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The Economics of the World Market for Business Services: Implications for Negotiations on Trade in Services

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The Economics of the World Market for Business Services: Implications for Negotiations on Trade in Services†

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INTRODUCTION

This paper examines key economic, historical and institutional forces that have shaped the development of a world market for business services since the end of World War II, and continue to do so today. The objective of the paper is to identify a few critical conceptual issues underlying the discussion of trade in business services and to show how these issues inform the entire debate on trade in services. This is done through an analysis of trends in the development of the world market for four business services: legal services, accounting, management consulting and advertising.

These four industries were selected for analysis because of the considerable overlap in the services provided by organizations in each of these four fields, and because of our interest in investigating the extent to which non-licensed business services, such as advertising and management consulting, and licensed business services, such as law and accounting, face similar constraints in the development of new markets.

The information presented in this article was obtained through extensive interviews with senior managers in business service firms and senior public officials in regulatory and trade agencies, as well as from published materials referred to in the footnotes. In all, over thirty executives and senior public officials were interviewed in the United States and three countries from the European Communities between 1984 and 1986. Arguments developed in this paper are based on those interviews unless otherwise

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indicated. To preserve confidentiality, those interviewed are not identified.

Following this introduction, the paper is divided into five sections. Section I presents overall measures of the importance of licensed and non-licensed business services in the U.S. and world markets. Section II reviews the development of a world market for business services following the Second World War, explaining where major growth occurred geographically, why it did where it did, and what kinds of market changes are now underway that may alter the course of development.

Section III describes some of the principal constraints on international trade in business services. In Section IV we discuss the three basic conceptual issues that are shaping the debate on trade in services: the distinction between "pure trade" in services and "investment" in services (i.e., the distinction between transborder sales of services and sales by foreign affiliates); the importance of labor migration, visa and professional licensing issues in relation to trade in services (i.e., the need for transborder movement of personnel); and the problem of competition in both domestic and international markets for services.

We conclude, in Section V, with the key implications of our analysis. In contrast to what seems to have become the conventional wisdom, we do not believe that processes of modernization and rationalization underway as a result of the introduction of advanced computerized systems will change the geography of service production to the extent that services will "behave" increasingly like goods.[1] We therefore believe that negotiations on the liberalization of trade in services must address issues not traditionally dealt with in discussions of trade in goods.

It is true that the new technology is making it increasingly possible to "can" the process of service production in the form of software, or to "store" service outputs in the form of electronic digits, so that the production of services can be separated from the point of final consumption. Nevertheless, there are equally powerful developments both in the technology of service production itself and in the evolution of markets that require increasingly close interaction between producers and consumers. In addition, even if

[1] For contrary views, see Jonathan D. Aronson and Peter F. Cowhey, Trade In Services: A Case for Open Markets (1985); Geza Feketekuty and Jonathan D. Aronson, The World Information Economy, a paper presented at the Conference on Policy Issues in the Canadian-American Information Sector, McGill University (Nov. 1983) (copy on file with the authors).

transborder trade in services grows dramatically in the years ahead, a significant part of that trade will continue to involve the movement of people as carriers of expertise ("human capital") as much as the movement of material objects such as printed documents, electronic messages and so forth. We think that these tendencies are very much in evidence not only in business services but in other service industries as well.

These observations have significant implications for the way negotiations on trade in services should be structured. We believe that negotiating an open trade system for a world service economy will demand addressing not only "pure trade" issues but also local investment issues and visa, labor migration and professional licensing issues. We draw no conclusions as to whether these three sets of issues should be addressed in one or several forums, but we do think that a one-sided focus on "pure trade" issues would be misguided.

I. Measuring the Market for Business Services

A. The Size of the U.S. and World Markets for Business Services

In 1982, the last year for which detailed data are available, U.S. output in licensed and non-licensed business services amounted to nearly $200 billion, or 6.5 percent of the U.S. gross national product (GNP) (Table 1). That same year, these industries employed approximately 4.7 million persons, slightly over 5 percent of the nation's total non-agricultural employment.[2]

Broadly defined, and in keeping with the *U.S. Standard Industrial Classification Manual*, the business service sector includes: the business service group (SIC 73) with large components such as advertising (SIC 731), computer and data processing services (SIC 737), and management consulting and public relations services (SIC 739); the legal services group (SIC 81); and the mis-

[2] U.S. Bureau of the Census, 1982 Census of Services, Geographic Area Series: United States 3-6 (1984).

Table 1

Business Services in the United States, 1972 and 1982
Gross Receipts of Establishment with Payroll
(billions of dollars)

SIC Codes/Sectors and Subsectors	Receipts 1972	Receipts 1982	Compound Annual Rates of Growth 1972-82
73 Business Services	$35.5	$111.4	12.1
731 Advertising	2.3	8.4	
7311 Advertising Agencies	1.8	5.9	12.6
737 Computer and Data Processing	3.4	22.7	20.9
739 Other Business Services			
7392 Management, Consulting and Public Relations	3.6	18.0	17.2
pt 1 Management and Administrative Services		4.2	
pt 2 Management Consulting	3.3	6.0	
pt 3 Economic Research		2.6	
pt 4 Consulting Services		2.1	
pt 5 Public Relations	0.3	1.1	
81 Legal Services	9.7	34.7	13.6
811 pt 1 Legal Services	9.7	34.3	
811 pt 2 Legal Aid Societies, etc.	n.a.	0.4	
89 Miscellaneous Services	n.a.	50.4	
891 Engineering, Architectural and Surveying	7.6	33.5	16.0
893 Accounting, Auditing and Bookkeeping	n.a.	14.6	n.a.
Total SIC 73, 81, 89	n.a.	196.5	n.a.
Gross National Product	1,185.9	3,069.3	10.0

Source: U.S. Bureau of the Census, Census of Services, 1972 and 1982.

cellaneous service group (SIC 89), with such major components as engineering, architectural and surveying services (SIC 891) and accounting, auditing and bookkeeping services (SIC 893).[3] As shown in the last column of Table 1, these services experienced phenomenal growth during the 1970s and early 1980s, with compound annual rates of growth in some sectors at least twice as high as the corresponding rates for the GNP.

The growth of these sectors has wrought havoc with our national income and product account system, designed originally to

[3] U.S. Office of Management and Budget, U.S. Standard Industrial Classification Manual 301-02, 304-08, 324, 333-34 (1972).

record changes in manufacturing or in such traditional service sectors as retailing or finance, not in the newer services. Thus, measurement of changes in the service sectors is hampered significantly by the fact that data are either incomplete or have been gathered only in the very recent past. For example, prior to the *1977 Census of Services*, the U.S. Bureau of the Census did not survey the accounting, auditing and bookkeeping industry. In addition, prior to 1967, the computer and data processing service group, which today includes not only data processing bureaus but also on-line data base services and software houses, was combined with the management consulting service group. Moreover, prior to the *1982 Census of Services*, the management consulting and public relations group was disaggregated into only two subgroups: management consulting services and public relations services. Management consulting services then included a hodgepodge of services ranging from administrative services rendered to motels through franchising contracts, to economic research and management consulting. This group has now been disaggregated into four major subgroups, including management consulting per se (see Table 1).

Accurate measures of the magnitude of the world market for business services do not exist. Limited available data on the market share of the largest firms, both in the U.S. and worldwide, suggest, however, that the world markets for advertising services, management consulting services, and accounting services was approximately twice the size of the U.S. market in the early 1980s. Worldwide revenues in these three sectors then would have been, respectively $12 billion, $12 billion and $30 billion in 1982 (see Table 2).[4] For legal services, we have found no way to develop a reliable estimate.

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[4] These are very rough estimates. They are based on published data for the U.S. market, published data for foreign sales by large U.S. business service firms, and estimates of the share of U.S. firms in foreign markets. Sources include: 1982 Census of Services: United States at 3-6 (cited in note 2); The World's Top 20 Accounting Groups, Int'l Acct. Bull. 6 (Jan. 1985); Thierry J. Noyelle, The Coming of Age of Management Consulting, A Report to the New York City Office of Economic Development 8-10, 31, 36, 44, 50 (1984); U.S. Advertising Agency Profiles, Advertising Age 1, 14 (Mar. 28, 1985).

Table 2

World and U.S. Gross Receipts in Four Business Services, 1982
(in billions of dollars)

	World Market (estimates)	U.S. Market
Advertising Agencies	$12.0	$5.9
Management Consulting	12.0	6.0
Legal Services	n.a.	34.3
Accounting	30.0	14.6

Source: Authors' estimates.

B. U.S. Business Service Firms in the World Economy

Measurements of the importance of business services in the U.S. balance of trade are also difficult to obtain. Some data are provided by the 1984 *U.S. National Study on Trade in Services* ("*U.S. Study*"), the U.S. government's response to the 1982 request by the General Agreement on Tariffs and Trade (GATT) for studies on trade in services by individual countries.[5] The *U.S. Study* estimates that in 1980, global services exports amounted to nearly $350 billion, about 20 percent of world trade. The U.S. was the leading exporter of services with $37.5 billion of exports, and was followed closely by the U.K. ($37.1 billion), West Germany ($33.8 billion), and France ($33.0 billion). Italy ($23.5 billion) and Japan ($19.8 billion) ranked fifth and sixth respectively.[6]

The share of U.S. services exported by U.S. business service firms is also difficult to assess. Using conventional reporting from the U.S. balance of payments, total service export and investment income in 1980 amounted to $92.0 billion, including $23.6 billion in transportation and transportation-related services, $4.7 billion in "other private services," $7.0 billion in fees and royalties and $56.7 billion of income on foreign investment (see Table 3).

[5] U.S. National Study on Trade in Services, A Submission by the United States Government to the General Agreement on Tariffs and Trade (1984) ("U.S. Study").

[6] Id. at 62.

Table 3

Service Exports and Investment Income
in U.S. Balance of Payments, 1980
(billions of dollars)

All Services	$35.3
Travel	10.0
Passenger fares	2.6
Other transportation	11.0
Fees and Royalties	7.0
Other private services	4.7
Income on investment	56.7
All Services and Investment Income	92.0

Source: U.S. Bureau of Economic Analysis, Survey of Current Business, June 1981.

Given the nature of the reporting system, the likelihood of considerable underestimation, and the extent to which "fees and royalties" and "income on foreign investment" represent disguised service exports, there is considerable uncertainty regarding the accuracy of these figures.

In a special study prepared for the U.S. Department of Commerce in 1981, Economic Consulting Service, Inc. (ECS) estimated the foreign revenues for the U.S. service sector for 1980 using a measuring base that included both direct exports and sales through foreign affiliates. ECS concluded that total foreign revenues of the U.S. service sector for that year amounted to $60 billion.[7] ECS's breakdown, shown in Table 4, suggests that the 1980 foreign revenues of all business services (accounting, advertising, business/professional/technical services, construction/engineering, employment, franchising and information) amounted to $13.2 billion, or nearly one-fourth of all service revenues. Perhaps nearly half this amount consisted of sales from the advertising, accounting, legal and management consulting industries, which this paper examines in more detail below.

[7] Economic Consulting Service, Inc., The International Operation of U.S. Service Industries: Current Data Collection and Analysis 294 (June 1981); Subcommittee on Economic Stabilization of the House Committee on Banking, Finance and Urban Affairs, Service Industries: The Changing Shape of the American Economy, Comm. Print No. 98-16, 98th Cong., 2d Sess. 331 (1984).

Table 4

Economic Consulting Service, Inc.'s Estimates of Foreign Revenues of the U.S. Service Sector, 1980 (billions of dollars)

Accounting	$2.35
Advertising	2.05
Banking	9.10
Business/professional/technical services	1.07
Construction/engineering	5.36
Education	1.27
Employment	0.55
Franchising	1.26
Health	0.27
Information	0.60
Insurance	6.00
Leasing	2.35
Lodging	4.60
Motion pictures	1.14
Tourism	4.15
Transportation	13.93
Others	3.95
Total for all U.S. services	60.00

Source: Economic Consulting Service, Inc., The International Operations of U.S. Service Industries: Current Data Collection and Analysis 294 (1981).

No detailed data are available that indicate the share of the world market captured by U.S. business service firms, either through direct exports or through their foreign affiliates. The recently released U.S. Department of Commerce benchmark study of foreign direct investment in service industries improves the pool of available data in this area.[8]

II. The Development of a World Market for Business Services

While most business services have existed for decades (if not centuries, as in the case of legal services), their importance increased dramatically after World War II. During that period busi-

[8] U.S. Department of Commerce, Bureau of Economic Analysis, U.S. Direct Investment Abroad: 1982 Benchmark Survey Data (1985). Highlights of the survey are summarized in Obie G. Whichard and Michael A. Shea, 1982 Benchmark Survey of U.S. Direct Investment Abroad, Survey of Current Business 37 (Dec. 1985).

ness services evolved from peripheral to critical in the workings of business and in the economy at large. The growth of business services paralleled the advent of a service economy, a transformation that gained strength throughout the 1950s and 1960s and accelerated considerably in the 1970s.

A. The Development of the U.S. Market for Business Services

It is useful to review some of the key factors that prompted the shift to a service economy in the United States, a shift that occurred earlier than in other nations. As Thomas Stanback and his colleagues have indicated in *Services/The New Economy*,[9] the advent of the service economy in the postwar era underscored the dual transformation in "what," and more importantly in "how," the economy produces. In terms of "what" the economy produces, that is, in terms of final outputs, the decades following the Second World War were marked by a growing demand for public sector, educational and medical services. In part, this change was caused simply by the growing wealth of the country and increased discretionary spending for things that had not been considered necessities of life previously.

In terms of "how" the economy produces, the advent of the service economy was marked by a fundamental transformation in the way final outputs, of both goods and services, are produced. Namely, this shift was marked by formidable growth in the demand for "intermediate service inputs"—such as transportation, communication, wholesaling, finance and business services, among others—which are purchased by firms at intermediate stages of production.

Recent calculations, based on the analysis developed by Stanback and his colleagues, suggest that the share of GNP originating in these service areas rose dramatically, from less than 29 percent in 1947 to nearly 40 percent in 1982.[10] Licensed and non-licensed business services have now become integral parts of new ways of doing business.[11] For example, the increased use of auditing services has resulted in improved accounting control systems and, in turn, in better controls over costs and productivity. Similarly, improved opinion surveys may have resulted in more accurate knowledge of consumer demand and, ultimately, expanded profit oppor-

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[9] Thomas M. Stanback, Peter J. Bearse, Thierry J. Noyelle and Robert A. Karasek, Services/The New Economy (1981).

[10] See generally id. at ch. I.

[11] See generally id. at ch. III.

tunities for firms.

Growth of business service firms has resulted also from the increasing externalization of service functions by firms. Services formerly handled by a firm's in-house personnel are now contracted out. For example, many firms that once kept track of changes in the tax laws themselves are now more likely to turn to large law or accounting firms to purchase tax expertise, in part because economies of specialization are such that this outside service is likely to be better and cheaper than that formerly produced in-house.

B. The Internationalization of U.S. Industrial Firms and the Development of a World Market for Business Services

Since demand for business services originated primarily in the largest industrial corporations, the internationalization of U.S. business service firms in its earliest stages followed closely the foreign expansion of large industrial clients. As they moved abroad, first into Western Europe and later into other regions of the world, U.S. business service firms often found that local firms had far less expertise to offer than they did. As a result, U.S. firms played a major role in opening many local markets abroad. American advertisers consider that they "invented" the advertising industry and created the principal markets, both in the U.S. and abroad. In accounting, the industry was largely a creation of American and British firms. In international business law, a somewhat loose term referring to the drafting or litigation of contractual matters that may involve at once parties and legal systems from more than one country, U.S. law firms also took the lead in developing many new areas.

The extent of the internationalization of U.S. business service firms over the past twenty-five years is shown in Tables 5 and 6 for accounting, Table 7 for management consulting and Table 8 for legal services. Table 5 shows the pattern of foreign expansion of Chicago-based Arthur Andersen & Company, the world's largest accounting firm.

The number of the firm's foreign offices grew from nineteen to 105 between 1960 and 1983. In a pattern representative of the industry, the firm's expansion focused at first on Western Europe and Latin America, later on Asia and the Pacific region, Africa and the Middle East. Table 6 shows the worldwide distribution of the offices of the world's thirteen largest accounting firms in 1982. In that year, four firms already had about 400 locations each worldwide.

The internationalization of a sample of thirty-nine U.S. management consulting firms that are members of the Association of Management Consultants (ACME) is shown in Table 7.[12]

The table reveals a steady process of internationalization among sampled firms during the 1960s and 1970s with the number of firms with international offices growing from four with four foreign offices in 1961, to nineteen with 139 foreign offices in 1980.

Finally, Table 8 shows the foreign expansion of the 100 largest U.S. law firms, with the number of firms with foreign offices growing from twenty-two firms with thirty-one foreign offices in 1965, to forty-six firms with ninety-five foreign offices in 1984.

Table 5

The Internationalization of Accounting:
Arthur Andersen's Offices Outside the U.S.

	Number of Offices		
	1960	1974	1983
Canada	1	5	7
Western Europe	6	21	50
Latin America and Carribean	12	13	19
Asia and Pacific Area	0	8	17*
Africa and the Middle East	0	1	12**
TOTAL	19	48	105

*Includes collaboration agreement with six local firms in six countries.

**Includes collaboration agreement with one firm in one country.

Source: Arthur Andersen, The First Sixty Years: 1913-1973 at 53-54 (1974). Arthur Andersen, Office Directory, various years.

[12] The Association is a closely knit association which includes a limited number of the largest and/or most prestigious independent management consulting firms. It had fifty-seven members in 1984. The Association of Management Consulting Firms, Directory of Membership (1984).

Table 6

The Internationalization of Accounting: Worldwide
Offices of the Thirteen Largest Accounting Firms, 1982
(ranked by worldwide sales)

Rank	North America	Europe	Latin America & Carribean	Asia & Pacific Area	Africa & Middle East	Total Worldwide
1. Arthur Andersen	83	42	20	11	10	166
2. Peat Marwick Int'l	122	76	42	69	42	351
3. Coopers & Lybrand Int'l	108	137	36	97	52	430
4. Price Waterhouse	107	74	59	68	43	351
5. Klynveld Main Goerder/KMG	129	153	25	52	35	394
6. Ernst & Whinney Int'l	131	66	41	58	36	332
7. Arthur Young Int'l	92	89	18	34	18	251
8. Deloitte Haskins & Sells	139	148	30	82	46	445
9. Touche Ross Int'l	107	130	37	80	45	399
10. Binder Dijker Otte/ BDO	101	105	5	13	14	238
11. Grant Thornton Int'l	107	112	39	27	20	305
12. Horwath & Horwath Int'l	44	54	16	25	12	151
13. Fox Moore Int'l	62	37	2	15	9	125

Source: Vinod B. Bavishi and Harold E. Wyman, Who Audits the World? Trends in the Worldwide Accounting Profession 36, 37, 39 (1983).

Table 7

The Internationalization of U.S. Management Consulting:
Foreign Branch Offices of ACME Member Firms Headquartered
in New York, Chicago and Philadelphia

	Number of Firms in Sample	Number of Firms with Foreign Branch Office and Number of Foreign Branch Offices (f.o.) 1961		1970		1980	
		# firms	# f.o.	# firms	# f.o.	# firms	# f.o.
New York firms	25	3	3	15	62	12	73
Chicago firms	9	1	1	5	23	5	32
Philadelphia firms	5	0	0	1	10	2	34

Source: The Association of Management Consulting Firms, Directory of Membership, various years; Thierry J. Noyelle, The Coming of Age of Management Consulting 33 (1984).

Table 8

The Internationalization of U.S. Law Firms:
Foreign Offices of the 100 Largest U.S. Law Firms

	1965	1978	1984
Number of firms with foreign offices	22	33	46
Location of offices:			
Paris	18	17	17
London	2	21	28
Brussels	3	6	5
Other European cities	3	9	9
Riyadh	0	0	4
Other Middle Eastern cities	0	1	4
Hong Kong	0	6	11
Singapore	0	1	6
Tokyo	1	3	4
Other Asian cities	0	4	8
Other cities	4	8	9

Source: National Law Firms Survey, National Law Journal, various years.

Not surprisingly, the patterns of foreign expansion described in these tables were influenced in part by the nature of the relationships between service firms and their clients, and in part by the nature of the restrictions imposed by various governments. The influence of the firm-client relationship on the structuring of the world market is discussed in the following paragraphs, with some reference to regulatory barriers. Section III below will review the influence of national restrictions in more detail.

1. *Accounting.* In accounting, the traditional relationship between accounting firms and their clients is based on the need for audits of the accounts of parent companies and their subsidiaries, typically for regulatory reporting purposes or in advance of debt or equity financing. As they followed industrial clients abroad, accounting firms had to respond to demands from local governments that branch offices be set up in partnership with locally licensed accountants. In most cases, American accounting firms expanded by joining forces with existing local accounting partnerships, under a more or less binding federated structure called an "affiliation." The affiliation structure provides a legal framework which facilitates the sharing of certain training and development costs, the exchange of personnel, and the introduction of uniform accounting

methods worldwide.[13]

The pressure to keep major clients is well known to members of the industry. Mergers among growing affiliations have often been driven by the need to expand smaller networks into larger ones in order to satisfy the needs of key clients. For example, the 1957 merger of Coopers (U.K.), Lybrand (U.S.) and McDonald (Canada), resulting in the creation of Coopers & Lybrand, was dictated in part by Lybrand's need to follow Ford to Europe and Coopers' need to follow Unilever's expansion in North America.

The pressure to develop large international networks has been a powerful factor behind the formation of very large firms. In 1983, the world's fifteen largest firms probably controlled over one-third of the world's accounting business.[14] The nine largest, or "Big Nine," firms all had gross worldwide revenues approaching or exceeding $1 billion. Among the top fifteen firms, only Klynveld Main Goerdder, the fifth largest, and Binder Dijker Otte, the tenth largest, were not Anglo-Saxon creations, but products of the affiliation of continental European partnerships (see Table 9).

[13] In the most centralized affiliation system, that of Arthur Andersen, partners are members both of a Swiss-based partnership and of their local partnership. In addition, the firm has expanded abroad primarily by creating its own local partnerships rather than by absorbing others. See Arthur Andersen & Co., The First Sixty Years: 1913-1973 at 53-54 (1974); Frank A. Rossi, Government Impediments and Professional Constraints on the Operations of International Accounting Organizations, 1986 U. Chi. Legal F. 135, 143.

[14] See The World's Top 20 Accounting Groups, Int'l Acct. Bull. 13 (Dec. 1983).

Table 9

Worldwide Fees of the 15 Largest Accounting Firms, 1983
(millions of dollars)

Rank	International Affiliation	Worldwide fees	U.S. fees	Non-U.S. fees
1	Arthur Andersen	$1,238	$909	$329
2	Peat Marwick Int'l	1,230	750	480
3	Coopers & Lybrand	1,100	625	475
4	Price Waterhouse	1,103	493	610
5	Klynveld Main Goerdder	1,000	179	821
6	Ernst & Whinney, Int'l	972	625	347
7	Arthur Young Int'l	955	440	515
8	Deloitte Haskins & Sells	900	415	485
9	Touche Ross Int'l	900*	420	480*
10	Binder Dijker Otte	400	84	316
11	Grant Thornton Int'l	340	137	203
12	Horwath & Horwath Int'l	247	125	122
13	Dunwoody, Robson, McGladrey & Pullen	220	122	98
14	Fox Moore Int'l	218	91	127
15	Spincer & Oppenheim	170	28	142

*estimated

Source: International Accounting Bulletin 13, December 1983.

2. *Advertising.* In advertising, as in accounting, the need for a close relationship between agencies and industrial clients influenced worldwide expansion considerably. In a business in which 200 to 300 companies generate perhaps two-thirds or more of worldwide advertising revenues, the need to meet clients' wishes is paramount.[15]

By the late 1970s, the internationalization of advertising was quite advanced. Using data published by *Advertising Age,* the United Nations Center on Transnational Corporations estimated that in 1977 the market outside the United States was shared fairly equally by "transnational" agencies and "local" agencies, with roughly 90 percent of the advertising expenditures occurring in Western Europe and in Japan (see Table 10).[16]

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[15] 100 Leading National Advertisers, Advertising Age 10-11 (Mar. 28, 1985).

[16] United Nations Center on Transnational Corporations, Transnational Corporations in Advertising (Technical Paper) (Document ST/CTC/8) 8-10 (1979).

Table 10

Gross Income of Transnational and Other Major Advertising Agencies by Geographical Region, 1977

	Transnat'l Agencies		Other Agencies		Total	
	$ millions	%	$ millions	%	$ million	%
Developed countries	$780.0	86.7	$811.4	91.0	$1,591.3	88.8
Southern Europe	16.7	1.8	11.4	1.3	28.1	1.6
Africa and the Middle East	6.6	0.7	5.3	1.3	11.9	0.7
Latin America and the Carribean	75.4	8.2	51.8	5.8	127.2	7.0
Asia	22.4	2.5	10.8	1.2	33.2	1.8
Grand Total	901.1	100.0	890.7	100.0	1,791.8	100.0

Note: Figures based on gross income of 722 advertising agencies operating in 68 countries.

Developed countries: Australia, Austria, Belgium, Canada, Denmark, Federal Republic of Germany, Finland, France, Italy, Japan, the Netherlands, New Zealand, Norway, Puerto Rico, South Africa, Sweden, Switzerland, and the United Kingdom.

Southern Europe: Greece, Malta, Portugal, Spain, Turkey, Yugoslavia.

Africa and Middle East: Egypt, Ghana, Kenya, Morocco, Nigeria, Sierra Leone, Iran, Kuwait, Lebanon, Israel.

Latin America and Caribbean: Argentina, Brazil, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraquay, Peru, Uruguay, Venezuela, Barbados, Bermuda, Curacao, Dominican Republic, Jamaica, Trinidad.

Asia: Hong Kong, India, Indonesia, Malaysia, Pakistan, Singapore, Republic of Korea, Sri Lanka, Thailand, Philippines.

Source: United Nations Center on Transnational Corporations, Transnational Corporations in Advertising (Technical paper) (Document ST/CTC/8) 8 (1979).

The group of "transnational" agencies included between thirty and fifty highly competitive, large multinational agencies, and was dominated by U.S. firms. Only four of the world's thirty largest firms in 1977 were not of American origin: three Japanese agencies and one French firm (see Table 11).

Table 11

World's Largest Advertising Agencies in 1977
(millions of dollars)

Rank	Agency	Country of origin	Gross income
1	Dentsu Inc.	Japan	$212.6
2	J. Walter Thompson	United States	189.0
3	Young & Rubicam	United States	164.7
4	McCann-Erickson	United States	162.6
5	Ogilvy & Mather International	United States	127.9
6	BBDO International	United States	118.6
7	Leo Burnett	United States	116.0
8	SSC & B Inc.	United States	100.5
9	Ted Bates & Co.	United States	98.8
10	Grey Advertising	United States	97.2
11	Foot, Cone & Belding	United States	89.1
12	D'Arcy-MacManus & Masius	United States	81.4
13	Doyle Dane Bernbach	United States	74.8
14	Dancer-Fitzgerald-Sample	United States	72.0
15	Benton & Bowles	United States	70.7
16	Hakuhodo Inc.	Japan	70.1
17	Campbell-Ewald	United States	61.2
18	N. W. Ayer ABH International	United States	57.4
19	Kenyon & Eckhardt	United States	45.6
20	Needham, Harper & Steers	United States	41.2
21	Norman, Craig & Kummel	United States	40.8
22	Wells, Rich, Greene	United States	39.1
23	Compton Advertising	United States	38.7
24	Marsteller Inc.	United States	36.0
25	Eurocom	France	35.2
26	William Esty Co.	United States	33.0
27	Daiko Advertising	Japan	32.4
28	Ketchum, MacLeod & Grove	United States	29.9
29	Bozell & Jacobs International	United States	27.3
30	Ross Roy	United States	21.9

Source: United Nations Center on Transnational Corporations, Transnational Corporations in Advertising (Technical Paper) (Document ST/CTC/8) 5-6 (1979).

3. *Legal Services.* In contrast to accounting or advertising, a different pattern of internationalization occurred in the legal services sector. Rather than being driven mostly by a relationship with major multinational industrial clients, law firms in the post-

war period have tended to locate near major banks and financial institutions (see Table 8). This is both because financial institutions are a principal source of referrals to large law firms and because the legal work involved in the preparation of financial documents is a major source of revenue for the business law firm.[17] In addition, regulatory constraints played a much greater role in the internationalization of large law firms than of other licensed business services. Consequently, the internationalization of corporate legal services has demanded mostly that firms work their way through the regulatory constraints of just a few large international financial centers.[18]

Because of their role as major financial centers, London and Paris became Western Europe's major legal centers during the 1960s and 1970s, as did Hong Kong and Singapore later in Asia. In recent years, negotiations have been underway to open up Tokyo to foreign law firms.[19]

In Western Europe, Brussels also profited from the growth of legal activity during the 1960s and 1970s, by capitalizing on the presence of the European Commission. In contrast, West Germany did not capture a share of legal activity commensurate with the importance of its economy and the size of its banks. A highly restrictive regulatory environment locked out foreign firms, closed out options for the emergence of large local firms, and confined the bulk of business legal work to a few large, in-house legal departments of large German banks.[20] Paris benefited from Germany's stance, with Paris-based firms capturing some of the German legal business. Paris also profited from its traditional links to the Middle East, North Africa and French-speaking Africa, as a number of Paris firms developed expertise relevant to those countries, for which demand grew in the late 1970s. In addition, Paris benefited from the growth in international arbitration activity under the aegis of the International Chamber of Commerce, headquartered in the city. London, of course, capitalized primarily on its role as the

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[17] See Christopher R. Brown, France's Growing International Law Firms, Int'l Fin. L. Rev. 4, 8 (Jan. 1984).

[18] For a more extensive discussion of these issues, see Sydney M. Cone, III, Government Trade Policy and the Professional Regulation of Foreign Lawyers, 1986 U. Chi. Legal F. 169; Issac Shapiro and Michael K. Young, The Role of Law and Lawyers in Japan and the United States, 1985 Mich. Y.B. Int'l Legal Stud. 25.

[19] See Shapiro and Young, 1985 Mich. Y.B. Int'l Legal Stud. at 35-36 (cited in note 18).

[20] Christopher R. Brown, Europe's Top Lawyers and Law Firms, Int'l Fin. L. Rev. 4, 6 (Oct. 1983).

center of the Eurodollar market.[21]

In the Far East, links to financial markets have again been a major reason for the expansion of multinational law firms in Singapore and Hong Kong. In addition, in the past few years Hong Kong has benefited from its role as a gateway to China at a time when that country has reopened its doors to the rest of the world. Indeed, a number of the large multinational law firms have only recently established themselves in Hong Kong, both to pick up some of the new business and in the hope of being grandfathered in when the colony reverts to China's control.

Some law firms, as well as other business service firms, have also looked to Australia in anticipation of its development as a major center for business services because of its special links to both Asian and Anglo-Saxon cultures. This perception has been reinforced in recent years by sizable Japanese, South Korean and Hong Kong Chinese investment. So far, however, no one court in any state within Australia's federal system has emerged as the country's dominant jurisdiction, and this has tended to hold back the development of that country's legal service market.

C. New Markets for Business Services

In assessing the future of the world market for professional business services, most executives interviewed in the course of our research expected that new business opportunities would arise from three principal sources: the development of new geographic markets; the expansion of business service sales to a much wider range of customers; and the diversification of offerings.

1. *New Geographical Markets.* Although the Western European market is not as developed as that of North America, most service firms tend to regard these two markets as relatively mature. Business service firms are looking to other areas of the world for new, relatively undeveloped markets. Typically, these include the newly industrialized countries (NICs)—in particular, South Korea, Taiwan, Hong Kong, Malaysia, Singapore and Indonesia, as well as India and China.

Latin American countries are seen as lackluster performers, troubled by their huge debt. Middle Eastern countries are thought to provide potentially large markets, but are considered too unstable at the moment. African countries are thought to be still too underdeveloped for significant business expansion.

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[21] Id. at 4.

2. *New Customers.* In countries with fairly highly developed markets—mostly those of Western Europe and North America—firms are seeking to grow by expanding their customer bases. Yet conditions differ. In accounting in Italy and Spain, for example, legally certified audits have been required only recently and there is still substantial competition for large corporate customers. In other European countries, changes promoted by recent European Communities directives requiring most incorporated firms to issue certified accounts have opened up the audit market among middle-sized firms.[22] In the U.K. and the U.S., where the market for certified audits has become quite saturated, the emphasis has shifted to offering a broader range of services to a wider range of corporate customers, especially to middle market firms which have traditionally limited their demand to basic services.

3. *The Development of New Services.* Finally, business service firms are trying to develop new business opportunities by diversifying their offerings. In the market for business customers, accounting firms have expanded and continue to expand aggressively in areas of tax services and management advisory services.[23] In European countries such as Belgium, where the practice of legal counsel under a *conseil juridique* status is largely unregulated, some of the large accounting firms have developed in-house *conseil juridique* departments which advise clients on legal matters.[24] Similarly, a new breed of advertising firms, with the U.K./U.S. firm Saatchi & Saatchi, Compton in the lead, are now stressing their capacity to offer a very wide range of marketing and advertising services.[25]

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[22] For an overview of the European Communities' directives bearing on accounting services within the European Communities see Coopers & Lybrand Europe, The EEC Directives (June 1984).

[23] For further discussion of the expansion of accounting firms into management consulting see Noyelle, Management Consulting at 26-30 (cited in note 4). See also text at notes 57-58.

[24] In contrast to the U.S., which is characterized by a unitary legal profession, most countries distinguish between legal professionals who may represent clients in courts ("barristers" in the U.K., "*avocats*" in France and Belgium, etc.) and those who may only provide legal advice ("solicitors" in the U.K., "*conseils juridiques*" in France, "*conseillers juridiques*" in Belgium, etc). Typically, lawyers practicing in a foreign country will be able to do so under a more or less restrictive "*conseil juridique*" (legal consultant) status. Regulations differ from country to country, including in whether they apply to nationals or foreigners or both. For a more detailed discussion of the issue, see Cone, 1986 U. Chi. Legal F. at 172 (cited in note 18); Shapiro and Young, 1985 Mich. Y.B. Legal Stud. at 27-28, 35 (cited in note 18).

[25] Saatchi & Saatchi, Compton's advertising and marketing services range from corporate image promotion through Philadelphia-based subsidiary, Hay Associates, to market re-

Accountants and lawyers have also begun to market their services aggressively to high net worth individuals at least in North America, the U.K. and some of the wealthier Western European countries. Changes in the structure of financial markets have vastly expanded the investment opportunities available to individuals, and this in turn has created an enormous, and as yet underserved, market for tax and investment services for these individuals. Competition is bringing together many actors to satisfy this new demand, including commercial bankers, stock brokers, notaires (in Continental Europe), lawyers and accountants.

Such trends towards diversification are not unlike those underway in other service industries, particularly in the financial sectors of those countries where deregulation is most advanced. They underscore the tendency among some of the most dynamic firms to develop so-called "service supermarket" strategies, in which firms are refocused and reorganized to deliver a broad range of services to targeted market segments, rather than a few services to the entire market.[26] But because such strategies may require combining different areas of professional expertise in ways which are currently illegal in some countries, the extent to which firms are allowed to proceed will be determined by the extent to which domestic regulatory constraints are relaxed.

III. Restrictions on Multinational Business Service Firms

In our interviews with senior executives in law, accounting, advertising and management consulting firms, seven types of restrictions faced by multinational business service firms in their efforts to expand in international markets were cited: restrictions on local ownership, on international payments, on the mobility of professional personnel, on technology and information transfers, on market access through local procurement policy, and on the business scope of firms.[27]

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search and polling through its Connecticut-based subsidiary, Yankelovitch, Skelly & White, and advertising services through Saatchi & Saatchi in the U.K. and Compton in the U.S. Sandra Salmans, Saatchi & Saatchi's Buying Binge, N.Y. Times, sect. 3, p. 1, col. 2 (July 14, 1985).

[26] Thierry J. Noyelle, New Technologies and Financial Services: A Paradigm for the New Economy (forthcoming).

[27] See also Rossi, 1986 U. Chi. Legal F. at 151-56 (cited in note 13); Cone, 1986 U. Chi. Legal F. at 170 (cited in note 18); Shapiro and Young, 1985 Mich. Y.B. Int'l Legal Stud. at 33-35 (cited in note 18).

A. Restrictions on Local Ownership

With regard to local ownership, restrictions differ for advertising and management consulting on the one hand, and accounting and law firms on the other. Typically, advertising and management consulting firms expand abroad by opening their own branches and subsidiaries or by buying local firms.[28] In trying to do so, however, they may face local restrictions on foreign ownership.

Western European countries are usually viewed as quite permissive in this regard; Canada, Australia and many Latin American countries, as rather restrictive. While Canada will grant minority interest (ranging from 35 to 49 percent) fairly easily, its Foreign Investment Review Board will subject attempts by firms to gain a majority interest to strict review.[29] Those seeking to acquire a majority interest must demonstrate that such investment is in Canada's interest and will result in increased local employment and increased local research and development efforts.[30]

In Latin America, restrictions have become commonplace in the wake of the Andean Pact,[31] although member countries interpret the Pact differently. In Argentina, Colombia, Venezuela, Peru and Uruguay, foreign firms are not allowed to hold equity in local firms, except for those with investments prior to the Pact which benefit from a grandfather clause. Columbia and Venezuela interpret the grandfather clause to mean that foreign firms may maintain a 20 percent equity interest in local firms. Chile has a looser interpretation of the Pact and allows anyone—grandfathered or not—to hold a 35 percent minority interest. As a result, in most of these countries foreign advertising and management consulting firms must operate through minority holdings or through loose as-

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[28] However, there has been a recent trend towards the formation of loose international affiliates among management consulting firms. Such relationships enable firms to bolster their international networks faster than in the past and to strengthen their competitive footing with accounting firms. See Noyelle, Management Consulting at 27-29 (cited in note 4).

[29] Canadian Foreign Investment Review Act, 1973-74 R.S.C., ch. 46; amended by 1976-77 R.S.C., ch. 52.

[30] Id.

[31] Andean Subregional Integration Agreement, 8 Int'l Legal Mat. 910 (Sept. 1969) (entered into force Oct. 16, 1969), later changed to Agreement of Cartagena. The Cartagena Agreement has been adopted by the governments of Bolivia, Chile (which withdrew in 1976), Colombia, Ecuador, Peru and Venezuela, "to promote a balanced and harmonious development of the Member states. . . ." Art. 1. The agreement calls for Member states to coordinate their policies toward foreign capital. Art. 26(d). This coordination has resulted in "the adoption of a common set of more or less restrictive conditions for the entry of foreign capital into the union." David Morawetz, The Andean Group: A Case Study in Economic Integration Among Developing Countries 46 (1974).

sociations with local firms. In Brazil, not a member of the Andean Pact, foreigners can hold a majority interest, but the country places drastic restrictions on the repatriation of profits and capital.

In the Pacific region, restrictions differ from country to country. Japan, for example, has no restrictions. Australia does, but is interested in attracting foreign investment other than from Japan and is thus currently acting favorably towards non-Japanese foreign investment.

On the whole, advertising firms have been affected more significantly by many of these restrictions than management consulting firms, because the latter have ventured primarily into Western Europe and only to a very limited extent into Latin America or the Pacific area.

In both law and accounting, restrictions are of a different nature, usually limiting the right of establishment of foreign firms and the right of foreign professionals to practice. As Sydney Cone has noted in his paper for this conference, and as Isaac Shapiro has noted elsewhere, in law the greatest obstacles to international expansion are restrictions imposed on the right of foreigners to practice abroad.[32]

In accounting, while most countries demand that local affiliates be set up as national partnerships, most allow such local partnerships to join international affiliations. In recent years, however, some firms have begun to meet with more restrictive environments in parts of the Middle East and in the Pacific regions. Most of these restrictions take the form of limitations on the right of local partnerships to link with international affiliations.

B. Restrictions on International Payments

A more serious type of restriction on the ability of foreign business service firms to enter new markets arises from the limitations many countries place on international transfer payments. These payments are important to multinational business service firms for two main reasons.

The first stems from the attempt to create and profit from scale economies. International payments by local offices are needed so that the costs of training and services developed jointly may be

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[32] See Cone, 1986 U. Chi. Legal F. at 170 (cited in note 18); Shapiro and Young, 1985 Mich. Y.B. Int'l Legal Stud. at 33-35 (cited in note 18). Principally, a few major jurisdictions are involved, including London, Paris and Brussels in Western Europe; Riyadh and Abu-Dhabi in the Middle East; Tokyo, Hong Kong and Singapore in the Pacific region; and key states in the United States (in the case of non-U.S. lawyers).

shared. Accounting firms, for example, train all levels of their personnel extensively. While some training can be provided easily on the job or be shared by several offices within the same country, other training requires that personnel from various countries be brought into one or several centralized locations. A principal purpose of centralized training is to develop a joint set of standards, techniques and procedures for the entire international affiliation.

Second, international payments are needed for the purpose of intra-firm billing of costs incurred by one branch office when working on an assignment handled and billed directly by another. Such inter-branch billing may be necessary, for example, during the audit of the consolidated accounts of a multinational client, in the preparation of a legal document requiring expertise from more than one office in more than one country, and in similar situations.

There are several ways in which international payments are restricted. Countries may tax international transfers directly, or they may discourage them indirectly by denying the right to deduct intra-firm payments for income tax purposes. In addition, countries may limit the value of international transfers to some direct proportion of capital investment. Since most professional business services are labor-intensive, this rule tends to discriminate against such businesses.

C. Restrictions on the Mobility of Personnel

Restrictions placed on the mobility of non-nationals are complex because they have different origins and distinct, but related, effects.[33] The restrictions include: visa restrictions for both short-term travel and long-term residency, restrictions on the right to do business or practice, and restrictions on the right of establishment.

Executives, managers and other employees from multinational business service firms must travel often in order to transfer technology, expertise and skills to branch offices. As long as those needs can be met through short-term travel, and as long as the person visiting the branch office does not become directly involved in the conduct of business, restrictions are usually rare except for those that limit the right of a country's own nationals to travel abroad.

Where the purpose of travel involves the conduct of business, visa restrictions can be major impediments. This can be true when

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[33] Rossi, 1986 U. Chi. Legal F. at 154 (cited in note 13); Shapiro and Young, 1985 Mich. Y.B. Int'l Legal Stud. at 26-33 (cited in note 18).

partners and associates travel to service short-term assignments or develop business assignments to be carried out later in the home office, or more importantly, where foreign nationals are assigned to a firm's office in another country. While visa problems are not unique to business services, service firms are uniquely burdened by them because countries may often link the right to practice with the right of establishment, citizenship requirements and/or local licensing requirements. Many countries, including the United States, impose severe restrictions on the ability of certain professionals to practice their trade on a transient basis. Such restrictions are most onerous to lawyers, since expertise in international business law requires a degree of familiarity with the law of several nations that can be acquired only by actual practice in those countries. In accounting, by contrast, these restrictions are less burdensome because most services can be rendered by nationals.

D. Restrictions on Technology Transfer

For professional business service firms, restrictions on technology transfers most frequently take the form of restrictions on the movement of personnel as carriers of expertise. Typically, countries restrict transfers as a way to ensure that firms develop locally some of the technology that they need, including new operating procedures and the training of personnel in the use of these procedures.

In addition, countries may place high tariffs on technical and training publications imported from abroad. In accounting, some firms complain of tariffs placed on the import of software. In advertising, while most countries place few restrictions on the import and local use of printed advertising copy material, many countries forbid the local use of advertising videos made elsewhere. These countries see local production of videos as essential to the development and modernization of their movie and television industries.

E. Restrictions on Information Transfers

None of the firms in the four industries surveyed cited restrictions on transborder data flows as a major problem, since none of them depends significantly on such flows. For most, the need for transborder data flows is rare, be it the occasional use of legal case data base services by lawyers or the infrequent international transfer of data by accountants. This does not speak to the needs of other more extensive users, such as engineering and architecture firms. This issue is discussed in greater detail in the next section of this paper.

F. Restrictions on National Procurement

Some countries discriminate against foreign professional business service firms by channeling the business of public sector agencies, public authorities and firms from the nationalized sector to domestic service firms. In countries where these sectors represent a large share of the economy, this practice has significant consequences.

In advertising, for example, France made it a practice after World War II to channel most of the advertising budgets of French industrial firms to French advertising firms, primarily to Eurocom International, Havas Conseil and Publicis, which together control between 40 and 50 percent of the domestic market.[34] In accounting, Vinod B. Bavishi and Harold E. Wyman note that several countries have an unwritten rule that the accounting business of the public and nationalized sectors should go to local partnerships.[35] In management consulting, similar unwritten rules seem to have been in effect in the late 1960s and early 1970s in some European countries.[36] It is worth noting, however, that "buy-national" practices seem to have arisen more often as a reaction to the successes of a few foreign firms in local markets, and an effort to avoid total domination, rather than as an attempt to prevent foreign firms from participating in the local market in the first place.

G. Restriction on the Scope of Business

Finally, some firms whose executives we interviewed complained of local restrictions on the scope of their operations. Typically, however, these limitations apply uniformly to both domestic and foreign firms and simply reflect the way national governments regulate certain business sectors. In continental Europe, for example, the certification and preparation of accounts are two lines of business that legally must be kept separate.[37] Large accounting firms, however, can adjust to this requirement by establishing separate partnerships in each area.

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[34] Eudes Delafon, Merde a Seguela: Il Reve de L'Amerique, Medias 49-56 (Oct. 8, 1984).

[35] Vinod B. Bavishi and Harold E. Wyman, Who Audits the World? Trends in the Worldwide Accounting Profession 143 (1983).

[36] See Noyelle, Management Consulting at 42-44 (cited in note 4); Robert C. Albrook, Europe's Lush Market for Advice: American Preferred, Fortune 128 (July 1969).

[37] See Coopers & Lybrand Europe at 15 (cited in note 22).

In addition, many countries do not allow partnerships which include members of one profession either to include or employ professionals in another line of expertise, except for their own internal use. Because large professional business service firms are now trying to grow through "supermarket" style strategies that emphasize the ability to deliver a broad range of services tailored to particular market segments, this may in fact become a problem. Nevertheless, such restrictions are first and foremost domestic regulatory issues. As noted at the end of the next section of this paper, only to the extent that these restrictions may be used to restrain foreign competition might they need to be addressed in an international forum.

IV. Conceptual Issues Related to Trade in Services: Lessons from Four Business Services

The 1984 *U.S. Study* identified three conceptual issues central to negotiations on international trade in services: the distinction between "pure trade" and "investment" issues; the importance of visa, migration, labor certification and related issues; and the problem of competition in both domestic and international markets.[38] These three issues will now be considered.

A. Distinguishing "Pure Trade" from "Investment"

As noted in the *U.S. Study*, in the past governments found it useful to distinguish "pure trade" issues from "investment" issues and to develop distinct approaches to each.[39] Because the production of goods dominated most economies in the years after World War II, and because the distinction between goods produced locally and those produced abroad was easily established, a critical issue in earlier trade negotiations was how to secure equal access to national distribution networks for foreign goods, once the required import duties had been paid. Under the General Agreement on Tariffs and Trade, foreign producers' *access* to local distribution networks was regarded as a trade issue, while *upfront ownership* of a local distribution system was considered an investment issue.[40]

Today, an important problem confronting negotiators is the extent to which a similar formulation can be used to address trade in services. The *U.S. Study* emphasizes that advances in comput-

[38] U.S. Study at 37-39 (cited in note 5).
[39] Id. at 38.
[40] Id.

erized technology have enhanced the "tradability" of services. However, the study also recognizes that the extent to which the distinction between trade and investment can be used to structure negotiations on service trade is not simply a function of the extent to which services are technologically "tradable," but is also influenced by the fact that many outputs are regulated according to local professional standards.

In the rush to develop a trade negotiating strategy for service industries, there may be a tendency at the moment to over-emphasize the increasing potential for tradability of services and to overlook the importance of investment and labor mobility issues. This, we think, is misguided for two reasons: first, because the rush to find "tradability" in services stems in part from a misinterpretation of both *technological* trends and *market* trends; and second, because issues of labor mobility and professional regulation are too complex to be ignored.

Undoubtedly, advances in computerization and communications technologies are making it increasingly feasible to design service production procedures in the form of software, and to store the inputs and outputs of a production procedure in electronic memories. These trends permit the increasing separation of the production of services from their consumption, both in time and space. In this sense, the new technology has a powerful centralizing potential that can enhance the "tradability" of services. This fact has led some to conclude that since the largest share of a service's value can now be created in a centralized location, trade in services may be dealt with mainly from the perspective of *access* to the distribution networks.

Such a conclusion is based largely on what we regard as a misinterpretation of the case of the insurance industry. It is said that insurance products can now be produced in one country and sold in another by simply establishing data communication links between insurance producers and local distribution networks. Such a conclusion assumes implicitly that the computerization of production has greatly diminished the amount of value-added contributed through the distribution network. And that is simply wrong.

Our own studies of computerization in the service industries indicate that new computer technologies create both centralizing and decentralizing tendencies.[41] The computerization of routine production procedures enhances the capacity to tailor and custom-

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[41] See generally Noyelle, New Technologies (cited in note 26).

ize the output, but this can only be accomplished close to the market, that is, only in the course of an operating relationship between customers and distributors. Put another way, computerization helps generate new opportunities to create additional value-added in the distribution process through customizing.

Today's service economy involves extensive *market segmentation* and *customization* of outputs, in both goods and services. The new technology enhances the capacity of firms to segment markets and customize the outputs. These trends act as powerful decentralizing forces.[42]

Hence, the error in the interpretation of the insurance industry example noted above stems from the failure to recognize that computerization not only makes it possible for insurers to reorganize and produce policies more efficiently, but also makes it possible to tailor each policy to clients' needs. In other words, both the quality and the value-added of the service can be enhanced by insurance brokers and agents.

Our interviews in the accounting industry point strongly to a similar pull-push tendency. For example, one executive mentioned that improved communication links had made it possible for his firm to open mini-branch offices in several countries staffed only with accountants and project managers, and not with partners. While only partners have the right to sign statutory audits, the firm had relied for several years on telex to enable partners to sign statements prepared by project managers in the mini-branch offices. At the time the interview took place the firm was introducing an even more sophisticated electronic mail system to relieve congestion on its Telex system. The system did not necessitate transborder data flows since data exchanges were confined to the same country. In the opinion of the same executive, however, this ability to move information faster and better than in the past had created new opportunities for his firm to get closer to its clients.

Similarly, our interviews disclosed that some large law firms have computerized and centralized their paralegal work to improve efficiency in the production of certain legal documents. Nevertheless, a great deal of the value-added in the production of such documents remains in the identification and delivery of the service in the field, in other words in the relationship between lawyers and clients or lawyers and courts. This is unlikely to change in the near

[42] See Stanback, New Economy at ch. 1 (cited in note 9); Eli Ginzberg, Thierry J. Noyelle and Thomas M. Stanback, Technology and Employment: Concepts and Clarifications, ch. 1 (1986).

future.[43]

In the design of compensation and pension plans, a field of management consulting that has grown enormously since the early 1970s, computerization has enabled firms not only to reorganize the production of actuarial data through centralization, but also to strengthen thier expansion in new geographic markets. As in other services, a key to the business is customization of offerings in which face-to-face interaction between firms and clients is necessary. In addition, given the confidential nature of compensation and pension plans, personnel managers usually prefer to discuss issues related to the preparation of such plans outside their own offices to ensure privacy. Advanced communications and computer technologies have strengthened the firms' capacity to customize their output, and therefore have enhanced, not weakened, the strategic importance of the local branch office.[44]

Another major reason for the increased importance of the local investment issue in recent years stems from the market trends identified above. In Section II we noted the increasing emphasis business service firms are placing on developing new business opportunities among middle market business customers and some individual customer segments. This trend is not unlike that operating in other service industries, such as banking, where it is now recognized that some of the greatest profit opportunities lie in developing the relatively underserved wholesale markets for medium-sized firms and retail consumer markets. In both cases, developing such opportunities calls for creating a strong local presence to sell services.[45] In both cases, restrictions on transborder trade in services are relevant only in so far as they are used to limit foreign firms' capacity to do business abroad. But in the age of cheap, powerful, user-friendly computers, a U.S. bank operating a consumer banking operation in, say, West Germany, need not do the data processing for its German customers in the United States. Restrictions on local investment are therefore likely to be more important than those on "pure trade."

The third major reason why excessive emphasis on "pure trade" may be misleading is that it is based on an underestimation of the scope of the problems involved in labor mobility and professional regulations. The past thirty years of trade in licensed or

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[43] See John Mollenkopf, The Legal Services Industry in New York City, A Report to the New York City Office of Economic Development 19-20 (1984).

[44] See Noyelle, Management Consulting at 26 (cited in note 4).

[45] See generally Noyelle, New Technology (cited in note 26).

even non-licensed business services underscore the complexity of these issues.

B. The Importance of Visa, Migration, Labor Certification and Related Issues

The notion of transborder trade of professional services assumes that a service produced by a licensed professional from one country can be sold to consumers in another country in which the professional is not licensed to practice. This is a practice that most countries, including the U.S., have traditionally forbidden, not necessarily with the intent of discriminating against foreign service producers, but rather of protecting local consumers by certifying the competence of those who render services.[46] A relevant experience in addressing this issue is that of the European Communities, which over the years have found it useful to negotiate professional licensing issues separately.[47]

Broadly speaking, restrictions on the flow of personnel, licensed or not, are gaining significance because of the growing global nature of the service industries. As Peter Drucker noted in a recent *Wall Street Journal* article, internationalization today demands projecting a transnational image.[48] Multinational companies are focusing less on geographic markets and more on consumer market segments worldwide. To a large extent this demands the development of new procedures and ways of marketing goods and services on a global market segment basis. In turn, this requires being able to move personnel around extensively, both to transfer technology through transfer of "human capital" and to serve consumers wherever they happen to be.

C. Problems of Competition

A third conceptual issue raised by the authors of the *U.S.*

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[46] But see Cone, 1986 U. Chi. Legal F. at 176-77 (cited in note 18) (suggesting a protectionist motive for local licensing requirements).

[47] John H. Barton, Negotiation Patterns for Liberalizing International Trade in Professional Services, 1986 U. Chi. Legal F. 97, 108, 113 (discussing the European Communities' approach and suggesting that a similar approach might be fruitful in negotiations on international trade in services).

[48] Peter F. Drucker, The Changing Multinational, Wall Street Journal, p. 26, col. 4 (Jan. 15, 1986). Drucker notes that a few multinational corporations such as Citicorp and IBM already do this extensively. For example, he mentions Citicorp's U.S. credit card operation which is headquartered in North Dakota but is currently managed by a Venezuelan. The concern over labor mobility was expressed strongly by most of the executives interviewed in all four industries.

Study is competition.[49] The need to address problems of competition was cited both in service sectors which government-owned monopolies tend to dominate and in sectors characterized by highly regulated environments. Only the latter is relevant to the business services analyzed in this article.

In *Trade in Services: A Case for Open Markets*, Jonathan D. Aronson and Peter F. Cowhey argue that while other countries need not match the ardor of the U.S. for deregulation of domestic service markets, some leeway for greater competition may be necessary.[50] Broadly speaking, we would agree, and argue that a fundamental requirement for growth and economic development in the service economy is the ready availability of expertise and specialized knowledge from business service firms upon which both existing and new businesses can draw. This is a fundamental change from the previous, industrial era, during which firms had to rely for their growth on the relatively slow and more expensive development of in-house expertise. This, we believe, is an important lesson from the past fifteen years of economic development in the U.S. During that time, business expansion occurred mostly through a surge in the creation of new businesses, with the network of professional business services becoming part of the infrastructure upon which future economic growth was built.[51]

The implication of this trend is that the more extensive the network of business services, the better off a country will be. If we assume that preserving competition is the best way to ensure continued high levels of development, imperfect competition and excessive concentration may pose problems in the form of price fixing and disincentives for rapid technological developments within the sector. Based on the limited data available on trends in market share for the business services examined in this paper, several possibilities can be identified.

In advertising, the available data suggest that while a substantial share of the world market is held by large firms, in most markets there are enough such firms present to ensure high degrees of competition at the local level (see Tables 10 and 11). Further, because successful advertising must reflect national and cultural differences, extensive decentralization seems essential to the develop-

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[49] See U.S. Study at 37 (cited in note 5).

[50] See Aronson and Cowhey, Case for Open Markets at 20 (cited in note 1).

[51] See Thierry J. Noyelle, Economic Transformation, in Revitalizing the Industrial City, The Annals of the American Academy of Political and Social Sciences (November 1986).

ment of effective local campaigns. This tendency toward decentralization may occur simultaneously, however, with centralized development of advertising concepts and strategies in a few locations, as part of the trend toward "world advertising" for worldwide consumer segments.

From the points of view of most countries, however, a great number of world agencies are American, which means that world advertising concepts and strategies tend to be developed on Madison Avenue, rather than elsewhere. Furthermore, comparison of the lists of the thirty largest world agencies between 1977 (Table 11) and 1983 (Table 12) shows that, with the exception of Saatchi & Saatchi, Compton, a U.S./U.K. firm, the only non-U.S. firms which improved their standing between those two dates are from either Japan or France. Both France and Japan had imposed restrictive policies in the past, generally in the form of restrictive procurement policies. The success of Japanese and French advertising firms then would seem to imply that some degree of protection of domestic firms can be helpful in developing a strong homegrown industry.

In legal services, the European market seems to have remained quite competitive, particularly in countries like France and the United Kingdom which traditionally have been the most open to foreigners. For example, the opening of branch offices of American firms in France in the 1950s and 1960s under the *conseil juridique* status did much to spur activity and competition in a field previously dominated by a small number of mostly local *conseils juridiques* or *cabinets d'avocats*.[52] Competition from U.S. firms first caused others—both French and non-French—to start new *conseil juridique* firms. Later, in part as a result of changes in laws regulating the French avocats' right of association, the competition encouraged a new generation of French avocats to start their own *cabinets d'avocats*, specializing in international business (see Table 13).[53]

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[52] For a more detailed description of the practices of *conseils juridiques* and *cabinets d'avocats* see Sydney M. Cone, III, The Regulation of Foreign Lawyers 68-70 (3d ed. 1984) ("ABA Study"). This study was published by the Section of International Law and Practice of the American Bar Association.

[53] Brown, Int'l Fin. L. Rev. at 4 (cited in note 17).

Table 12

World's Largest Advertising Agencies in 1983
(millions of dollars)

Rank	Agency	Gross Income World	Gross Income US	US Rank	Rank Outside US	Gross Income Outside US
1	Jap. Dentsu	$437.7	$ 0.0	—	1	$437.7
2	USA Young & Rubicam	414.0	274.4	1	8	139.6
3	USA Ted Bates Worldwide	388.0	244.4	2	5	143.6
4	USA J. Walter Thompson	378.8	189.9	5	3	188.5
5	USA Ogilvy & Mather	345.8	204.1	3	7	141.7
6	USA McCann Erickson	298.8	95.4	13	2	203.4
7	USA BBDO Int'l	289.0	199.0	4	11	90.0
8	UK Saatchi & Saatchi Compton	253.3	110.9	10	6	142.4
9	USA Leo Burnett	216.5	135.0	8	14	81.5
10	USA Foote Cone & Belding	208.4	158.9	6	19	49.5
11	USA Doyle Dane Bernbach (DDB)	199.0	146.0	7	18	53.0
12	USA SSC & B Lintas	197.1	67.8	22	9	129.3
13	USA Grey Advertising	183.5	125.1	9	17	58.4
14	USA D'Arcy McManus Masius	181.1	91.6	15	13	89.6
15	Jap. Hakuhodo	180.2	0.0	—	4	180.2
16	USA Benton & Bowles	144.3	98.1	12	21	46.2
17	USA Marschalk Campbell Ewald	133.0	99.5	11	24	33.5
18	USA Dancer Fitzgerald Sample (USA)	113.1	94.1	14	n.a.	19.0
19	USA NW Ayer Inc.	97.4	83.2	18	n.a.	14.2
20	USA Needham, Harper & Steers	94.2	77.9	19	n.a.	16.2
21	USA Wells, Rich & Greene	92.7	91.0	16	n.a.	1.7
22	Fr. Eurocom International	90.0	0.0	—	11	90.0
23	USA William Esty	84.8	84.8	17	—	0.0
24	Fr. Publicis Intermarco Farner	82.1	3.0	n.a.	15	79.1
25	Fr. Havas Conseil	75.0	27.0	33	20	48.0
26	USA Bozell & Jacobs	74.4	73.5	20	n.a.	0.9
27	USA Kenyon & Eckhardt	60.5	45.0	25	n.a.	15.5
28	Jap. Daiko Advertising	59.8	0.0	—	16	59.8
29	USA Ketchum Communications	55.2	46.8	24	n.a.	8.4
30	USA Cunningham & Walsh	52.7	52.7	23	n.a.	0.0

Source: Eudes Delafon, Merde a Seguela: Il Reve de L'Amerique, Medias 49, 54 (Oct. 8, 1984)

Table 13

Leading Independent *Conseils Juridiques*, Leading Foreign *Conseils Juridiques*, Leading International *Avocat* Firms in Paris

Firm	Founded	Partners	Associates
1. Leading Independent *Conseils Juridiques*			
Law Offices of S.G. Archibald	1907	13	25
Phillips & Giraud	1977	4	2
Salans, Hertzfeld, Heilbronn Beardsley & van Riel	1977	7	5
2. Leading Foreign *Conseils Juridiques*			
Coudert Freres	1879	11	29
Cleary, Gottlieb, Steen & Hamilton	1949	9	18
White & Case	1959	2	3
Clifford-Turner	1962	12	14
Davis, Polk & Wardwell	1962	2	5
Shearman & Sterling	1963	6	6
Rogers & Wells	1965	3	3
Surrey & Morse	1970	3	6
3. Leading International *Avocat* Firms			
Gide Loyrette Nouel	1920	20	48
Jeantet	1925	10	15
Monahan & Duhot	1960	6	2
J.C. Goldsmith & Associes	1967	2	2
Tandeau de Marsac, Serrero, Popineau & Associes	1971	5	3
Giroux, Buhaghiar & Associes	1973	7	9
Simeon Moquet Borde & Associes	1974	4	16
Chartier, Hourcade, Weiser, Jobard, Guillerm-Kirk	1975	5	3
Berlioz Ferry David Lutz & Rochefort	1978	6	13
De Pardieu & Associes	1982	1	5
Delvolve & Associes	1983	4	5

Source: Christopher R. Brown, France's Growing International Law Firms, Int'l Fin. L. Rev. 4, 5-7 (Jan. 1984).

By comparison, West Germany's relatively protectionist stand may have retarded the development of its legal sector. Aside from the in-house legal departments of the large German banks, there have until recently been only a few independent business law firms. It is only in the past five to ten years that a number of independent German law firms with some market power have arisen.[54] Finally, in New York State, where foreign lawyers were not allowed to practice without being a member of the New York bar until 1974, it is significant that a number of foreign firms (mostly European) have responded to recent statutory changes and established themselves under the new legal consultant status.[55]

In short, the economics of international legal services would seem to be such that there are no great economies of scale to be achieved at the moment, hence no major threat that a few firms will achieve oligopolistic market power rapidly. In other words, opening up the field to foreign competition may not represent any great threat to anyone.

In accounting, the pattern of development is quite different. As noted earlier, most of the large international firms have developed by affiliating with formerly local independent practices. The resulting process of concentration has been formidable; the data suggest that the "Big Nine" collect nearly one-third of all auditing fees worldwide (see Table 9). Furthermore, historical data gathered from several countries by Bavishi and Wyman indicate increasing market power by the "Big Nine" in some market segments.[56] As shown in Table 14, there was significant market share concentration in the auditing of large corporations between 1971 and 1981 in the U.K., Canada and Australia.

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[54] Brown, Int'l Fin. L. Rev. at 4-7 (cited in note 20).

[55] ABA Study at 26-28 (cited in note 52).

[56] Bavishi and Wyman, Who Audits the World? at 133-140 (cited in note 35).

Table 14

Market Position of Accounting Firms in the U.S., U.K., Canada and Australia: Percentage of Certified Audits for a Sample of Large Corporations Carried Out by Big Nine Accounting Firms, Small Affiliations and Non-Affiliated Firms

	U.S.		U.K.		Canada		Australia	
	1971	1981	1971	1981	1971	1980	1971	1980
Big Nine firms	95.0	99.0	72.0	86.0	42.0	99.0	32.0	71.0
Small affiliations	1.0	0.0	8.0	5.0	41.0	0.0	12.0	3.0
Non-affiliated firms	3.0	1.0	20.0	9.0	17.0	1.0	56.0	26.0
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Number of large corporations in sample	1870	3202	677	1266	484	719	139	229

Source: Bavishi and Wyman, Who Audits the World? 133-140 (1984).

The share held by the "Big Nine" rose dramatically, while that of small affiliations and nonaffiliated firms dwindled respectively from 28 to 14 percent in the U.K., 58 to 1 percent in Canada and 64 to 29 percent in Australia.

While Bavishi and Wyman were unable to develop data for other countries, there is evidence that they too are experiencing similar market share trends. One French accountant, whose firm had recently joined a large affiliation, explained to us, rather bluntly, that "from the client's point of view, having one's accounts certified by one of the 'Big Nine' means interest rates several points lower on Wall Street."

While the demand for audits is not rising as fast as the demand for other accounting services, audits are often a principal means by which clients are attracted to other, more profitable services such as tax and management advisory services. Indeed, the price war in auditing fees that has broken out recently in the U.S. among large firms is in part a marketing strategy designed to attract new customers.[57] The power of this relationship is best demonstrated by the transformation of the market for U.S. management consulting services between the mid-1960s and the mid-1980s. During the twenty-year period, the share of the "Big Eight" grew from insignificant to between one-fourth and one-third of the

[57] See Gail Gregg, Throwing the Book at the Big 8, N.Y. Times, sect. 3, p. 6, col. 1 (June 22, 1986).

market.[58]

In his article in this issue of the *Legal Forum*, John H. Barton suggests that excessive market concentration is a national antitrust issue, not a trade issue.[59] We would prefer to argue that, within the context of a world market, were excessive market concentration going to occur, it might need to be be handled as a trade issue, if only because leaving the issue to be resolved by national governments might lead to the kind of unilateral, self-interested, retaliatory practices which should be avoided. Based on the lessons from the sectors reviewed in this article, issues of market concentration will have to be addressed in service trade negotiations.

V. Implications for Negotiations on Trade in Services

Three sets of conclusions may be drawn from our analysis. The first is likely to be the least controversial. Clearly, each sector is sufficiently unique that sector-specific negotiations should be useful in addressing some of the technical issues involved with each. Nevertheless, the four sectors have enough in common with one another (and probably with other service sectors as well) to warrant two additional concluding observations.

In our opinion, no long-term working strategy for negotiating international trade in services should simply mirror that used in the past for goods, which focused almost exclusively on "pure trade" issues. Instead, the economic dynamics of the four sectors examined in this paper suggest that a multiple-track negotiating strategy, in which local investment, mobility of personnel and "pure trade" issues are equally addressed, is necessary. Indeed, the experience of the past twenty or thirty years in negotiations on trade in professional business services, mostly on an ad hoc bilateral basis, shows that in fact negotiators have always been sensitive to the need to address these three issues concurrently. Nothing in recent or likely future developments of these sectors suggests that this multiple-track approach should be abandoned—in either bilateral or multilateral negotiations—in favor of negotiations that focus on "pure trade" only. This does not mean that negotiations emphasizing "pure trade" cannot be useful. It simply means that the linkages among "pure trade," local investment, mobility of personnel and professional certification issues are too important to be ignored.

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[58] Noyelle, Management Consulting at 20 (cited in note 4).

[59] Barton, 1986 U. Chi. Legal F. at 102-03 (cited in note 47).

Further, given the extent to which some segments of the world market for business services are dominated by U.S. firms, U.S. negotiators will have to suggest constructive solutions whereby other countries feel that their willingness to open up their markets to foreign competition is matched by a reasonable expectation of high-level competition and domestic development. Most countries are likely to feel that business service industries are playing an increasingly important infrastructural role in economic development, and will demand some say in how these sectors develop in the future. Indeed, the argument has already been raised in discussions of telecommunications, value-added networks and software trade.

An assessment of the extraordinary strength of U.S. business service firms in world markets must include both historical and technical considerations. Historically, U.S. business service firms have benefited from the fact that the U.S. market developed earlier than elsewhere. Technically, U.S. firms have developed a level of sophistication required to gain access to markets well in advance of that of most firms from other countries, partly because of a far deeper understanding of the strategic importance of customization and partly because of the sheer size of the American market.

We would argue that the U.S. might need to make special efforts not only to open its own markets, but also to create special linkages between foreign suppliers and U.S. customers in order to give smaller, non-American firms the opportunity to grow and develop the expertise they ultimately need to compete in their own countries.