moreover, the simple function of outsourcing **business functions** has developed into **business process outsourcing** – where an entire function like a company's HR support – is outsourced. The delivery of the service is seamless thanks to the low cost of communications. Hence, this increase in services exports is symptomatic of Asia's growing insertion in the global supply chain. This growing trend towards outsourcing and off shoring from companies in North America, the UK, and continental Europe offer at least a partial explanation behind the rise in Asian commercial services exports. Two countries in particular – China and India – are driving this growth centered on outsourcing of service activities by companies in industrialized countries.

Table 5 – China and India Services Exports by Principal Sub-Sector, 2000-2004 (US$ mlns and %)

		2000	2001	2002	2003	2004
China	Commercial Services	10,244	10,474	13,276	21,062	24,249
	Annual % change	***6.2***	***2.2***	***26.8***	***58.6***	***15.1***
	Transportation Services	3,671	4,635	5,720	7,906	12,068
	Annual % change	***51.7***	***26.3***	***23.4***	***38.2***	***52.6***
	Travel Services	16,231	17,792	20,835	17,406	25,739
	Annual % change	***11.9***	***9.6***	***14.6***	***-14.6***	***47.9***
	Total - China	***30,146***	***32,901***	***39,381***	***46,375***	***62,056***
	Annual % Change	***15.2***	***9.1***	***19.7***	***17.8***	***32.7***
India	Commercial Services	10,592	11,550	13,550	16,143	28,551
	Annual % change	***15.7***	***9.1***	***17.3***	***19.1***	***76.9***
	Travel Services	*3,460*	*3,198*	*3,102*	*3,887*	*5,342*
	Annual % change	***15.0***	***-7.6***	***-3.0***	***25.3***	***37.4***
	Transportation Services	1,979	2,050	2,473	3,062	4,468
	Annual % change	***7.3***	***3.6***	***20.6***	***23.8***	***45.9***
	Total - India	***16,030***	***16,799***	***19,125***	***23,092***	***38,361***
	Annual % Change	***14.5***	***4.8***	***13.8***	***26.7***	***66.1***

Source: WTO

China has experienced a rapid rise in both transport and travel, although growth in commercial services has been slightly slower (Table 5). Much of the recent growth in transportation receipts can be attributed to the country's emergence as a trading nation, making extensive use of transportation networks to participate in integrative trade. Moreover, China has become extremely popular as a travel destination in recent years, as seen in the rapid rise in exports of travel services. On the basis of recent data (see below – "Tourism Section") on growth of tourism to China, it is likely that growth in these areas – travel and transportation – continued into 2005 and 2006 at a broadly similar rate, though it should ease in 2007 owing to slowing world growth.

In contrast to China, **India's** growth in services exports has been much more focused on commercial services, which nearly doubled in 2004 to $38 billion, and most likely hit $50 billion in 2005. From a historical perspective, the growth in offshoring sharply accelerated during the tech-wreck in 2001, where cost-cutting was the watchword in the hi-tech world. Now, about one in five Fortune 500 companies have R&D centers in India. A notable feature of this process is that service outsourcing is moving up the value chain. While the first wave of outsourcing involved mainly call centers and data processing functions, outsourcing now commonly involves higher-value software development, and even business process outsourcing (BPO) – literally outsourcing a complete function. US-based technology research house Gartner has predicted that India will represent two-thirds of the international "offshore market" – work done outside a client's region – within three to four years.

Job losses in the US from this process have angered unions, and some US states have passed legislation to slow down outsourcing. Given the cost savings in outsourcing – with wages as much as 60% lower than in host countries – the trend will likely strengthen. In fact, however, the popularity of India (and other countries) as an outsourcing destination is a result of India's expertise in the services aspect of manufacturing, particularly regarding the large pool of highly educated technical and scientific staff on which it can draw to attract high-tech service activities to its shores. Meanwhile, job growth in services-intensive sectors in the US has remained strong in recent months, mainly on account of strong GDP growth, therefore dampening the backlash against offshoring. While there is a strong likelihood that the current trend will persist, the rise in protectionism brought about by slowing global growth poses a threat to India's success in the offshoring game, affecting India's future growth in the export of commercial services.

Table 6: World Services Exports by Sector, 1998-2005 (US$ billions and %)

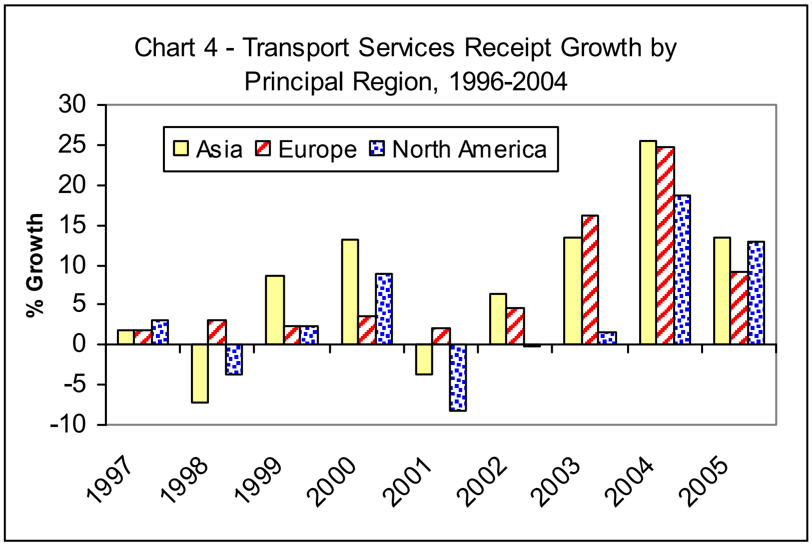
	1998	1999	2000	2001	2002	2003	2004	2005(e)
Total Services Exports	**1,350**	**1,406**	**1,492**	**1,495**	**1,601**	**1,834**	**2,180**	**2,415**
Annual % change	***2.3***	***4.1***	***6.2***	***0.2***	***7.2***	***14.5***	***18.8***	***10.8***
Commercial Services	593	621	666	683	752	888	1,040	1,154
Annual % change	***5.5***	***4.8***	***7.2***	***2.5***	***10.1***	***18.1***	***17.1***	***10.9***
Transport Services	314	325	349	345	361	409	506	563
Annual % change	***-1.0***	***3.5***	***7.1***	***-1.0***	***4.5***	***13.4***	***23.6***	***11.4***
Travel Services	443	459	478	467	489	537	634	698
Annual % change	***0.5***	***3.6***	***4.0***	***-2.3***	***4.7***	***9.9***	***18.0***	***10.1***
Memorandum: Goods Exports	**5,499**	**5,713**	**6,451**	**6,184**	**6,484**	**7,572**	**9,191**	**10,393**
Annual % change	***-1.6***	***3.9***	***12.9***	***-4.1***	***4.9***	***16.8***	***21.4***	***13.1***

Source: WTO; EDC

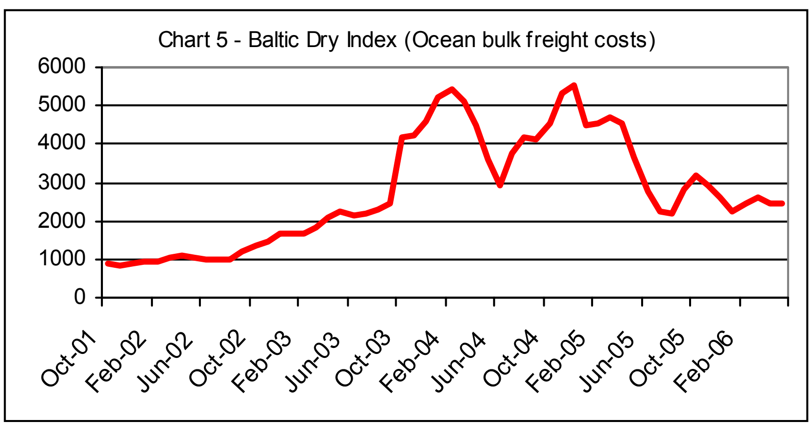
3. Outlook by Sub-Sector

While the sheer diversity of economic activities classified as "services" makes it difficult to make broad-based forecasts as a whole, sectoral and geographic trends may still be discerned from the three main sub-sectors of service trade: commercial services, transportation, and travel (i.e. tourism). Growth in services is showing solid gains across most sub-sectors, in line with continued world economic expansion (Table 6).

3.1. Commercial services



Exports in this sector increased to $1.2 trillion in 2005 from the 2004 level of $1 trillion. After three years of above-trend economic growth the world is beginning to bump up against capacity constraints, with most remaining pockets of excess capacity located in industries that are restructuring or reducing capacity. On top of that, physical infrastructure – roads, ports, airports, electricity generation, and the like – are showing growth strains in a number of countries. These capacity constraints mean that companies and countries alike do not have the physical means to accommodate the next leg of economic growth. The required investments in new capacity and infrastructure are expected to translate into higher demand for engineering and related services, therefore into the entire commercial services sector. As a result of the long lead times inherent in these projects, this boom is likely to outlast the economic cycle. On the other hand, the financial services component of commercial services exports – particularly regarding banks and insurance companies – is likely to slow along with the global economy. Rising risks, a flatter yield curve and turbulence in equity markets will make for a bumpy ride in the financial services sector over the short term.

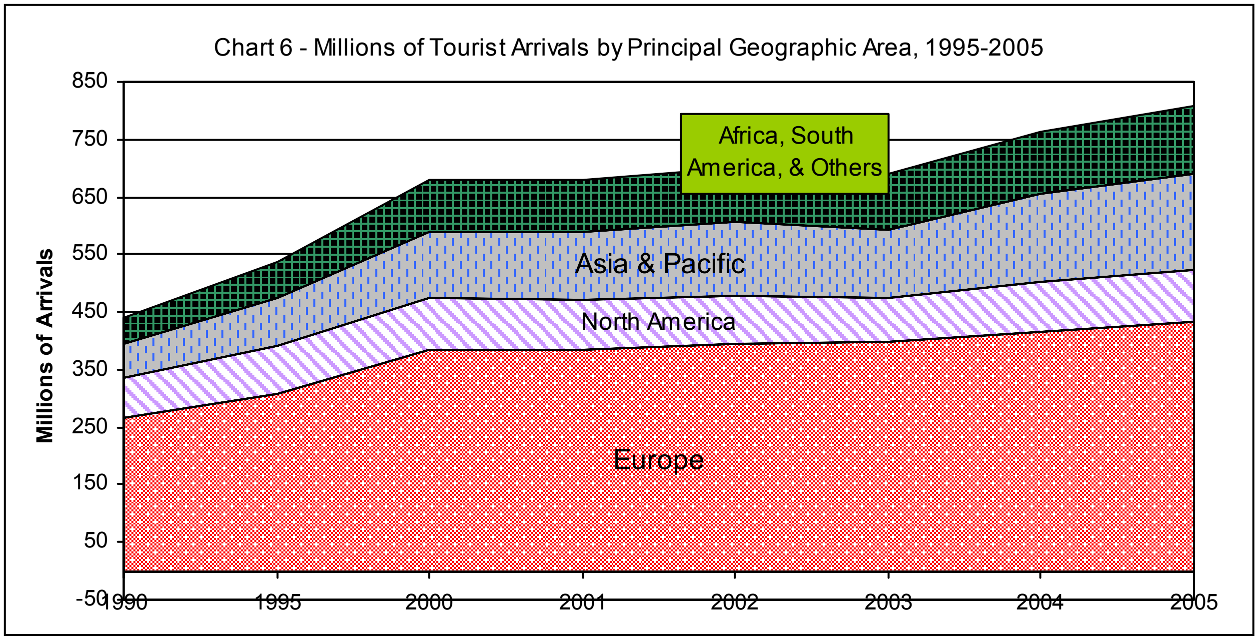


3.2 Transportation

This sector reported rapid growth of 24% in 2004 to $506 billion; and 11% in 2005 to $563 billion. These increases outpace the gains of previous years. But much of the growth reflects price increases for these services, justified by ballooning fuel costs and passed through as surcharges. The following is a brief examination of the major sectors.

Air transport has grown rapidly since 2001-02, recovering from 9/11 and supported by increasing economic activity. The most recent figures from the International Airline Transport Association (IATA) show steady growth worldwide, with actual passenger traffic growing by 5.7% in March 2006 over March 2005, and air freight traffic having expanded by a slightly higher 6.2% (year-year basis). Air cargo accounts for about 42% of world trade by value, though only about 2% by volume, according to International Air Cargo Association figures.

Internationally, demand for ocean freight has been solid in the past three years. Ocean capacity has remained tight, with carriers' utilization rates hovering around 90%. However, the port congestion reported in the US early in 2005 appears to have abated, with US-based ***Port Tracker*** reporting no congestion so far in 2006. Los Angeles/Long Beach, Oakland, Tacoma and Seattle on the West Coast, and New York/New Jersey, Hampton Roads, Charleston and Savannah on the East Coast – are currently rated "low" for congestion, the same as in May. The report indicates that inbound container traffic is growing more slowly than the same period last year. ***Port Tracker*** says that East Coast port inbound container volumes will reach a record level in June. The Baltic Dry Price Index which measures world freight rates weakened in the first eight months of 2005 from over 6,000 to less than 2,000, but had stabilized at 2,800 as of end-June (Chart 5).

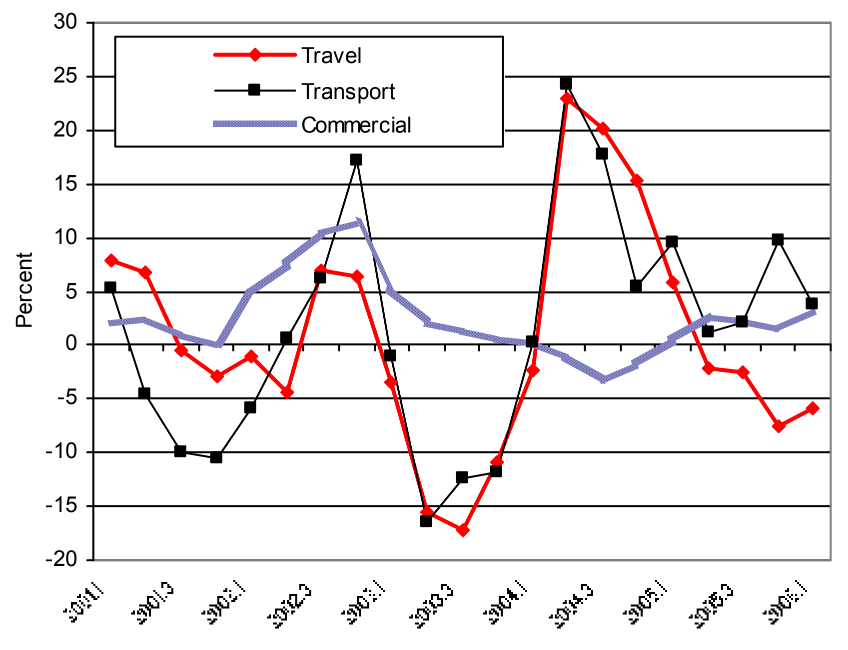


3.3 Tourism

The World Tourism Organization (WToO) reports that 2005 constituted the second year in a row of stellar results for the tourism industry, with total arrivals growing by 43 million to an unprecedented 808 million following another increase of 73 million arrivals in 2004 over 2003 (graph 6). This followed a period of slow growth in 2001-2003 related to the post-9/11 effects. Indeed, the sharp rebound in 2004 constitutes the only double-digit percentage increase since detailed data collection started in 1980. The growth in international tourist arrivals and tourism receipts has been underpinned by strong global economic growth, and recovery from SARS-induced setbacks in Asia. Fears of considerable slowdown in tourism arrivals caused by record oil prices have essentially not yet materialized.

Looking behind the headline increase in tourist arrivals, growth was broad-based with all regions registering positive growth. The strongest increase was in the Asia and Pacific (+28%) region and in particular, China, which rose to the fourth most popular destination in 2004 with 41.8mn visitors. The Middle East also performed credibly, increasing by 18%. This was fuelled largely by Egypt which saw arrivals increase by 2mn supported by the recent appreciation of the euro. Europe, which is still the most popular destination of tourists with a 55% market share, grew by 5% led by France and Spain. However, overall Europe and Africa (+8%) performed below the world average.

Chart 7 - Canada - Quarterly Services Export Growth (Y/Y), 2001Q1-2006Q1



IV. Canada's Services Export Sector

1. Canada's Services Sector

Over the past six years exports have been affected by numerous external shocks, ranging from the tech wreck in 2001 (much lower software and computer service exports); to the impact of SARS and forest fires on the inbound tourism in 2003-04, to the rising value of the Canadian dollar on tourism in 2005 and 2006. Moreover, transport and travel follow the global business cycle much closer than commercial services. These factors, combined with the eclectic nature of services, makes it extremely difficult to make broad-based generalizations for the sector.

Table 7: Canadian Services Exports 2001-2007

	2001	2002	2003	2004	2005	2006 (f)	2007(f)
Total Services Exports*	**60,066**	**63,486**	**61,133**	**63,862**	**64,968**	**66,668**	**68,366**
annual % change	**0.6**	**5.7**	**-3.7**	**4.5**	**1.7**	**2.6**	**2.5**
Commercial Services	*31,546*	*34,248*	*35,024*	*34,510*	*35,114*	*36,029*	*36,907*
annual % change	**1.4**	**8.6**	**2.3**	**-1.5**	**1.8**	**2.6**	**2.4**
Transport Services	*10,626*	*11,061*	*9,895*	*11,023*	*11,632*	*12,141*	*12,649*
annual % change	**-5.1**	**4.1**	**-10.5**	**11.4**	**5.5**	**4.4**	**4.2**
Travel Services	*16,437*	*16,742*	*14,776*	*16,746*	*16,460*	*16,654*	*16,893*
Annual % change	**2.8**	**1.9**	**-11.7**	**13.3**	**-1.7**	**1.2**	**1.4**
Government Services	*1,457*	*1,435*	*1,438*	*1,583*	*1,762*	*1,843*	*1,917*
Annual % change	**2.4**	**-1.5**	**0.2**	**10.1**	**11.3**	**4.6**	**4.0**

Sources : Statistics Canada (2000-2006); EDC Economics

2. Key Developments

In 2005 weakness in key sectors – particularly travel and some commercial services sub-sectors – slowed export growth of total services exports to 1.7%. Water-borne transport showed a stellar 14% increase on top of a 20% hike in 2004, helping to boost transport to 6% growth in 2005. Commercial services rose by 1.8%, transportation services by 5.5%, but travel (tourism) declined by 1.7% – mainly due to the higher loonie and gas prices.

For 2006, the services forecast calls for overall export growth of 2.6%, with performances varying substantially across sectors. Commercial services are expected to grow by 2.6%, albeit with variations among individual sub-sectors. Transportation revenues are expected to grow by 4.4%, although with specific sub-sectors - like water-borne transport - growing faster. But overall growth in travel (largely tourism) exports is expected to be more subdued at 1.2% as a result of the continuing problems with US border security, combined with the impact of the high Canadian dollar and fuel prices on budget-sensitive US tourists.

While all components of international trade are vulnerable to higher friction stemming from higher security requirements, this is particularly true for the tourist sub-sector. Specifically, the US is gearing up for the implementation of the Western Hemisphere Travel Initiative (WHTI) beginning in 2007. The WHTI essentially requires citizens of the Americas – including US citizens - to carry a passport or other document establishing the bearer's identity prior to entering or re-entering the United States. The WHTI is expected to have a dampening effect on Canada's travel industry. Still, by mid-year 2006 there was growing uncertainty about the implementation date for the time frame. (See below – "Travel and Transportation Sub-Sectors.")

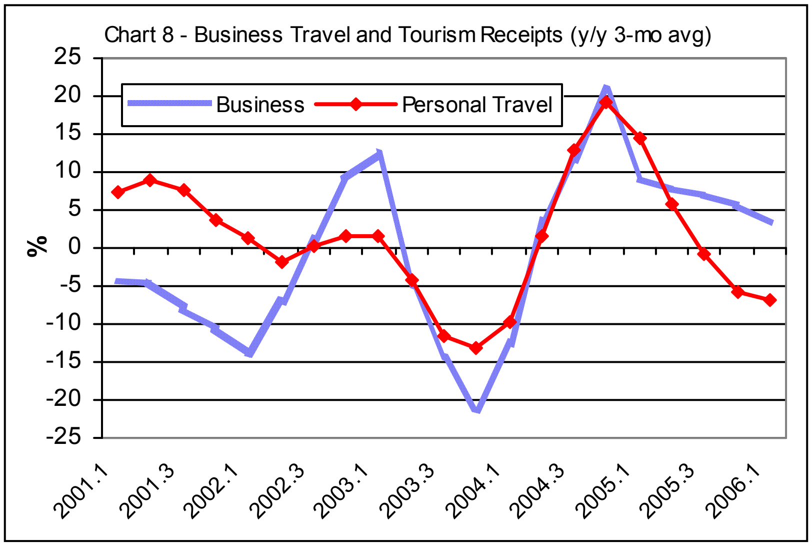


Table 8: Canadian Travel Services Receipts, 2000-2007 (Cdn $ mlns and %)

	2000	2001	2002	2003	2004	2005	2006	2007
Total Receipts	15,997	16,437	16,742	14,776	16,746	16,460	16,654	16,893
% Change	5.7	2.8	1.9	-11.7	13.3	-1.7	1.2	1.4
Business Receipts	2,920	2,658	2,737	2,381	2,660	2,792	2,918	3,020
% Change	0.8	-9.0	3.0	-13.0	11.7	5.0	4.50	3.50
Personal Receipts ("tourism"	13,077	13,779	14,005	12,395	14,086	13,668	13736	13,874
% Change	6.8	5.4	1.6	-11.5	13.6	-3.0	0.5	1.00

Sources : Statistics Canada (2000-2005); EDC Economics

2.1 Travel Sub-Sector

While normally associated with tourism, the **travel sub-sector** includes receipts from all types of travel, including business and personal travel for health and education. This sector experienced rapid growth through the mid-1990s until 2003, when it declined by 12% as a result of the perfect storm resulting from SARS, higher fuel prices, terrorism, war in Iraq and generally slower growth. It rebounded by 13% in 2004, but declined by 1.7% in 2005 – coinciding with the sharp hikes in fuel prices and the Canadian dollar. By individual sub-sector, personal travel (i.e. tourism) which accounts for four fifths of the sector's receipts fell by 3% in 2005. Recent Statistics Canada data shows visitors to Canada from the US declined by 8.6% in 2005 over the previous year, while non-US origin travel to Canada increased by 6.8% during the same period. While higher inflows from non-US countries are reassuring, the fact remains that the majority – over three quarters - of the nearly nineteen million tourists to Canada in 2005 were from the US. Hence, tourist inflows from non-US countries would need to increase by a very large amount to compensate for the drop in visitors from the US.

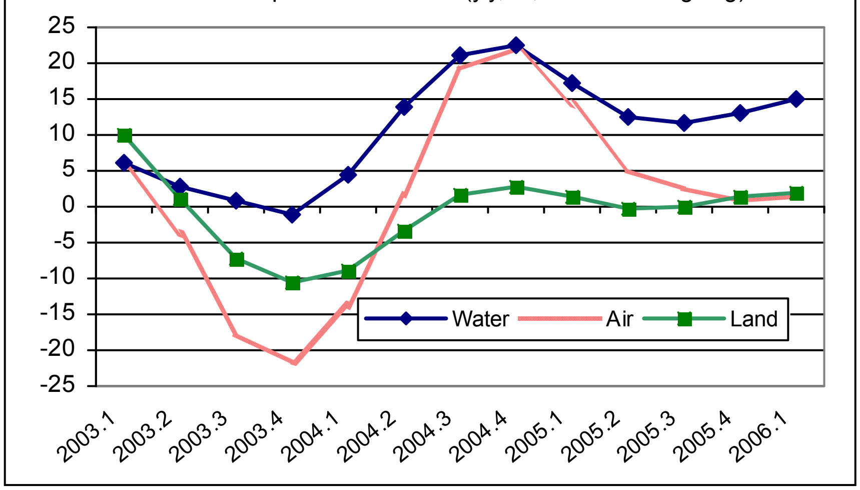


Chart 9: Transportation Sectors (y/y, %, 3-mo. moving avg)

Table 9: Canadian Transportation Sector, 2000-2007 (Cdn $ mlns and %)

	2000	2001	2002	2003	2004	2005	2006	2007
Total Receipts	11,196	10,626	11,061	9,895	11,023	11,632	12,141	12,649
% Change	15.5	-5.1	4.1	-10.5	11.4	5.5	4.4	4.2
Water Transport	2,317	2,400	2,391	2,413	2,886	3,278	3,573	3,895
% Change	20.4	3.6	-0.4	0.9	19.6	13.6	9	9
Air Transport	5,184	4,826	4,948	4,051	4,674	4,841	5,020	5,171
% Change	17.6	-6.9	2.5	-18.1	15.4	3.6	3.7	3
Land and Other Transport	3,695	3,400	3,722	3,431	3,463	3,513	3,548	3,584
% Change	9.9	-8.0	9.5	-7.8	0.9	1.4	1	1

Sources : Statistics Canada (2000-2005); EDC Economics

2.2 Transportation Sub-Sector

Receipts from transportation have reflected both recent economic growth and trade – thus higher demand for transport services, and external shocks. Particularly, overall receipts declined dramatically in 2003 – the height of the SARS crisis – though they rebounded in 2004. Air transport receipts showed the strongest decline in 2003, and while they rebounded in 2004 and 2005, they appear to have recently tapered off, possibly reflecting fuel prices. Receipts from land transport (trucking and rail) showed less decline than air during the SARS crisis, but similarly experienced less of a subsequent rebound. Finally, water transport has shown very rapid growth both in 2004 and 2005 (+20% and +14%, respectively). In the past, water transport has been often touted as an underappreciated resource, though recent sectoral growth appears to be changing this. Looking forward, the forecast for overall transportation services would be easing slightly toward the end of 2006 and into 2007 as a result of easing world economic growth.

Table 10: Commercial Service Exports by Sub-Sector

Service Exports	CAD bn 2005	% Share of Exports (2005)	Export Outlook (% growth) 2005	2006(f)	2007(f)
Communication Services	2.7	7.6	0.5	2	2
Insurance	3.7	10.6	-0.3	1	1
Other Financial Services	2.1	6.1	52.3	2.5	2.5
Computer & Information Services	4.1	11.8	1.4	2.5	2.0
Royalties & license fees	4.2	12.0	1.0	4.0	4.0
Management Services	4.9	13.8	-7.6	1.5	1.5
Research & Development	2.9	8.3	0.7	6.0	6.0
Architectural, Engineering, and Other Technical	4.1	11.6	-1.6	3.0	2.0
Miscellaneous Services to Business	4.3	12.1	3.1	2.0	2.0
Audio-Visual Services	2.0	5.7	9.7	2.0	2.0
All Other Commercial Services	0.1	0.5	0	3	2
Total Commercial Services	**35.1**	**100.0**	**1.8**	**2.6**	**2.4**

Source: Statistics Canada, EDC Economics. 2005 actual, 2006 and 2007 are forecast.

2.3. Commercial Services

Commercial services exports rose by 1.8% in 2005 – an improvement considering that receipts declined by 1.5% in 2004 following growth of just 2.3% in 2003 (Table 7). From a general standpoint it appears that the recent appreciation of the Canadian dollar could be responsible for some of the lackluster growth seen recently in this sector. Recent highlights are as follows:

Receipts from "other financial services" rose by 52% to $2.13 billion, largely as a result of higher bank commissions. Foreign revenues from Canadian financial institutions are increasing dramatically as a result of these institutions' growing presence abroad. A recent Statistics Canada study[1] notes that as Canadian banks increasingly expand abroad their foreign revenue growth is faster than that from domestic sources. Specifically, between 1997 and 2004 the total real value of services produced by the domestic banks rose at an annual average rate of 1.8% in Canada, compared to 4.8% worldwide.

Audio-visual services turned in a respectable performance in 2005 as receipts increased 9.7% to $4.3 billion. This follows a decline of 1.3% in the sector in 2004. While numerous factors appear to be responsible for the decline and growth story of the past two years, one possible factor cited for the decline in revenues in 2004 and the subsequent increase in 2005 is the NHL strike, with its temporary loss of broadcasting revenues from the US.

Miscellaneous services to business rose slightly by 3.1% to $4.3 billion. Export receipts accruing to this immense catch-all sector – which includes advertising, equipment rentals, and non-financial commissions - had previously declined by 3.4% in 2004.

However, these successes were dampened by declines or pauses in almost every other sector, including insurance services (no change in export volumes from 2004, with total receipts at $3.72 billion); communication services (+0.5% to $2.7 billion); computer and information services (+1.4% to $4.1 billion); management services (-7.6% to $4.9 billion); and R&D (+0.7% to $2.9 billion).

2.4 Outlook

The current world economic boom means that services export demand will be tightest in areas currently experiencing high rates of growth. Still, this optimistic outlook needs to be dampened by the Canadian dollar's rapid rise, and therefore the loss of what was undoubtedly a solid selling tool. In this respect, the expectation for the dollar to remain high in the foreseeable future will certainly have the same effect as on the goods sector – particularly the shift toward higher productivity to offset the dollar's higher value. A key item to remember in this respect is noticeable increase in call centers locating in Canada in recent years to capitalize on Canada's attractiveness. Given the continuing trend toward outsourcing, it is reasonable to assume that this will continue. In this respect, Canada has been touted as possessing an advantage over other countries thanks to its infrastructure, quality labor force, and cultural proximity to key markets.

Similarly, the recent growth in export receipts to banks and insurance is not an accident, with companies in these two sectors having invested abroad for years. Particularly, the big six Canadian banks are currently pursuing a policy of expanding abroad in certain key markets (e.g. Latin America for Scotiabank; and the US for certain others). This business model being increasingly broadcast in overseas markets – particularly the foreign affiliate/subsidiary model – is also likely to continue generating this kind of head office/home office dynamic.

To sum up, therefore, the outlook for commercial services is favourable, thanks to the current global economic boom, supported by the continuing trend toward outsourcing and greater reliance on foreign affiliate/subsidiary model.

V. Geographic Distribution – Canada's Principal Markets for Service Exports

Unlike the export of merchandise goods which are predominantly destined for the US, Canada's services exports are more geographically diversified. Consider that while 87% of all goods are exported to the US, less than 60% of service receipts are provided by the US (Table 11). Also, Asia accounts for 9% of total Canadian services exports, about double the share for merchandise exports.

[1] Christine Hinchley, *"Foreign Banks in the Canadian Market"* - Statistics Canada 11-621-MIE2006041 2006.

VI. Bottom Line – Services Trade

Three years of above-trend economic growth culminated in global services exports growth of 11% in 2005, to $2.4 trillion. With economic growth gradually slowing to 4.5% in 2006 and 4.1% in 2007, world services export growth should also slow somewhat to 6% in 2006 (to $2.6 trillion) and 4.5% in 2007 (to $2.7 trillion). The impact of globalization on services trade cannot be overemphasized: from the growth of offshoring and creation of global supply chains, which is fueling growth in commercial services; to the growth in goods trade which is catalyzing growth in transportation services; and finally the growth in tourism and travel worldwide which is fueling expansion in travel services, particularly tourism.

Table 11: Canadian Services Receipts by Geographic Destination, 2001-2003

Country	Sub-Sector	2000	2001	2002	2003
United States	Total:	36,601	35,736	36,647	35,098
	Travel	9449	9972	10334	9080
	Commercial Services	20,813	19,747	20,134	20,575
	Transportation	6,338	6,017	6,178	5,443
Europe	Total:	11,455	11,863	13,067	12,182
	Travel	3,220	3,088	2,956	2,797
	Commercial Services	5,194	6,015	6,772	6,206
	Transportation	3,041	2,761	3,339	3,178
Middle East	Total:	597	702	702	637
Africa	Total:	1,062	1,013	1,164	1,288
Central and East Asia	Total:	5,916	6,196	5,633	4,826
Oceania	Total:	755	731	810	975
South America	Total:	946	894	1007	851
Central America	Total:	523	628	665	609
Antilles	Total:	1,789	2,223	2,579	2,975

On a geographic basis, while Europe maintains its position as the largest trader of services in the world, Asia is clearly the fastest-growing region on this count. Within countries, China and India are posting near-record growth in services exports, although with India clearly leading the way for commercial services growth, and China with transportation services growth. This development reflects the different structure of economic growth in the two countries. Specifically, China specializes on trade in goods, while India is focused on participating in the global supply chain via technology solutions and the outsourcing of business processes. A notable feature of this process is that service outsourcing is moving up the value-added chain. Both developments – continued outsourcing and moving up the value chain – are expected to continue and spread across a broader industrial spectrum.

Canadian service providers are benefiting from this expansion in global services activity. Following the 2004 return to export growth to 4.5%, total service exports rose by nearly 2% in 2005. This more subdued performance was due to stresses in well-defined sectors like travel services (-1.7%) which were hurt by the twin impact of the higher Canadian dollar and fuel prices. In the critical commercial services category, weaknesses were constrained to a few sectors that should recover in 2006. As a result, Canada's commercial services exports are forecast to improve in 2006 and 2007.

Annex1

Services Trade – A Primer

Services represent 60% of global output but only 20% of global trade. In contrast to goods trade which is easy to both understand and measure, services trade is more difficult to grasp. At their simplest, services are ideas and effort valued by the market. Or, using a simple example, if you can drop it on your toe, it cannot be a service. Many services are neither tradable nor storable. For example, reading a gas meter, delivering mail, and cutting hair must be done on site. This indivisibility of the provider from the recipient partly explains why services are less traded than goods. But it also suggests that the delivery method for services is more important than goods. Recent data on sales of foreign affiliates (FATS) show that service firms are more likely than goods exporters to set up offices abroad to be closer to their clients.

Annex 2

WTO Update: The Doha Round

The WTO Ministerial meeting held in Hong Kong on December 13-18 2005 did not produce a breakthrough in the current round of the Doha Round negotiations. But it did score a partial success in that the national governments agreed to continue talking. The Doha Round is likely the most complex of all the trade liberalization that occurred since 1947, given the large number of players (148 members), and the focus of the negotiations on numerous hitherto untouched sectors – particularly agriculture and services. Negotiations are taking place along four main axioms: agriculture; services; trade facilitation and other topics; and non-agricultural market access. While the negotiations on services could potentially deliver some of the greatest gains from the round, progress so far has been disappointingly slow. Part of the difficulty in negotiating services stems from the fact that no clear target has been established for a successful outcome, given the qualitative (rather than quantitative) nature of services barriers. In the vast majority of instances, the offers made bind liberalization at levels that are already exceeded by current practice. Bottom line: no liberalization of services is likely in the near future.