

SMEs in Legal and Architecture Services

July 2023

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Abstract

Through analysis of available data and outreach to representative firms, this paper focuses on small- and medium-sized enterprises (SMEs) in two segments of the professional services sector: legal and architecture services. We discuss the definition of SMEs in each of these industry segments; SMEs' contribution to the number of U.S. establishments, employment, and exports; the types of services provided to overseas clients; and the channels through which these services are supplied. The analysis reveals meaningful distinctions between large and SME professional services firms, including differences in revenues, number of employees, the means of providing services to foreign clients (with larger firms tending to have establishments abroad), and the types of services provided (with small firms tending to provide niche services). Architecture services SMEs generally appear to be more reliant on overseas travel relative to SMEs in the legal services industry; however, different practices may exist across and within firms due to individual preferences and needs.

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Introduction

The professional services sector includes industries that supply intangible products to individuals and organizations.¹ Frequently, the supply of such services demands specialized skills or knowledge, and practitioners often hold certifications, licenses, or memberships in professional organizations.² While the classification systems used by national statistical agencies and international organizations differ slightly, industries generally identified as professional services include legal services, accounting, architecture, engineering, advertising, management consulting, and research and development, among others.³

Through analysis of available data and outreach to representative firms, this paper focuses on the overseas activities of small- and medium-sized enterprises (SMEs) in two segments of the professional services sector: legal services and architecture services. Attorneys and law firms engaging in international trade typically provide legal advisory services supporting international transactions or business operations, along with other matters involving international law, their home country's law, and third-country law. Architects provide design and planning services for the construction and renovation of various types of structures and buildings.⁴

SMEs make up a significant share of the number of enterprises, employment, and exporting firms across the U.S. economy, as well as a high share of export value in certain professional services industries. Relative to larger firms, however, there is less data on, and understanding of, the role that SMEs play in services trade. Outreach to SME representatives provides insights that data does not typically capture, including the types of services traded by SMEs, the channels they frequent, and barriers they face when providing services to foreign clients. Since legal and architecture services can be provided to foreign clients via multiple channels—e.g., digitally, in-person, and via affiliates established abroad—a deeper understanding of how these services are traded provides insight into the relative importance of, and relationship between, these modes of delivery.

The paper begins by discussing the definition of SMEs in the legal and architecture industries and identifying these firms' contribution to the number of U.S. establishments and employment. The paper then presents descriptive statistics on U.S. professional services SMEs' contribution to U.S. exports, discusses the means through which SMEs in the legal and architecture services segments provide services to overseas clients, and examines the impact of trade agreements and trade barriers on SME activities in these industries. It concludes by summarizing the authors' findings and identifying issues for further analysis.

¹ Rouse, "Professional Services," March 2019; Spacey, "26 Examples of Business Services," March 18, 2018.

² Merriam-Webster, "Professional Service," accessed December 4, 2019; Business Dictionary, "Professional Services," accessed December 4, 2019.

³ See for example, Sector 54 (professional, scientific, and technical services) of the 2022 NAICS from the U.S. Census Bureau and also see the sectoral classification of professional services used for negotiating trade agreements from the WTO: U.S. Census, "North American Industry Classification System," 2022; WTO, "Services Sectoral Classification List," July 10, 1991.

⁴ Morea, *Architects in the US*, June 2016, 2; U.S. Census, 2012 NAICS Definitions, 2012.

Defining SMEs in Professional Services Industries

In the first of a series of studies on SMEs, the USITC reported the lack of a universal definition of an SME.⁵ The definition of an SME varies because size is relative across and within sectors. Further, in a 2014 paper, the WTO suggests that technological developments have mitigated the consequences of firm size and further complicated the identification of SMEs.⁶ In the sections below, we provide an overview of these varying definitions and present statistics which rely on the SME definitions used by data sources.

For the purposes of its studies on SMEs, the USITC adopted an employee-based definition of less than 500 employees across all industries, a threshold defined by the U.S. Small Business Administration (SBA) Office of Advocacy.⁷ In addition to this economy-wide definition, the SBA has proposed industry-specific SME definitions that are based on either employment or annual revenue. Across most professional, scientific, and technical services subsectors, definitions are delineated at a six-digit NAICS code and are based on firm revenue. Professional services subcategories for which the SBA provides specific revenue-based SME size standards include NAICS 54110 (Offices of Lawyers, set at \$15.5 million) and NAICS 541310 (Architectural Services, set at \$12.5 million).⁸

Using these definitions may be problematic, however, when conducting industry-specific research. For example, for legal services, only the largest firms' revenues are regularly reported (such as in the publication *American Lawyer*). Although an employee-based classification (focusing on the number of attorneys and excluding support staff) would be relatively easier to apply and more compatible with how industry tends to view size standards, it is difficult to define a specific threshold and there is no consensus on a definition within the industry.⁹ One representative of an SME law firm suggested that small law firms are best identified by the type of services that they provide and not by staff or revenue size, with smaller firms tending to offer boutique services and larger firms offering a larger suite of services.¹⁰ Another representative of an SME law firm indicated that the establishment of foreign offices may be a meaningful distinction between small and large law firms.¹¹

⁵ USITC, *Small and Medium-Sized Enterprises*, January 2010, 1–2.

⁶ For more information, see WTO, “SME Competitiveness and Aid for Trade,” 2014.

⁷ SBA, “Frequently Asked Questions,” August 2018. Other definitions were for gathering and analyzing data —i.e., in services, revenue-based definitions were combined with the employee ceiling of 499 employees. USITC, *Small and Medium-Sized Enterprises*, January 2010, 4–4.

⁸ SBA, “Table of Size Standards,” March 17, 2023.

⁹ Industry representatives, telephone interviews by Commission staff, October 2018 through November 2019.

¹⁰ Industry representative, telephone interview by Commission staff, November 21, 2019. The law firm has under 70 attorneys and about 100 support staff.

¹¹ Industry representative, interview by USITC staff, November 21, 2019.

Representatives of small architectural services firms tend to base their assessments of firm size on number of employees, with 10 employees and 40–70 employees generally considered the upper thresholds for small- and medium-sized firms, respectively.¹² One representative of an architectural services SME stressed the importance of design quality and academic connections for his firm, and indicated that he does not consider large architectural firms as competitors but as participants in a separate market.¹³ Another SME representative indicated that her firm does not provide the broad range of services that are offered by larger firms, but often works on large projects with other firms providing different architectural services.¹⁴

Professional Services SMEs as a Share of U.S. Establishments and Employment

In the United States and most developed countries, SMEs—including SMEs in the professional services sector—generally make up a significant share of the number of enterprises and employment but account for a relatively smaller share of exports.¹⁵ The USITC reported that professional services SMEs accounted for about 94 percent of all establishments, 62 percent of all employees, and 50 percent of total exports in the United States in 2007.¹⁶ While this general trend also prevails in more recent years, this paper shows that there is heterogeneity across industries, especially with respect to the SME share of exports.

The OECD reports that enterprises with fewer than 250 employees accounted for 92.8 percent of all establishments and 56.4 percent of employment in the U.S. professional, scientific, and technical services sector in 2015 (latest data available) (figure 1 and figure 2).¹⁷ In the same year, micro-enterprises (firms with fewer than 10 employees) alone accounted for 78.5 percent of U.S. professional services establishments and 19.5 percent of U.S. employment.

Data published by the U.S. Census Bureau are reported for different enterprise class categories and are based on different industry classifications than data published by the OECD, yet reveal similar patterns. For example, based on U.S. Census data for NAICS 54, “Professional, Scientific, and Technical Services,”

¹² Industry representatives, interviews by USITC staff, November 12, 14, and 19, 2019.

¹³ Industry representative, interview by USITC staff, November 19, 2019.

¹⁴ Industry representative, interview by USITC staff, November 12, 2019.

¹⁵ USITC, *Small and Medium-Sized Enterprises*, January 2010, 1–1.

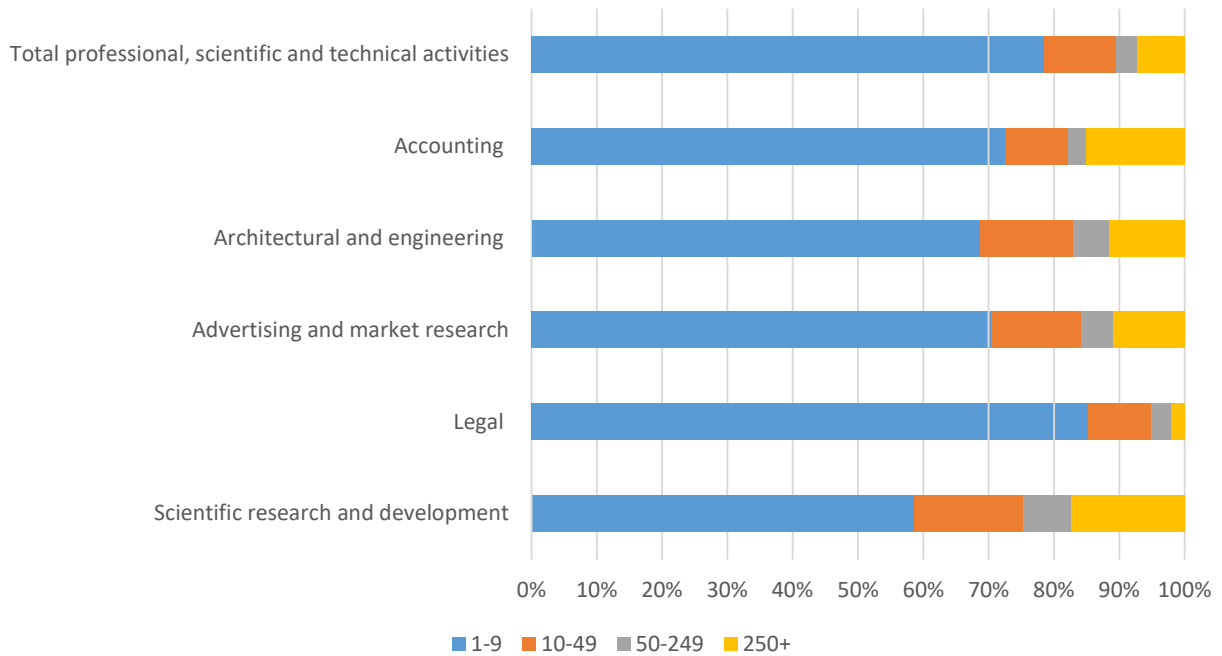
¹⁶ Across a subset of U.S. services sectors in 2007, SMEs accounted for about 83 percent of all establishments, 43 percent of all employees, and 38 percent of total exports. USITC, *Small and Medium-Sized Enterprises*, November 2010, D–3 and D–11.

¹⁷ While an establishment is a single unit, an enterprise may consist of one or more units or establishments. In 2015, 99.7 percent of all professional, scientific, and technical services enterprises were SMEs (under 250 employees). Data discussed in text and shown in figures are from the OECD Structural and Demographic Business Statistics, which likely draw from U.S. economic census statistics. OECD data is reported according to ISIC Rev.4 while data directly from the U.S. Census Bureau is reported by NAICS.

U.S. enterprises with fewer than 300 employees accounted for 91.4 percent of all establishments and 54.5 percent of employment in 2016.¹⁸

SMEs accounted for particularly high shares of the number of establishments and employment in some professional services industries. For example, SMEs accounted for 98 percent of all establishments and 77.3 percent of total employment in the U.S. legal services industry in 2015, while micro-enterprises accounted for 85.3 percent of all establishments and 33.7 of total employment in that industry.

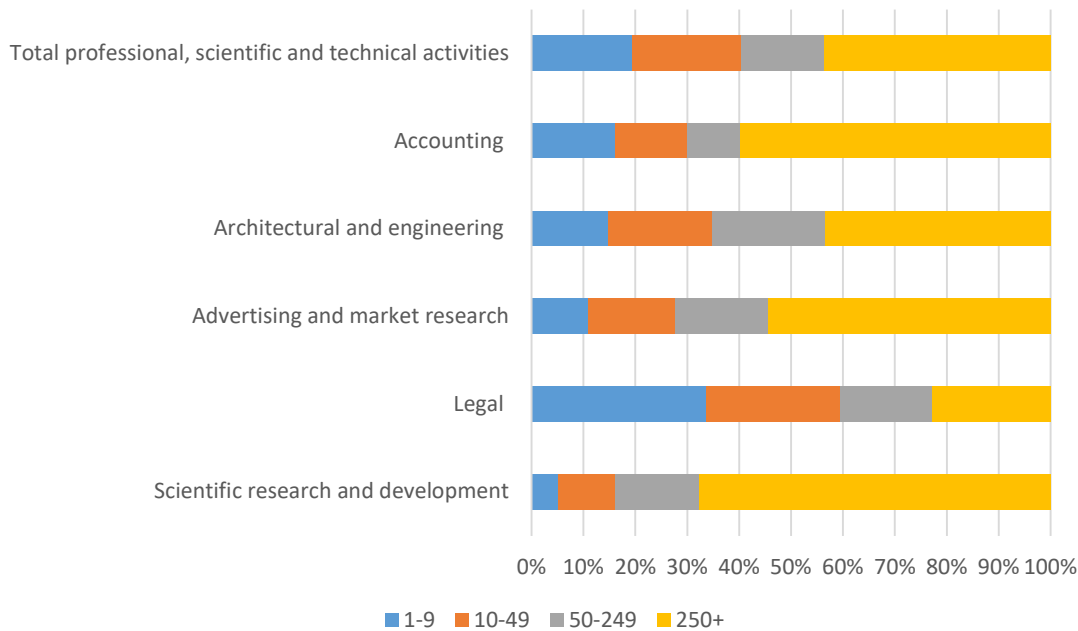
Figure 1: Share of Total Establishments by Enterprise Size (Number of Employees) in Certain Professional Services Sub-Sectors, 2015



Source: The OECD Structural and Demographic Business Statistics (SDBS) – ISIC Rev 4.

¹⁸ U.S. Census, 2016 SUSB Annual Data Tables by Establishment Industry, “Number of Firms, Number of Establishments, Employment, and Annual Payroll by Enterprise Employment Sizes for the United States and States, NAICS Sectors: 2016,” December 2018. Data for 2016 is reported here as a point of comparison to the OECD data.

Figure 2: Share of Total Employees by Enterprise Size (Number of Employees) in Certain Professional Services Sub-Sectors, 2015



Source: The OECD Structural and Demographic Business Statistics (SDBS) – ISIC Rev 4.

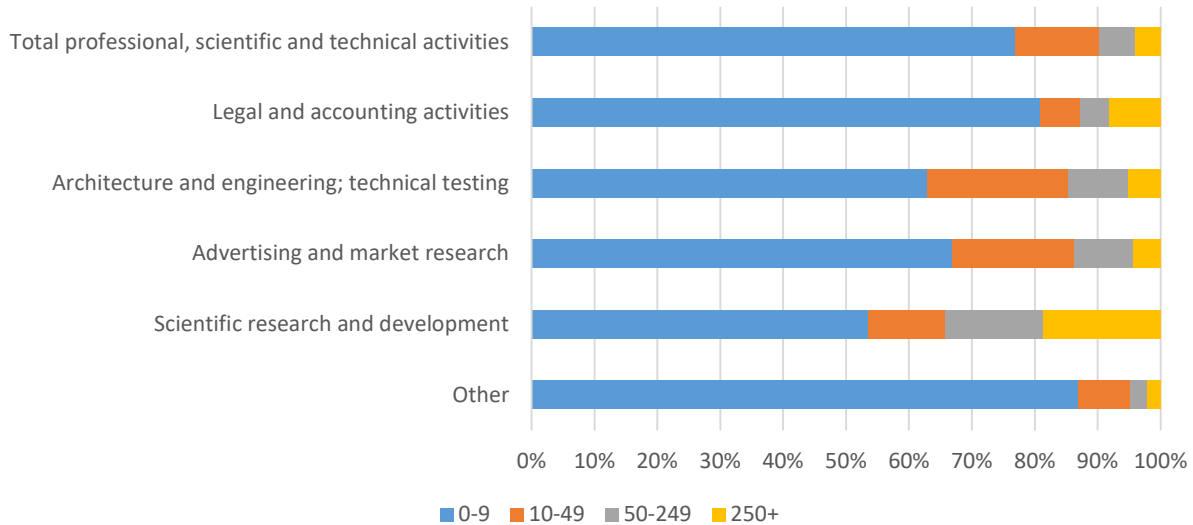
Professional Services SMEs’ Participation in Overseas Markets

Share of U.S. Exports

Data published by the OECD indicate that the vast majority of U.S. professional services firms that export are SMEs.¹⁹ In 2018 (the most recent year for which complete data for legal, architectural, and engineering services are available), firms with less than 250 employees accounted for almost 96 percent of all U.S. professional services exporters, with micro enterprises alone accounting for over 76 percent (figure 3). Micro-enterprises are relatively numerous among U.S. legal and accounting services exporters (accounting for 80.9 percent of such firms) and comprise a somewhat smaller share of U.S. architectural, engineering, and technical testing services exporters (with 62.8 percent).²⁰ This pattern is similar to the average for all U.S. goods and services industries, with SMEs—and micro enterprises in particular—having accounted for the majority of all U.S. exporters in 2018.

¹⁹ This is also true across the U.S. economy as a whole. Specifically, SMEs accounted for over 95 percent of all U.S. exporters in 2018. OECD, Trade by Enterprise Characteristics (ISIC rev. 4).

²⁰ The OECD does not publish disaggregated data on the number of SME exporters in the legal services and architecture and engineering services industries.

Figure 3: Share of Exporting Entities by Firm Size (Number of Employees), 2018

Source: OECD, Trade by Enterprise Characteristics (ISIC rev. 4).

Note: This figure includes all subsectors of the professional, scientific, and technical activities category for which complete 2018 data are available. Certain 2018 data for activities of head offices and management consultancy and veterinary activities were confidential and non-publishable.

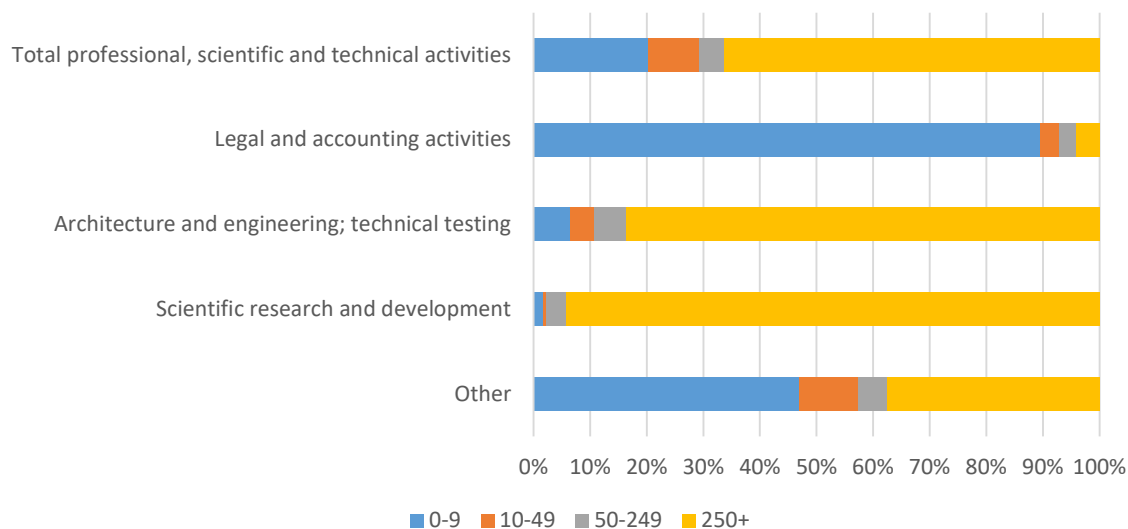
While SMEs are numerous among U.S. professional services exporters, their contribution to overall export value in this sector is markedly smaller.²¹ Firms with less than 250 employees accounted for only 33.8 percent of the value of exports by U.S. professional services firms in 2018 (figure 4). At the same time, there is wide disparity among professional services subsectors. For example, SMEs account for a very large share of the export value generated by U.S. legal and accounting services firms, with micro enterprises alone accounting for over almost 90 percent of this value in 2018.²² By contrast, all firms with less than 250 employees accounted for 16.3 percent of the export value generated by U.S. architectural, engineering, and technical testing firms in 2018.²³

²¹ This is also true across the U.S. economy as a whole. Specifically, SMEs accounted for less than 30 percent of total U.S. export value in 2018. OECD, Trade by Enterprise Characteristics (ISIC rev. 4).

²² The OECD does not publish disaggregated data on export value for SMEs in the legal services industry.

²³ The OECD does not publish disaggregated data on export value for SMEs in the architecture and engineering services industry.

Figure 4: Share of Trade Value by Firm Size (Number of Employees), 2018



Source: OECD, Trade by Enterprise Characteristics (ISIC rev. 4).

Note: This figure includes all subsectors of the professional, scientific, and technical activities category for which complete 2018 data are available. Certain 2018 data for activities of head offices and management consultancy, advertising and market research, and veterinary activities were confidential and non-publishable.

Data published by the U.S. Census Bureau also reveal that SMEs account for a larger share of exporting companies than export value. Specifically, in 2019, firms with fewer than 500 employees accounted for 97.3 percent of all U.S. exporters classified in NAICS 541, “Professional, Scientific, and Technical Services,” and 30.9 percent of export value by entities classified in that category.²⁴

OECD data suggest that trends observed in the United States are similar to those in other large developed economies. As in the United States, firms with less than 250 employees accounted for at least 75 percent of all professional services exporters in each of the countries for which 2018 data are available.²⁵ Some large OECD economies also exhibit a trend in export values that is similar to the United States, with SMEs accounting for less than half of the export value generated by professional services firms in Denmark (with 37.2 percent), France (37.1 percent), Germany (44.0 percent), and the United Kingdom (45.3 percent).²⁶

Recent and detailed data are not available on the number of professional services SMEs that have established a presence in foreign markets, or on SMEs’ contribution to U.S. affiliate sales in foreign

²⁴ USITC staff calculation based on U.S. Census, “A Profile of U.S. Importing and Exporting Companies,” April 5, 2022, 47.

²⁵ Some countries reported estimated numbers of companies with 0-9, 10-49, and 50-249 employees, but also reported that employment in a certain number of companies was “unknown.” As such, these countries did not report a total number of companies with 0-249 employees, and staff used a sum of those companies 0-9, 10-49, and 50-249 employees to estimate the share of SME exporters. Staff did not estimate the share of SME exporters for countries that did not report values for one or more SME category.

²⁶ In several smaller OECD countries, firms with less than 250 employees are majority contributors to the export value generated by professional services industries. For example, SMEs account for more than 90 percent of professional services firms’ export value in Belgium, Finland, Hungary, Sweden, and Romania.

markets. According to a 2010 USITC report, SME MNCs (defined as U.S. parents with less than 500 employees) accounted for 2.1 percent of total U.S. MNC sales in the professional, scientific, and technical services sector in 2007.²⁷

Activities in Overseas Markets

Like SMEs in other industries,²⁸ SMEs in the architecture and legal services industries provide customized or niche services to consumers in foreign markets. Both large and small architectural firms typically provide specialized design services in foreign markets.²⁹ Such firms may choose to provide services overseas as a result of client relationships with customers that establish a presence abroad, after winning a foreign design competition, or due to a lack of opportunity in the domestic market, among other reasons.³⁰ SMEs in the architecture industry are particularly focused on providing unique, progressive, or niche design services. Representatives of architecture SMEs indicate that they frequently collaborate with local partners or work on large projects with multiple architects in foreign markets.³¹ International design competitions are particularly important way for very small firms to provide architectural services abroad. While participation in these competitions entails some risk—such as the possibility of not getting paid or the appropriation of intellectual property—foreign competitions reportedly yield larger commissions than U.S. competitions and place greater emphasis on design (as opposed to experience and financial concerns).³²

Trade in legal services typically involves the provision of legal advisory services to support international transactions, with demand fueled by globalization and increased capital flows, among other factors.³³ Foreign attorneys tend to provide legal services in relation to international law, home-country law (law of the service providers' home country), or third-country law.³⁴ Although domestic or host country law (law of the country receiving the service) is an increasingly important component of international trade, it is widely subject to local requalification requirements or restricted from trade³⁵ and is typically associated with the provision of services through foreign affiliates, in which SMEs are not as active. Industry representatives indicate that demand for services from SME law firms stems from firms' expertise in specific practice areas.³⁶ One attorney at an SME U.S. law firm indicated that though the firm is active in three practice areas (tax law, litigation, and political law), its cross-border practice is limited to tax law. The firm only advises on U.S. law and does not provide services with respect to law of

²⁷ USITC, *Small and Medium-Sized Enterprises*, November 2010, 3-20.

²⁸ OECD, *Chapter 3: The Benefits of Open Services Markets*, 2017, 74.

²⁹ Miller, *Architects in the US*, July 2019, 20; Keune, "Architectural Services in Global Trade," February 15–16 2007, 11; Industry representatives, interviews by USITC staff, November 2020.

³⁰ Keune, "Architectural Services in Global Trade," February 15–16 2007, 11.

³¹ Industry representatives, interviews by USITC staff, November 12 and 19, 2020.

³² Industry representatives, interviews by USITC staff, November 14 and 19, 2020.

³³ Hook, "Sectoral Study on the Impact of Domestic Regulation," February 6, 2007, 5-6; Geloso Grosso et al., *Services Trade Restrictiveness Index (STRI)*, November 2014, 7.

³⁴ Geloso Grosso et al., *Services Trade Restrictiveness Index (STRI)*, November 2014, 7–8. Home country law refers to the law of foreign lawyers' home country.

³⁵ OECD, "STRI Sector Brief: Legal Services," 2019. Certain policies included in the OECD STRI index for legal services are classified as either pertaining to international or domestic law practice.

³⁶ OECD, *Chapter 3: The Benefits of Open Services Markets*, 74. Industry representatives, interviews by USITC staff, November 21, 2019.

another country.³⁷ The firm handles a variety of cases in this specialized area; for example, providing legal advice to foreign entities on inbound investment into the United States and to U.S. entities on outbound investment in foreign countries.³⁸

Modes of Service Delivery Abroad

Overall Industry Trends on Modes of Supply

Services may be traded on a cross-border basis or through transactions by foreign-based affiliates. Cross-border trade occurs when a service is supplied to an overseas customer through the international transfer of information or natural persons (roughly equivalent to modes 1, 2, and 4 under the General Agreement on Trade in Services, or GATS). The preceding discussion on the share of exporting entities and export value by firm size covers trade conducted through these three modes. Affiliate transactions occur when services are provided to foreign customers through the establishment of a foreign subsidiary, branch, or office (roughly equivalent to GATS mode 3).³⁹

The United States was a net supplier of both legal services and architectural and engineering (AE) services throughout 2010–20,⁴⁰ with U.S. cross-border exports exceeding imports and U.S. affiliate sales exceeding purchases in both services segments.⁴¹ However, the ways in which each of these services are most typically provided to overseas customers differs substantially. Legal services are most commonly provided on a cross-border basis, with U.S. cross-border exports of legal services consistently exceeding affiliate sales by foreign legal services affiliates of U.S. firms during 2010–2020 (figure 5). By contrast, U.S. affiliate sales by AE services firms exceeded U.S. cross-border exports of such services throughout the period (figure 6). While this paper focuses on U.S. firms’ activities in foreign markets, it is interesting to note that cross-border trade also dominates U.S. consumption of legal services from foreign providers

³⁷ Industry representative, interview by USITC staff, November 21, 2019.

³⁸ Industry representative, interview by USITC staff, November 21, 2019.

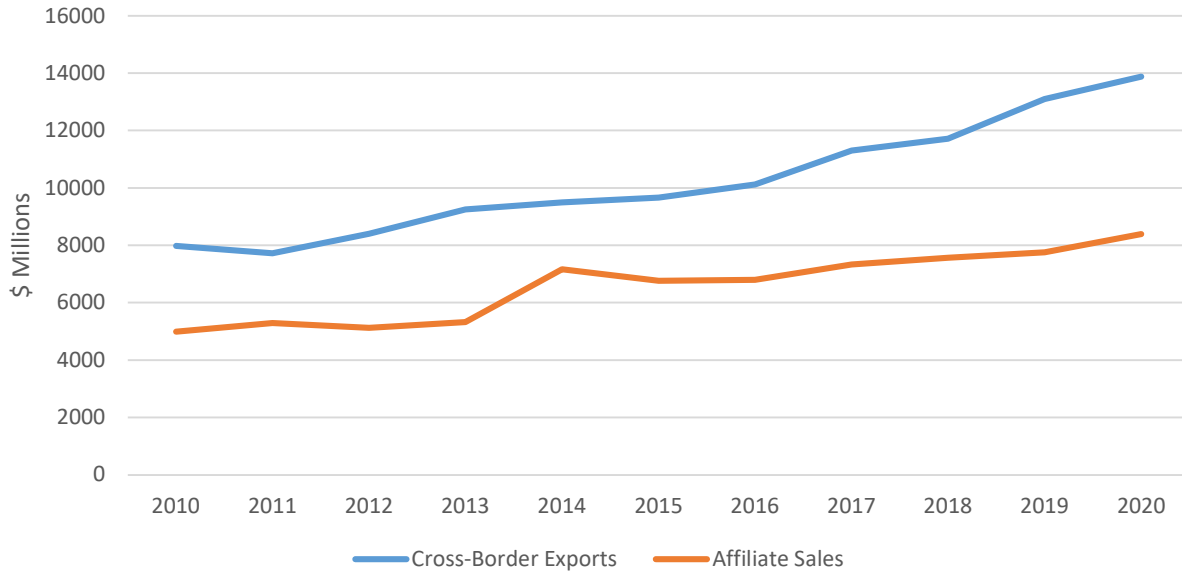
³⁹ There are four modes of supply identified by the GATS: mode 1 (cross-border supply), mode 2 (consumption abroad), mode 3 (commercial presence), and mode 4 (temporary presence of natural persons). More specifically, mode 1 occurs when a service is supplied by an individual or firm in one country to an individual or firm in another (i.e., the service crosses national borders). In a mode 2 transaction, an individual from one country travels to another country and consumes a service in that country. Mode 3 occurs when a firm based in one country establishes a local affiliate in another country and supplies services through that affiliate. Lastly, mode 4 occurs when an individual from one country travels to another country on a short-term basis to supply a service. For a fuller description of services modes of supply, see USITC, *Recent Trends in U.S. Services Trade*, May 2022, 14–15.

⁴⁰ The U.S. Department of Commerce (USDOC) Bureau of Economic Analysis (BEA) does not publish discrete data on affiliate transactions in the architecture services industry, but reports such data for the aggregated “architectural, engineering, and related services” category. In the interest of comparability, the data on cross-border trade in AE services that are presented in this analysis include both “architectural services” and “engineering services” as affiliate transactions data on “architectural, engineering, and related services” capture both of these industry segments.

⁴¹ In 2021, cross-border imports of architecture and engineering services exceeded exports by a small margin. Affiliate transactions data for 2021 are not available.

and affiliate transactions account for the largest share of U.S. consumption of services from foreign AE services firms.⁴²

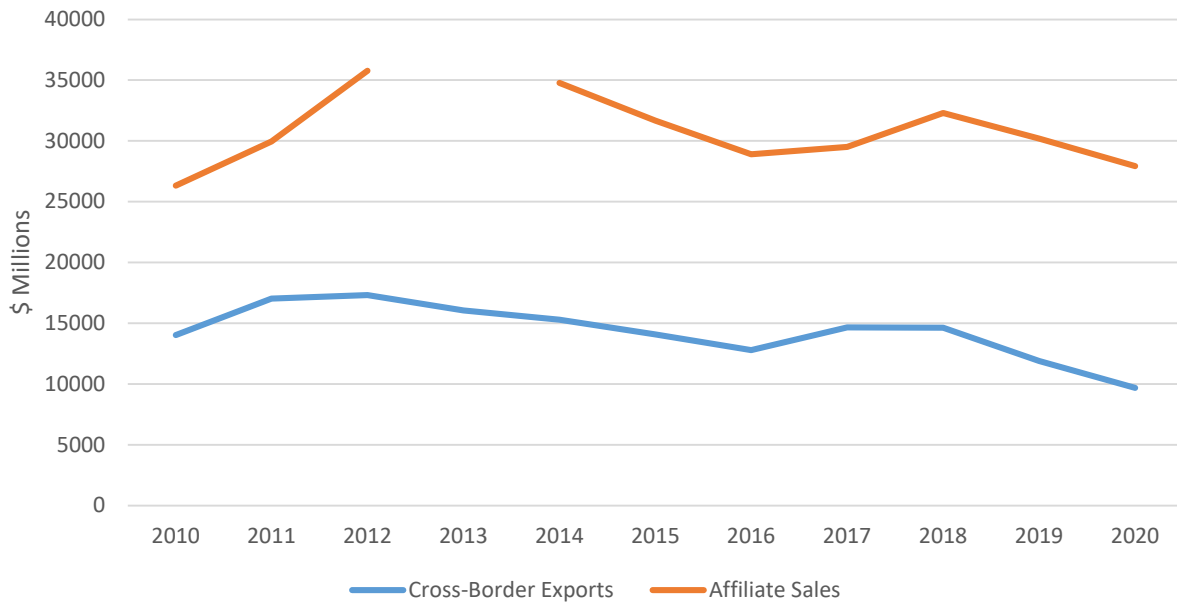
Figure 5: U.S. Cross-Border Exports and Affiliate Sales of Legal Services, 2010-20



Source: USDOC, BEA, table 2.3, “U.S. Trade in Services,” and table 4.1: “Services Supplied to Foreign Persons,” (accessed March 16, 2023).

⁴² USDOC, BEA, Table 2.3, “U.S. Trade in Services, by Country or Affiliation and by Type of Service;” Table 4.1: “Services Supplied to Foreign Persons by U.S. MNEs through Their MOFAs, by Industry of Affiliate and by Country of Affiliate;” Table 5.1, “Services Supplied to U.S. Persons by Foreign MNEs through Their MOUSA, by Industry of Affiliate and by Country of UBO,” accessed March 16, 2023.

Figure 6: U.S. Cross-Border Exports and Affiliate Sales of Architectural and Engineering Services, 2010-2020



Source: USDOC, BEA, table 2.3, “U.S. Trade in Services,” and table 4.1: “Services Supplied to Foreign Persons,” (accessed March 16, 2023).
 Note: Data on affiliate sales of architectural and engineering services in 2013 are suppressed to avoid disclosure of individual company information.

Work based on survey data published by Mann (2019) provides U.S. trade estimates by mode of supply and by sector.⁴³ Though these estimates are not specific to SMEs, they illustrate patterns of international trade and how companies conduct business abroad across sectors. According to Mann, about one half of trade in legal services occurs through mode 1, about one-third of trade in legal services occurs through mode 3, and the remainder is split between modes 2 and 4. For architecture and engineering services, only mode 1 and 4 values are reported; the share of mode 3 is not disclosed and mode 2 is marked as not applicable for the sector.⁴⁴

Mann’s paper also provides estimates for the share of mode 1 in overall cross-border exports (measured as the sum of modes 1, 2, and 4) in both legal and architecture and engineering services. Though mode 1 is substantial in both sectors, it is lower in architecture and engineering services due to the higher relative values of mode 4 delivery (mode 1 accounts for 80 percent of legal services exports and 61 percent of architecture and engineering services exports).⁴⁵ More recent UK data show a dramatic increase in the mode 1 share of cross-border exports, reflecting effects from the COVID-19 pandemic and greater digital delivery of services. Within the UK’s other business services category (which includes

⁴³ Mann, “Measuring Trade in Services,” 2019, 20 (table 4). All estimates discussed here refer to exports of services supplied.

⁴⁴ Hook discusses the potentially important role of mode 2 trade in legal services (for example certain jurisdictions act as centers for arbitration, and clients that are resident in countries with particularly high trade barriers sometimes travel abroad to seek legal advice.) Hook, “Sectoral Study on the Impact of Domestic Regulation,” February 6, 2007.

⁴⁵ Mann, “Measuring Trade in Services,” 2019, 10 (table 1).

professional services) exports to the world, the share of mode 1 rose from 69.5 percent in 2019 to 89 percent in 2020.⁴⁶ Further discussion on COVID-19 impacts is included in the conclusion.

Modes of Supply by SMEs

In contrast with overall industry trends, qualitative information suggests that cross-border exports dominate the overseas provision of services by SMEs in both the legal and architecture services segments. A recent USITC report indicates that professional services SMEs typically provide services to foreign clients by sending workers abroad or by transmitting work products via email, phone, or other means, as SMEs often do not have the resources to set up offices abroad.⁴⁷ Representatives of both the legal and architecture services SMEs confirm this, indicating that they often provide services through remote communications and foreign travel.⁴⁸

Interestingly, architecture services providers stress the importance of traveling to their clients' markets while legal services representatives indicate that much of their overseas work is done via phone and email. This is reportedly due to the different natures of these professions: the development of architectural designs often requires an understanding of the client and frequent communication and site visits through potentially long projects. In the legal profession, overseas visits have become less frequent due to the practice of hourly billing and the high cost of travel itself.⁴⁹

Two representatives of legal services SMEs indicated that they almost exclusively provide work to foreign clients via mode 1 (email or phone communications).⁵⁰ One industry representative indicated that the prevalence of mode 1 service delivery with occasional mode 4 travel to meet with clients was generalizable to other boutique firms. However, the other representative indicated that it was not possible to generalize about mode of delivery as some attorneys at SME law firms travel a fair amount, though he did note that travel time is billable and relatively expensive. In his experience, mode 4 travel has been limited to relatively larger cases or to expert witnessing and mode 2 is operative as clients often travel to U.S. offices to seek advice.

Each of the architectural industry representatives interviewed for this paper indicated that providing services to foreign customers regularly involves overseas travel, though the frequency of travel may differ depending on the extent of the customer's financial commitment to the project, the state of progress on the project, and project stage.⁵¹ This is reportedly due to the personal nature of architecture, which requires close communication with clients.⁵² Further, one architectural industry

⁴⁶ Scott, "UK Trade in Services," February 25, 2022 (figure 3).

⁴⁷ USITC, *U.S. SME Exports*, September 2019, 176.

⁴⁸ Industry representatives, interviews by USITC staff, November 12, 14, 19, and 21, 2019.

⁴⁹ Industry representatives, interviews by USITC staff, November 12, 14, and 21, 2019. One industry representative noted that, while lawyers tend to conduct most overseas business through phone calls and email, they do travel overseas to serve as expert witnesses. Industry representative, telephone interview by Commission staff, November 21, 2019.

⁵⁰ Industry representatives, interviews by USITC staff, November 21, 2019.

⁵¹ Industry representatives, interviews by USITC staff, November 12, 14, and 21, 2019. One type of architectural services work that may not require frequent travel is participation in international design competitions, as work for such competitions is largely sent back-and-forth via Internet. Industry representative, interview by USITC staff, November 19, 2019.

⁵² Industry representative, interview by USITC staff, November 12, 2019.

representative indicated that it is beneficial to establish offices in overseas markets, as it facilitates the process of building relationships with potential clients; however, unlike larger firms, SMEs are often unable to absorb the costs of establishing and maintaining an overseas affiliate while waiting for the affiliate to become profitable.⁵³

SME-Specific Impacts of Trade Barriers and Trade Agreements

Barriers to Trade as Illustrated by the OECD STRI

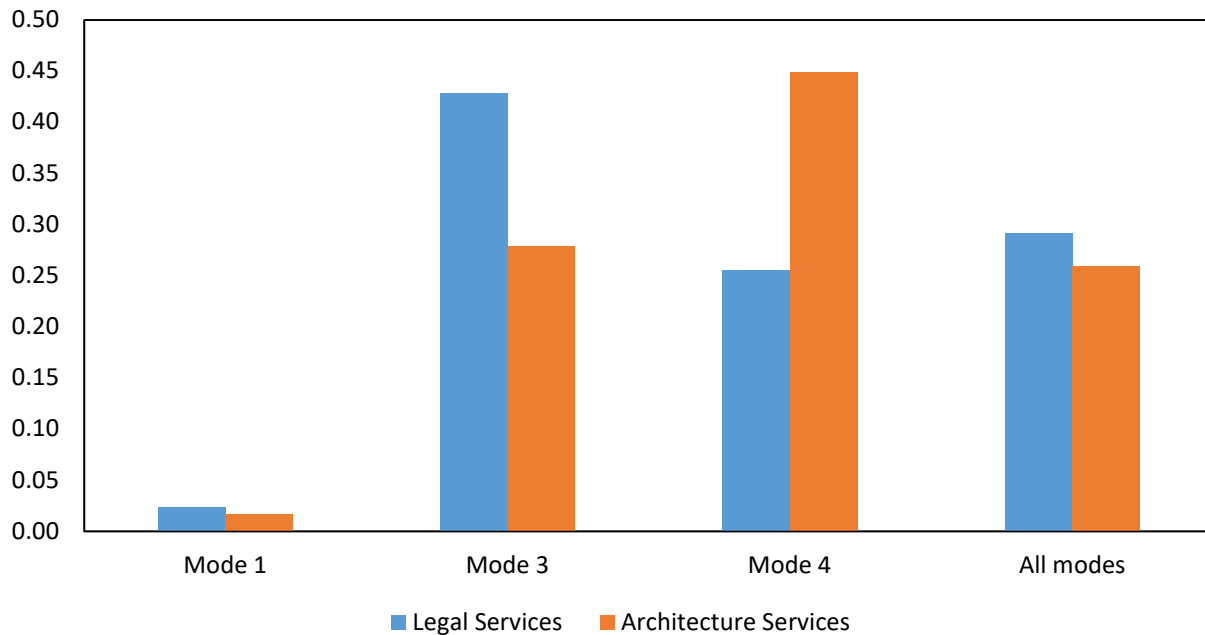
The OECD Services Trade Restrictiveness Index (STRI) quantifies information on laws and regulations affecting international services trade in OECD and select non-OECD countries and includes discrete information on several professional services industries. Based on cross-country average 2019 STRI values, legal services tends to be among the most restricted services sectors in the database, while architecture services falls in the mid-range in terms of restrictiveness.⁵⁴ STRI scores for 2019 are used here as they more closely correspond to data presented earlier in this paper. However, more recent STRI scores suggest that architectural services are less restricted than indicated in the 2019 data set.⁵⁵ Policies in the STRI can be grouped by mode of supply. According to 2019 STRI values and across countries in the OECD database, mode 3 policies contributed most to the overall legal services index while mode 4 policies accounted for the highest share in the architecture services index (figure 7). Mode 1 policies tend to be relatively open across both sectors.⁵⁶

⁵³ Industry representative, interview by USITC staff, November 12, 2019.

⁵⁴ This is on par with previous years for which the STRI is available. OECD, *OECD Services Trade Restrictiveness Index*, 7, 2020 (Figure 3).

⁵⁵ For more information on changes in both sectors, see OECD, *OECD Services Trade Restrictiveness Index: Policy Trends up to 2023*, February 2023.

⁵⁶ OECD, *OECD Services Trade Restrictiveness Index*, 9, 2020 (Figure 4). For STRI by policy categories, see OECD, *OECD Services Trade Restrictiveness Index*, 36-37, 2020 (see Figure B.18 for legal services by policy area and B.21 for architecture services by policy area).

Figure 7: Legal and Architecture Services: Share of STRI by GATS Modes of Supply (2019)

Source: OECD, OECD.Stat (accessed April 27, 2020).

Examples of prevalent restrictions affecting all modes of trade in legal and architectural services include lack of recognition of foreign attorney or architect qualifications, specific licensing requirements, and nationality and/or residency requirements (particularly for legal services). An example of a common mode 3 restriction in legal services is the limitation of firm ownership to locally qualified lawyers.⁵⁷ Mode 4 barriers typically include quotas and labor market tests which restrict or limit travel by foreign architects and attorneys to host countries.⁵⁸

Impact of Barriers on SME Services Trade

A small number of studies have examined the types of barriers that affect SMEs and estimated their relative impact. This research generally shows that services trade restrictions impose different and at times higher costs on SMEs relative to large firms exporting to and establishing in foreign markets.

Using firm-level data and a gravity approach, Rouzet, Benz, and Spinelli (2017) analyze the potentially differential impact of services trade restrictions as measured by the overall STRI index on SMEs vis-à-vis larger firms.⁵⁹ Although not all results were observed for professional services, they are discussed here to shed light on broader findings related to SMEs. Regardless of whether firms are defined as SMEs based on total firm turnover or number of employees, a reduction in the STRI across sectors appears to

⁵⁷ This restriction is prevalent in the practice of domestic law (as opposed to international law). OECD, "STRI Sector Brief: Legal Services," 2019.

⁵⁸ USITC, *The Economic Effects of Significant U.S. Import Restraints*, 2017, 83–92.

⁵⁹ Rouzet et al., "Trading Firms and Trading Costs in Services," 2017. Also see OECD, *Chapter 3: The Benefits of Open Services Markets*, 74–75, for a summary of the analysis presented below, which is also broken up between specialized and standardized services.

more strongly impact SME market entry—increasing the number of export destinations via cross-border trade—relative to large firms.⁶⁰ Measuring firms by turnover across a subset of services sectors, the authors also found that larger firms are more able to export greater volumes to countries with higher STRI values than SMEs. The authors estimate that given an STRI level of 0.2, SMEs with an approximate turnover of EUR 500,000 face additional trade costs of 8-28 percent as compared to large firms with a turnover of EUR 400 million.⁶¹ The authors also find that firm size has implications for affiliate sales in certain industries. Relative to foreign affiliates of SME parent firms, affiliates of large firms tend to sell greater volumes of services in markets with higher levels of restrictions. Given an STRI level of 0.2, SMEs with an approximate turnover of EUR 500,000 are calculated to face additional trade costs of about 14-50 percent.⁶²

The WTO's 2016 World Trade Report includes a discussion on services SMEs, which suggests that the impact of trade barriers on services SMEs depends on firms' propensity to provide services through certain modes of supply.⁶³ For example, due to the high cost of establishing a presence in a foreign market, very small firms do not typically provide services through overseas affiliates and mode 3 restrictions may have little or no effect. For larger SMEs, measures that increase the administrative burden of establishing an overseas presence—such as minimum capital and local incorporation requirements—may have a particularly large effect. The authors argue that mode 4 barriers and rules requiring a commercial presence to provide services through mode 1 may have a relatively large effect on SMEs. They also indicate that rules governing professional qualifications, licensing, technical standards, work permits, and visas may have a particularly large impact on SMEs.

Using firm-level data on French services providers, Lejarraga and Oberhofer (2015) find that larger and more productive firms are relatively more likely to export, suggesting that trade barriers have a disproportionate effect on smaller services firms.⁶⁴ They analyze export propensity among SMEs in four discrete services industries (financial services, ICT, professional services, and travel services). They find that, in all industries, current exporters are more likely to export in the future than firms that are entirely focused on the domestic market, suggesting that barriers affecting firms' initial entry into foreign markets have a particularly large impact. With regard to professional services in particular, the authors find that firm size, productivity, and membership in a corporate group have a positive effect on propensity to export by firms in this industry. They also find that professional services firms are particularly likely to export if they are located near certain national borders, suggesting that travel costs impact firms' willingness to export.

Adlung and Soprana (2013) identify the types of GATS disciplines that may have a relatively large effect on SMEs and inventory current GATS members' commitments to determine the prevalence of country-

⁶⁰ It appears the probit analysis covers the years 2008-2014 with a corresponding 2014 STRI and includes Belgium, Finland, Italy, Germany, the United Kingdom, and the United States across several services sectors. See figures 20 and 21 and figure C.1 for a list of sectors, which include professional services.

⁶¹ These estimates exclude professional services and are based on Belgium, Finland, Italy, Germany, Sweden, the United Kingdom, and the United States. See figure 22.

⁶² These estimates exclude professional services and are based on Finland, Germany, Japan, and the United States. See figure 30.

⁶³ WTO, "Trade Obstacles to SME Participation in Trade," 2016.

⁶⁴ Lejarraga and Oberhofer, "Performance of Small and Medium-Sized Enterprises," 2015.

specific measures that may affect SME operations.⁶⁵ While some of these measures are directly related to size and while some schedules exclude industries in which SMEs are key services providers, many of the country-specific GATS provisions that have a relatively large impact SMEs are not specifically directed at small firms. These include mode 1 restrictions; the absence of mode 4 commitments; and training, local presence, local partnership, and residency requirements, among others. The authors also mention several types of measures that do not necessarily fall under GATS disciplines but that may have a disproportionately positive (e.g., zoning rules) or negative (e.g., high license fees) impact on small firms.

Barriers to Trade Reported by Legal and Architecture Industry Representatives

SME representatives highlighted several measures that impact their ability to provide services in foreign markets. One legal services industry representative noted some countries apply taxes to fees charged to foreign clients even if the work itself is conducted in the United States.⁶⁶ Another representative noted that India’s legal services market is particularly restrictive as the establishment of foreign law firms is not permitted (although he also reported that his SME firm would not likely have an office in India even in the absence of this restriction).⁶⁷

Representatives of architectural services SMEs did not note any market access barriers to the foreign provision of these services; however, they did identify a few factors that may impact firms’ competitiveness and willingness to provide services in overseas markets. Two representatives indicated that firms have had difficulty getting paid in certain markets, which may have a particularly large impact on small firms.⁶⁸ One architectural SME representative suggested that U.S. firms might be at a disadvantage in the global market as some foreign architectural firms may receive support from their home-country governments.⁶⁹ Additionally, as with legal services, one representative of an architectural services SME indicates that tax issues—such as cumbersome tax regulations and the need to pay both U.S. and overseas taxes on profits—impact architects that provide services abroad.⁷⁰

Benefits of Trade Agreements Specific to SMEs

Bilateral, regional, and multilateral trade agreements include both SME-specific provisions and provisions of more general applicability that may have a relatively substantial impact on SMEs due to these firms’ resource constraints. SME-specific provisions—which have become increasingly common⁷¹—largely encourage SME-related cooperation or exclude members’ SME support programs

⁶⁵ Adlung and Soprana, “SMEs in Services Trade – A GATS Perspective,” 2013.

⁶⁶ Industry representative, interview by USITC staff, November 21, 2019.

⁶⁷ Industry representative, interview by USITC staff, November 21, 2019.

⁶⁸ Industry representatives, interviews by USITC staff, November 12 and 14, 2019.

⁶⁹ Industry representative, interview by USITC staff, November 19, 2019.

⁷⁰ Industry representative, interview by USITC staff, November 12, 2019.

⁷¹ As of July 10, 2020, 149 of the regional trade agreements that have been notified to the WTO contained SME-specific measures. The United States is party to 12 of these agreements. WTO, Regional Trade Agreements Database, accessed July 10, 2020.

from the scope of an agreement's coverage.⁷² These provisions likely do not have a direct effect on factors that impact SME trade. While some agreements include services schedules with SME-specific reservations, many of these measures apply to financial, mining, and fishing services.⁷³

Theories regarding the impact of generally applicable trade agreement provisions on SMEs (all SMEs or services SMEs) are mixed. In its 2016 World Trade Report, the WTO indicates that regional trade agreements (RTAs) may expand market access for services SMEs in sectors which have been liberalized under these agreements.⁷⁴ Morita-Jaeger and Borchert (2020) argue that trade agreements which lower the fixed costs associated with cross-border trade—such as the protection of intellectual property rights and the acquisition of market information, among others—have a particularly large impact on SMEs.⁷⁵ In contrast, Adlung and Soprana (2013) argue that SME issues cannot be addressed systematically within RTAs. They also find that there has been no systematic effort to attend to SME concerns in the GATS, and transparency obligations which might particularly benefit SMEs have not been enforced.⁷⁶ Further, one legal services industry representative indicated that FTAs or bilateral investment treaties (BITs) do not bring about significant opportunities.⁷⁷

Conclusion and Issues for Further Analysis

Analysis of available data and outreach to SME representatives reveal distinctions in the definition and cross-border activities of professional services SMEs across the sector and within individual industries and firms. Meaningful differences between large and small professional services firms in particular industries may be associated with revenues, number of employees, how services are provided (larger firms tending to have establishments abroad), and which types of services are provided (small firms tending to provide niche services). There are wide disparities in the SME share of exports within the professional services sector, exemplified by the relatively high contribution by U.S. legal and accounting SMEs relative to architectural and engineering SMEs in 2018. There also appears to be considerable differences in the predominant modes of supply across professional services industries. For example, architecture services SMEs are generally more reliant on mode 4 relative to legal services; however, there may be different practices across and within firms due to individual preferences and needs.

Given the heterogeneity across services on several dimensions, future qualitative and quantitative research should focus on the disaggregated industry level. Additionally, research should focus on least understood aspects of services trade. For example, services delivery via mode 4 is presumed to account for a relatively small share of services trade, yet barriers to the provision of services through this mode of supply have a large impact on SMEs. This impact is particularly substantial in sectors that rely on the development of personal relationships, such as architecture services. This disparity between the estimated share of mode 4 trade and the impact of mode 4 barriers on professional services SMEs may merit further analysis.

⁷² Monteiro, "Provisions on Small and Medium-Sized Enterprises," June 2016, 1.

⁷³ WTO, *World Trade Report 2016*, 2016, 122.

⁷⁴ WTO, *World Trade Report 2016*, 2016, 122.

⁷⁵ Morita-Jaeger, Minako, and Borchert, "The Representation of SME Interests in Free Trade Agreements," January 2020.

⁷⁶ Adlung and Soprana, "SMEs in Services Trade," 2013.

⁷⁷ Industry representative, telephone interview by Commission staff, November 21, 2019.

Relatedly, research could focus on the long-term impacts of the COVID-19 pandemic on trade by professional services SMEs. Much work to date has focused on the short-term impacts of lockdowns and other COVID-related measures. Across OECD countries, professional services were among the sectors with the most adverse initial effects of COVID-19 restrictions and SMEs accounted for significant employment shares of these sectors.⁷⁸ Similarly, in a paper based on a survey of Serbian firms in the summer of 2020, Paunović and Aničić (2021) examined the pandemic’s effects on SME business operations.⁷⁹ The authors found that firms in the professional, scientific, and technical services segment registered a relatively more negative impact than the overall services sector and the economy as a whole.⁸⁰ In research specific to international trade, Benz et al. (2020) estimated impacts of COVID-related international passenger travel and other restrictions on trade costs.⁸¹ Expressed as a share of export values, the costs were estimated to be higher for architectural services (13 percent) than for legal services (9 percent), likely related to the relative importance of movement of people in the provision of architecture services.⁸²

Future analyses could also focus on the pandemic’s lasting impact on firms’ propensity to trade services digitally and the effect of these potential new trade patterns on SME competitiveness. As shown by surveys conducted by the OECD across countries throughout 2020, the pandemic accelerated the adoption of digital technologies by SMEs (which survey respondents viewed as permanent shifts).⁸³ Relatedly, analysts have considered the potential longer-term effects of the pandemic, showing patterns of significant remote work within professional services industries.⁸⁴ Greater digitization could have beneficial outcomes for SMEs involved in trade, as the ability to provide services remotely were shown to lower COVID-related trade costs calculated by Benz et al. (2020) in more digitally intense sectors, and notably, to the greatest degree in professional services.⁸⁵

More recent analysis on the U.S. economy by the Small Business Administration shows resilience of the domestic professional services sector and in particular, among the smallest firms. Between March 2020 and March 2021, the “professional and business services” sector experienced among the highest sectoral percent gains in establishments with the highest contribution from smallest firms.⁸⁶ Similarly,

⁷⁸ OECD, *OECD SME and Entrepreneurship Outlook 2021*, 2021, figure 1.4 and figure 1.5.

⁷⁹ Paunović and Aničić, “Impact of the Covid-19 Crisis on SMEs,” 2021.

⁸⁰ More specifically, business segments were assigned scores between 1 and 5, with lower scores suggesting a more negative effect. The overall score for all SMEs in the professional, scientific, and technical services segment was 2.00, as compared to 2.07 for all service sector SMEs and 2.09 for all SMEs across industries. The authors found that factors such as firm size and the extent of digitalization, among others, led to differences in the pandemic’s effects on certain SMEs.

⁸¹ Benz et al., “The Impact of COVID-19 International Travel Restrictions,” 2020.

⁸² More broadly, the authors found that these costs vary across services sectors and countries (with the overall sectoral costs varying between 5 and 30 percent) according to the importance of business-related travel in each sector and by the degree of pre-existing restrictions on the mobility of labor in each country.

⁸³ OECD, *OECD SME and Entrepreneurship Outlook 2021*, 2021, figure 4.5.

⁸⁴ For example, a 2021 report by the McKinsey Global Institute provides estimates of the remote work potential and projected post-COVID labor demand in certain industry occupations. According to these estimates, between 62 and 75 percent of work in the U.S. professional, scientific, and technical services industries could be done remotely, and net U.S. employment of business and legal professionals is expected to remain virtually unchanged. Lund et.al. “The Future of Work after COVID,” February 2021, 40, 75.

⁸⁵ Benz et al., “The Impact of COVID-19 international travel restrictions,” 2020.

⁸⁶ Richards, “Business Dynamics During the COVID-19 Pandemic,” January 2023, table 9.

over the same period, “professional and business services” experienced among the lowest net percent change in employment, with the smallest firms experiencing gains.⁸⁷ Future research could also focus on disentangling the degree to which these effects are due to digital intensity in certain professional services and/or the unique contributions of SMEs, as well as consider whether SMEs engaged in cross-border trade demonstrate similar resilience.

⁸⁷ Richards, “Business Dynamics During the COVID-19 Pandemic,” January 2023, table 10.

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