

Sectoral Issues and the Multilateral Framework for Trade in Services: An Overview¹

Murray Gibbs and Michiko Hayashi

The first proposals for the negotiation of a multilateral framework for trade in services were put forward in the early 1980s. From the beginning it had been recognised that effective liberalisation of trade in services would be difficult unless it covered all traded services. But at the same time the great heterogeneity of the service sector makes it difficult to construct a general set of principles and disciplines. This process of examining the applicability and specific application of concepts, principles and rules to different sectors has been the main activity of the Group of Negotiations on Services at the Uruguay Round during 1989, where six service sectors, telecommunications, construction, transport, tourism, financial and professional services have been addressed [see GATT 1989].

Efforts to draw up a multilateral framework for trade in services also confront difficulties in applying traditional trade policy concepts and principles, which have evolved to govern trade in the goods sector, to services, where questions of the cross-frontier movement of persons, capital and information are paramount [Grey 1989]. In addition, attempts to liberalise trade in services have to deal with basic asymmetries between developed and developing countries, to permit all countries to perceive that they have something to gain from the liberalisation of trade in services.

It has long been recognised that in all countries certain service sectors are key to the achievement of some national policy objectives, which transcend considerations of economic growth. Any multilateral framework for trade in services acceptable to developing countries would have to take account of the impact of liberalisation on policy objectives vital to development, including employment, balance of payments, national security and sovereignty (including cultural sovereignty), and social objectives such as that of providing access to services of an acceptable quality to all members of the population. In addition, the impact of services on competitiveness in the production and export of services and goods, especially manufactures, has begun to be addressed more seriously in recent studies [see for example, UNCTAD 1988].

The purpose of this article is to identify, in summary form, some of the characteristics common to several service sectors which have to be taken into account by policy makers in developing countries in deciding what type of multilateral obligations they would be prepared to accept.

Market Structure

Developing countries as a whole, and most developing countries individually, run deficits in trade in services. The main exceptions are the tourism sector, and the services rendered through the movement of labour abroad. The latter may appear as unorganised labour remittances or as the export of other services, such as construction.

The statistics for measuring trade in services and for estimating the overall size of markets are extremely inadequate [see for example, UNCTAD 1988 and Coalition of Service Industries 1989]. Different approaches are used to measure trade: in financial services it is hard to disaggregate trade from capital flows; difficulties in measuring inter-firm transactions are compounded by the tendency of firms to offer a heterogeneous package of services. A further problem relates to the absence of an internationally agreed 'nomenclature' for services.

Major efforts are being made to improve statistics on the trade and production of services, both at the national level and by the 'Voorburg' group of experts, organised informally under the auspices of the United Nations Statistical Office [UNSO]. It is difficult to envision governments accepting binding international commitments on trade for which the destination and origin could not be identified, nor a reasonable level of disaggregation achieved.²

Clearly, efforts to reach agreement on a multilateral framework to progressively liberalise trade in services would be difficult in the absence of a definition of 'trade in services', if only to delineate the scope of concessions which could be requested and granted in future negotiations.

Developing country trade deficits in services, when they arise, can be explained largely by the weak economic and financial position of developing

¹ The arguments put forward in this paper are argued in greater detail and fuller referencing to the literature in Gibbs and Hayashi (1989).

² Pursuant to the discussion at the Uruguay Round, GATT (1989) has suggested a reference list based on the Central Product classification.

countries. In some sectors, however, developing countries have presented the most dynamic import market (e.g. construction and engineering services). The very low 'insurance density' in developing, as opposed to developed countries, indicates that developing countries constitute a large potential market [see, for example, Yoon-je 1987]. Cultural and geographical factors have an important effect in shaping markets in many service sectors, tourism and audio-visual services being obvious examples. In air transport, the long-standing international regulatory system explains the relatively respectable share enjoyed by the developing countries. Market structure is also influenced by the existence of bilateral agreements, such as the practice of reciprocity in the banking sector [EPA 1988].

In the rapidly growing area of business services, the concentration of supply in industrialised countries is mostly a consequence of the increasing symbiotic links between services and manufacturing. Initially geared to the domestic market, producer service firms in these countries are concentrating and expanding their business across borders, exploiting their know-how and specialisation economies, and serving their transnational clients on a world-wide basis.

Comparative Advantage

The expectation that a general process of trade liberalisation will provide benefits for all participants is based on the view that developing countries will be able to increase their exports of services in service sectors or sub-sectors where they possessed a 'comparative advantage'.³ In the case of services, comparative advantage may be derived from factors which are clearly not 'natural', but are a result of the level and pattern of prior development, and whose relative endowment is a function of the amount of resources invested in R & D and education, of the existing industrial and technological development, as well as the state of regulation. To these factors must be added institutional ones, economies of scale in production and distribution, the existence of a large domestic market on which to build up know-how; economies of specialisation, the accumulation of specific know-how and contact information, and the role of state regulation in furthering or preventing such scale economies. It is for these reasons that the conclusion has been drawn 'that developed countries overall, are likely to be more competitive than developing countries in most services'. Any apparent developing-country 'strengths' in trade in services would seem to arise from (a) inadequate statistics; (b) an ability to move persons across borders; (c) international regulatory frameworks which permit them at

least a minimum market share; (d) unique cultural and geographical factors; and, more recently (e) an ability to link lower-cost skills to information technology and telecommunication [UNCTAD 1988].

Interlinkages with Other Sectors

The interlinkages among the service sectors and the blurring of the frontiers between sectors are becoming more pronounced through technological advance. Such interlinkages highlight the importance, for example, in negotiating an international trade policy in the area of telecommunication services to arrive at acceptable definitions to differentiate functionally telecommunications infrastructure facilities and equipment, telecommunications and services from information or message content.

Regulatory Framework

Since the beginning of the international debate on a possible multilateral framework for trade in services, attention has been drawn to the fact that service activities are more highly regulated than the production of goods, and for different reasons peculiar to the special characteristics of services [see UNCTAD 1985, Ch IV]. In the Uruguay Round context, it has been recognised that progressive liberalisation should aim at reducing the 'adverse effects' of laws, regulations and administrative practices. Different types of regulations exist for different purposes at different levels, posing different sets of problems for efforts to liberalise trade. Some services are subject to a carefully articulated structure of agreements and others to none at all. For example, in civil aviation and telecommunications, a set of multilaterally agreed regulations already exists. In other sectors, regulation at the national level is more prevalent. Such regulation can apply to the quality of the service, the activity of providing the service, and/or the service provider. Such regulations can be imposed by governments, as well as self-regulation by non-governmental bodies such as professional associations.

Certain aspects of the regulation of services are inherent to the situation of the developing countries. Their balance of payments difficulties are the motive for regulations which affect trade in financial services in particular, but also in tourism, transportation and other sectors. The fragility and vulnerability of their economies, their enterprises and often their cultures are the justification for regulations whose purpose is precisely to protect domestic producers in many sectors against the perceived threat of domination by foreign corporations. However, in many cases, the motivation is not to shield local producers (which may often be the state) from foreign competition *per se*, but rather to limit the macroeconomic, strategic or cultural impact of the activities of foreign suppliers.

³ For important insights into the applicability of comparative advantage to trade in services, see Nusbaumer (1987) and Richardson (1987).

The effects of technological advances and changing institutional structure often require an almost continuous process of adaptation of regulations. Many developing countries find that their regulatory structure is inadequate for the purpose of strengthening certain service sectors and upgrading human skills, and therefore such considerations will dictate an increase in regulations in the future. Their concern not to be impeded in such a process have led to the recognition of their right to introduce new regulations in the Uruguay Round context [see GATT 1989, Part II, para 7(h)].

Regulations introduced to enforce standards have a special significance in services. Such standards can be of a prudential nature, as in insurance. They can also relate to professional qualifications, to cultural content and levels as in audiovisuals or advertising, or to technical levels and compatibility as in telecommunications, civil aviation, and electronic data interchange. Efforts to liberalise trade in services progressively, while promoting the development of developing countries and respecting national policy objectives, will have to address the 'standard' issue and the possible desirability of international harmonisation in certain cases.

The activities of specialised international organisations with respect to standards would appear to have an impact on developing countries' ability to expand their service exports and undertake commitments to liberalise services trade. In the area of technical standards, international harmonisation has had a major impact on telecommunications and transport. Recent attempts to reestablish the role of multilateral negotiation on standards and regulatory policy, and technical standards, are intended to encourage worldwide conformity. However, the rapid and uneven development of technology in different countries tends to undermine international standards where they exist, and thus brings dangers of an exacerbation of technological asymmetries, and intensified barriers to market entry and creation of captive markets.

Barriers to Trade in Services

The implementation of such a regulatory framework, along with the introduction of new laws and administrative practices, is equally likely to inhibit trade in services. The liberalisation of trade in services will necessitate separate legal mechanisms for dealing with each mode of delivery and with movement of factors of production, whether it be (a) persons, (b) capital, (c) goods, (d) information, or a combination of these factors. The movement of persons across borders to supply services would require the innovative mechanism of linking immigration regulations to trade agreement obligations.

The movement of capital would appear to give rise to legal issues not completely analogous to the movement of persons. As noted above in the Uruguay Round context, it has been recognised that some movement of the capital factor to create a commercial presence may be 'essential' to the supply of the services. This gives rise to two questions (a) the technical question of 'essentiality' and (b) the legal question of the negotiation of 'rights' of establishment, or 'commercial presence'.

The question of when presence in the market is 'essential' for the provision of a service mirrors the discussion of barriers to trade and modes of delivery below. This concept has been defined in the context of the Canada/United States Free Trade Agreement in the specific context of 'enhanced or computer services' [see Peter Barn for the Commonwealth Secretariat in UNCTAD 1988]. It seems that this concept of 'commercial presence' would differ considerably as between different sectors.

No 'right' of establishment has ever been accepted multilaterally. For example, the Havana Charter stated that a country has the right 'to determine whether and to what extent and upon what terms it will allow future foreign investment'. An agreed paragraph of the draft UN Code of Conduct on Transnational Corporations confirms that 'States have the right to regulate the entry and establishment of transnational corporations including determining the role that such corporations may play in economic and social development and prohibiting or limiting the extent of their presence in specific sectors' [see Fatourous 1989]. However, countries have exchanged concessions relating to establishment in bilateral treaties, although any 'right' of establishment is usually highly qualified. Another problem relates to the origin of the firms that would obtain such commercial presence.

There is currently a wide variation in the criteria used by governments to determine whether a firm is national or foreign [see Whichard 1989]. This problem is related to issues of 'national treatment', since it would also give rise to the question as to whether foreign-owned firms could be considered 'national' for the purposes of domestic, including fiscal law, while still continuing to enjoy 'rights' under the multilateral agreement in virtue of obligations or concessions in favour of their home country. As has been pointed out in several studies, the application of the national treatment principle in negotiations on services will require a greater measure of agreement on the acceptable limit of the assertion of jurisdiction extra-territorially [see Grey 1989:157].

However, it is clear that a definition of trade in services is much more easily applied to some sectors than to others. The difficulties in establishing a multilateral agreement for the treatment of persons (either

individual or 'corporate') should not be underestimated.

The importance of information as a key factor in the international competitiveness of firms has been discussed in considerable detail in UNCTAD documentation [see, for example, UNCTAD 1988]. Information flows through the telecommunications network or, more accurately, through the inter-connection of national networks, by which services are jointly provided by the national operators in two countries and which thus cannot be considered as 'trade' under the criteria set down in, for example, paragraph 4 of Part II of the Montreal text. Liberalisation of the movement of information as a means of delivering a particular service would have to be distinguished from the liberalisation of telecommunication services *per se*, i.e. the ability of foreign firms to provide telecommunication services to customers in foreign countries. As such information movement would conceivably be an element of a negotiated market access concession, it would not give rise to the same set of issues of national sovereignty as is involved in liberalising access to foreign services directly to domestic customers.

Information flows can be viewed as a competitive factor in which access to strategic information from abroad can provide firms with absolute advantages, giving them a competitive edge over local firms, despite the latter's advances in 'know how'. This raises the question of the extent to which information should be considered as private or confidential, subject to proprietary rights; and the desirability that cross-border transfer and use of proprietary know-how and form specific services, including through private infrastructures, be made available as an 'externality' to other local users. This in turn raises certain politically-sensitive issues, such as the storage of data in foreign data bases.

Access to Information Networks and Distribution Channels

The importance of access to information networks and distribution channels as a means of enabling developing countries to expand their service exports has been recognised in the Uruguay Round [see 'The Uruguay Round mid-term review']. The significance of information networks and distribution channels for the maintenance of a competitive position in international trade in services is dramatically apparent in many service sectors. In the tourist sector, for example, worldwide tourist revenues are dominated by developed country firms which have been able to establish such networks, i.e. hotel chains, travel agencies and computer reservation systems (CRS). The CRS are a dramatic example of the importance of information networks.

On the other hand, the concept of access to networks and distribution channels is somewhat different in the telecommunication sector, where it is seen as the right to 'plug in' to the national network so as to be able to provide so-called 'enhanced' or 'value-added' services directly to customers in the importing country. This has led to a set of problems related to national sovereignty, standards, and related issues of access to markets for goods and equipment.

However, the concept of information networks extends beyond these more obvious examples. Bressand and Nicolaidis [1989] refer to a 'networked economy' in which information networks are vital to maintaining a competitive position and creating value in virtually all service sectors, and constitute the main link between services and the attainment of competitiveness and value creation in the manufacturing sector. The concept of access to information networks involves much more than just 'plugging in', and is closely linked to access to, and transfer of, technology. In combining information networks and distribution channels a feedback mechanism is created (e.g. market intelligence, inventory management) whose competitive impact has worrying implications.

Restrictive and 'Unfair' Practices

In certain sectors, notably audiovisual, restrictive business practices (RBPs) such as cartels would seem to be a major factor in world trade. It has been pointed out in the literature that although most countries regulate imports of films and television programming, the most significant constraint to free trade lies in the structure of the market, and particularly in the overwhelming dominance of film and television programme distribution by a few transnational firms.

Although, in general, limited information exists on RBPs in the service sector, action has been taken by a variety of developed country governments to deal with RBPs in sectors such as insurance, banking, air transport, and advertising, and would appear to be occurring in other sectors as well. The changing nature of the corporate structure resulting from technological advance and regulatory changes may result in corporate behaviour which, on the one hand, could result in RBPs assuming forms that are more difficult both to define and detect, and, on the other, a series of corporate practices — not RBPs in the legal sense — which could have negative effects on development programmes and necessitate new forms of regulation at national and international levels.

There is perhaps a need to redefine what constitutes 'normal competition' in a world where a firm's competitive position derives from its networking ability. Efforts will have to be made by governments, particularly those of developing countries, to ensure that such practices do not serve to nullify the beneficial

results of the progressive liberalisation of services trade, through undermining the expected efficiency gains or creating barriers to market entry for developing country firms. In any case, any efforts progressively to liberalise trade in services will have to address the law on competition.

Among the set of what have traditionally been considered as 'unfair trade practices' there could be a tendency toward predatory dumping. Certain countries have begun to introduce unfair competition legislation to deal with services comparable to anti-dumping and countervailing duty legislation on goods trade; for example, the European Community in the area of shipping [see Bellis, Vermullis and Musgrave 1989]. It seems inevitable that governments will seek to protect the interests of national service suppliers against actions comparable to predatory dumping in the goods sector, and that consequently this could provide a potential mechanism for the harassment of legitimate trade, as has occurred with respect to trade in goods.

In many service sectors there is a geographical decentralisation of skills within corporate structures and a built-in necessity on the part of the foreign corporations to invest heavily in the training of local personnel, particularly in developing countries, which often subsequently employ domestic firms. However, other studies foresee a new international division of labour in services production where centralised decision-making headquarters coordinate widespread and distant operations, many of which are only 'delivery' branches. Firms investing abroad may also wish to centralise a number of key operations to reduce their vulnerability to expropriation and other policy actions of the host government. Therefore, a distinction must be drawn between on the one hand, the development of human skills, and on the other, access to the strategic information necessary to take decisions effectively.

The free circulation of information is restrained by a number of factors including (a) the need for specific capital equipment to read, store, process and transmit digital information, and (b) 'access' to information, which is most often protected by a number of proprietary devices. Rather than promoting competition, these constraints can constitute significant barriers to entry. Information technology can permit both extensive decentralisation or centralisation — it is a matter of corporate strategy and policy framework, although the operation of certain service industries has been shown to be incompatible with centralised operations.

Supplier Right and Obligation

As noted above, it has been accepted in the Uruguay Round that trade in services as defined in an eventual

multilateral framework could involve the cross-border movement of factors of production, where such movement is essential to suppliers. This approach has given rise to considerable difficulty in applying trade policy principles developed in the GATT context for goods to trade in services.

If the multilateral framework for trade in services is to be based upon a set of mutual rights and obligations, such rights and obligations will have to address (a) the rights of governments with respect to the treatment of their 'persons', with respect to their entry into foreign countries and their operations in foreign territory; (b) the obligations of such foreign governments with respect to the activities of such 'persons'; (c) the obligations of these 'persons' with respect to the government of the territories in which they are allowed to enter and conduct business.

If persons, 'moral' (enterprises) or physical, are to be given 'rights' under a multilateral agreement, e.g. to national treatment, then it would seem logical that these 'persons', and not only foreign governments, should be called upon to accept a set of obligations aimed at maximising their contribution to the national policy objectives of the host country and, in particular, the development policy objectives of the developing countries. A greater degree of transparency in estimates of trade in services and the size of markets could, in itself, reduce one of the major reasons for the reluctance of countries to accept contractual obligations with respect to the liberalisation of trade in services. This would be particularly true for developing countries, where greater transparency with respect to the operation of foreign service suppliers, both in their own countries and in the world market, could help identify ways in which such suppliers could contribute more effectively to their development objectives.

While economists tend to scorn arguments in favour of trade reciprocity, it is a clear political reality that governments need to do this. However, in trade in services, difficulties will be encountered in applying multilateral reciprocity, due to the difficulty of applying a mechanism affecting all service sectors, comparable to an across-the-board tariff reduction.

The term 'relative reciprocity' has emerged in the negotiations as a means of calibrating developing country concessions in line with their development situation. This approach appears somewhat analogous to the so-called 'non-reciprocity' provision contained in Part IV of GATT (Article XXXVI:8). However, in the context of negotiations on trade in services the question of reciprocity, 'relative' or otherwise, must be seen in an entirely different perspective, where it is primarily the developed countries which are seeking access commitments in developing country markets. The problem in the negotiations on trade in services is not the ability of developing countries to grant

reciprocity; it is rather how developing countries will obtain reciprocity from developed countries in respect of any concessions they might agree to make, given that the ability of developing country exporters to translate such liberalisation into export gains appears extremely limited.

Non-Discrimination

Much has been written about the key role played by the unconditional most favoured nation clause in the process of trade liberalisation in goods carried out over 40 years in GATT. Some authors have chosen to address what they consider to be a 'conflict' between unconditional most favoured nation treatment and reciprocity. In reality however, the conflict would seem to be more between broad, multilateral reciprocity, and narrowly conceived sectoral or bilateral reciprocity.

It is clear that countries would not wish the multilateral framework to inhibit their opportunities to liberalise trade in services within the context of regional integration schemes, or interregional preferential arrangements, among developing countries. The key role of services in achieving such integration and the negative effects of having not addressed services issues in earlier agreements is increasingly recognised. Liberalisation of services within such regional and preferential frameworks could assist developing country firms to build up their competitive strengths and thus facilitate efforts towards eventual liberalisation at the multilateral level.

Conclusion

In conclusion, it would appear that the liberalisation of service imports can have a dynamic effect on the development process in developing countries, through the stimulation of efficiency in key sectors, access to technology and support to exports, if carried out selectively and within the appropriate regulatory framework. In such liberalisation, care should be taken that imports of services do not undermine the ability of developing country governments to carry out strategic national objectives, including national security and cultural sovereignty, nor result in the stifling of the development of higher skills, knowledge-based services and information resources. Access to services needed to ensure their ability to compete in foreign markets should not result in developing country producers or consumers becoming 'captive' to foreign service suppliers, now exacerbate existing balance of payments disequilibria. The developing countries themselves would be in the best position to judge where liberalisation could have a relatively positive impact on their economies.

The application of trade policy concepts to trade

services will require care to avoid introducing new discriminatory and restrictive measures or an unnecessary undermining of the unconditional most-favoured-nation principle. Difficulties will be encountered in providing effective reciprocity to developing countries whose firms rarely have the capacity to translate liberalisation in developed countries into expanded service exports. Compensatory action at the national and international level to assist developing country firms to increase their competitive position is required.

The decision with respect to the structure of the multilateral framework would be a matter of utmost importance in that overly ambitious approaches, which attempted to lock signatories into across-the-board access commitments from the beginning, will only tend to discourage wide acceptance of the framework. It would seem sufficient that the initial framework include basic elements such as (a) a definition of trade in services to delineate the scope of concessions that could be requested or granted; (b) progressive liberation in the form of a commitment to engage in future negotiations; (c) a commitment that such future negotiations will aim at increasing the participation of developing countries in world trade in services; and (d) transparency. Specific market access commitments, a 'positive list', (similar to Article II of GATT) which could include a national treatment principle where applicable, could be offered as 'initial payment' such initial commitments which would consolidate the legal structure of the framework agreements and could be enlarged in future rounds within this framework. An exception clause (comparable to Articles XX and XXI of GATT) and a safeguards mechanism — where countries felt it necessary to modify negotiated access commitments for reasons of balance of payments, market domination etc — would also appear necessary.

References

- Bellis, J. F., E. Vermullis and P. H. Musgrove, 1989, 'The New EC Regulation on unfair pricing practices in maritime transport: a forerunner of the extension of certain trade concepts to services?', *Journal of World Trade Law*, February
- Bressand, A. and K. Nicolaidis (eds.), 1989, *Strategic Trade in Services: A Services World Forum Project*, Harper and Row, New York
- Coalition of Service Industries, 1989, 'The Service Economy', Washington DC, October
- Economic Planning Agency (EPA), 1988, 'Service Boeki Jiyuka No Tameni', October

- Fatourous, A. A., 1989, 'Key concepts in international investment arrangements and their relevance to international transactions in services' paper presented to a UNCTC Workshop on the Activities of Transnational Corporations in Services, Montreux, November 11-12
- GATT, 1989, 'Focus', No. 61, May
- Gibbs, A. A. and M. Hayashi, 1989, 'Sectoral issues and the multilateral framework for trade in services: an overview', Draft paper, December 20, mimeo
- Grey, de C., 1989, 'Conceptual trade diplomacy and trade in services', *Thames Essay* No. 56, Trade Policy Research Centre Gower, London
- Nusbaumer, B. J., 1987, *Services in the Global Market*, Klawer Academic Publishers, Boston/Durtrrecht/Lancaster
- Richardson, J. B., 1987, 'Approaches to service trade theory' in *The Emerging Service Economy*, Pergamon Press, Oxford
- UNCTAD, 1985, *Services and the Development Process*, TD/B/1008/Rev. 1, New York
- 1988, *Trade and Development Report. Part Two. Services in the World Economy*, New York
- Whichard, O. G., 1989, 'International transactions in services: conceptual and definitional issues', paper presented to an UNCTC seminar on the Activities of Transnational Corporations in Services, Montreaux, November 11-12
- Yoon-Je, Che, 1987, 'How the United States broke into the Korean Insurance Market', *World Economy*, December, pp 483-96