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A Service to the Economy
Removing Barriers to "Invisible Trade"

by Sallie James

Executive Summary

Although they are part of a large and growing segment of world trade—and a prominent feature in healthy, vibrant economies—services are often overlooked in trade negotiations in favor of higher-profile trade in agriculture and manufactured goods. Yet countries with more open services markets benefit from higher growth rates and living standards. Because services are an input to most other sectors of the economy, the benefits from open and competitive markets are pervasive. Indeed, the gains from lowering remaining trade barriers in services would eclipse the gains from trade liberalization in agriculture and manufacturing. The recently derailed Doha round of global trade talks seem to have put globally coordinated efforts towards liberalizing services trade on the back burner for the foreseeable future.

Fortunately, the United States does not have to wait for a negotiated trade agreement to benefit from a more open trade in services. The United States should continue to press other nations, including developing countries, to open their markets to American service providers, while removing unwieldy restrictions at home. By autonomously reducing the remaining barriers on maritime services, rail and air transportation services, distribution services, and restrictions on the temporary entry of workers from abroad, many of the benefits to American consumers and industry will be realized regardless of what other nations choose to do.

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Liberalizing services trade is likely to lead to lower prices, improved competition and choice for consumers, and improved productivity.

Introduction

Few sectors in the economy are as underappreciated as services. Largely invisible, although often an input to other more prominent goods, they are the "silent majority" in the U.S. economy. What is true of the United States is also true globally: although they are part of a large and growing segment of world trade, services are frequently relegated to second-tier status in trade negotiations. The Doha round of multilateral trade talks at the World Trade Organization recently collapsed over arguments about agricultural trade barriers and, to a lesser extent, nonagricultural market access: delegates put services on the back burner, to be dealt with after those threshold issues were settled. The low priority given to services trade is a failure of leadership and a failure to recognize the importance of services both in the world economy and to economic development.

As with lowering barriers to trade in goods, liberalizing services trade is likely to lead to lower prices, improved competition and choice for consumers, and improved productivity. Because many services are an input to the production of other services and goods, the indirect effects can be especially pervasive. For example, efficient financial services and insurance markets lead to better risk sharing in the economy and direct savings and investments to their best use and economical open transport system enables goods and people to flow more easily and contributes to lower prices and increased trade. Effective storage and distribution systems help poor farmers get their perishable goods to market. Telecommunications are vital to the spread of information and entertainment and are an especially important factor in efficient markets. Education and health services are crucial to human development. Access to foreign audiovisual and other entertainment services benefits consumers directly. An inefficient and inadequate services sector is therefore a de facto tax on production.

The considerable, yet often unseen, contribution of services to the global economy is remarkable. One study estimates that the global gains from free services trade would be over 30 times larger than those from agricultural trade liberalization and more than twice the gains from free trade in manufactured goods.[1] Moreover, many of these gains are not dependent on the actions of our trading partners: the United States can open its markets to imported services autonomously and reap rich rewards.

While all countries, including the United States, can gain from deregulating service sectors and introducing competition from abroad, the benefits for developing countries appear particularly stark. In a March 2006 document, released at the time the United States made its request to other World Trade Organization members for improved access to markets as part of the Doha round of trade negotiations, the Office of the U.S. Trade Representative stressed the role of services in promoting development by improving the flow of goods within and between countries, and in lowering transaction costs:

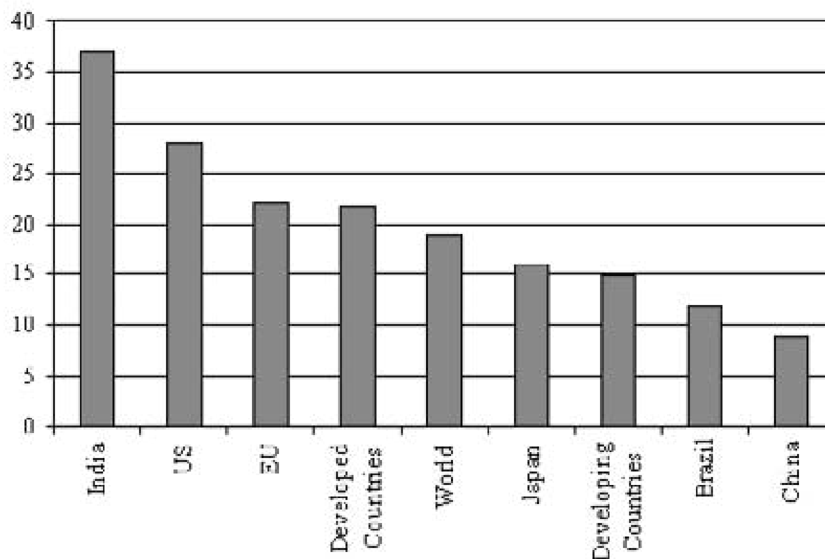
> Removal of services barriers in sectors such as telecommunications, transportation, and financial services improves competitiveness in the goods sector, increases efficiency and productivity by enabling firms to track consumer demand, facilitate product distribution, and expand global reach . . . Access to efficient accounting and legal services can lower transaction costs . . . [and] enables investors to distribute their resources in a manner that maximizes returns and spreads risks. Access to health and education services may benefit and build a country's labor force and access to environmental services supports efforts to achieve sustainable economic development.[2]

One of the best examples of how services can disseminate technology is the recent growth of mobile telecommunications. In a June 2005 article, *The Economist* hailed the extra benefits that the growth of mobile technology can bring to developing countries:

> Mobile phones have become indispensable in the rich world. But they are even more useful in the developing world, where the availability of other forms of communication—roads, postal systems or fixed-line phones—is often limited. Phones let fishermen and farmers check prices in different markets before selling produce, make it easier for people to find work, allow quick and easy transfers of funds and boost entrepreneurship.[3]

It should be no surprise that services trade is growing, despite the many trade barriers that remain.

Figure 1
Services Exports as a Percentage of Total Exports, 2007



Source: World Trade Organization.

A Large and Growing Sector

A transaction in services often requires proximate contact for trade to take place, and the service is "consumed" at the same time as it is "produced." At least before international travel and communications became so easy and cheap, many services were therefore considered inherently nontradable. That is still true of many services: think of taxi services, for example, or haircuts, where cross-border exchange is either impossible or prohibitively expensive. Unlike trade in goods, which is in many ways a substitute for factor mobility (for example, the United States is able to enjoy the benefits of products that are unskilled-labor-intensive without enjoying the comparative advantage that comes from having a relative abundance in unskilled labor), trade in services often requires some factor mobility.[4]

In 2007, the latest year for which statistics are available, global services exports were $3.3 trillion, making up about 24 percent of total world trade. That represented a growth rate of 18 percent over the previous year, compared with the 15 percent growth rate of merchandise trade.[5]

Given the emphasis on developing countries in the Doha round (indeed, the round is formally named the Doha Development Agenda), and the unfortunate mercantilist outlook of WTO negotiations—where lowering barriers to imports is seen as a necessary "concession" in order to gain improved market access for exports—it is perhaps not surprising that services have been overlooked. Usually, services account for a greater proportion of economic activity in developed countries than they do in developing countries. In other words, developed countries are more likely than developing countries to have export interests in services, as Figure 1 shows.

Economists often refer to a country's "revealed comparative advantage" in a given industry, which can be calculated by dividing the share of that industry in the country's exports by the share of that industry in total world exports. It is an imperfect measure, since any country's exports of a good or service are influenced by government interventions that have little to do with natural comparative advantage. Indeed, the most protected industries are often those which go *against* a country's comparative advantage: industries in which a country has a comparative advantage do not need to be protected or subsidized. As a general rule, however, a revealed comparative advantage number greater than one would indicate that country has a comparative advantage in a sector.

The number of people employed in services is increasing in all regions, and is positively correlated to national income.

Figure 1 shows graphically that developed countries, as a group, have a revealed comparative advantage in services (i.e., services exports from developed countries are higher than that of the world as a whole), whereas developing countries, in general, do not. India is a notable exception: their comparative advantage in services is greater than even that of the United States. In 2007, services accounted for 28 percent of U.S. exports, but only 19 percent of total world exports.[6] Thus, the United States has a revealed comparative advantage in services of about 1.5 (compared to India's 1.9).

The United States is trading according to its comparative advantage. It is the world's largest exporter of commercial services, worth $254 billion in 2007. Although a substantial importer of services, and indeed the world's largest, the United States ran a surplus in services trade of $120 billion in 2007. Moreover, America's imports of services are growing at a slower rate—9 percent—than its exports (14 percent),[7] although the growth in services exports relative to imports could also reflect the 2007 and early 2008 general trend of slowing U.S. imports, as the U.S. economy slowed compared to the rest of the world and the dollar depreciated. In any case, trading according to our comparative advantage is good news for American workers: the average wage in service-providing industries is higher than the average wage in manufacturing industries.[8] And research by the Office of the United States Trade Representative has shown that to be especially true of wages in services export industries.[9]

The largest services trade surpluses are in business and professional services, royalties and license fees for intellectual property (e.g., music and films), financial services, and education.[10] The largest deficits in services are in insurance (as U.S. firms pay European and Bermudan reinsurers to assume some large risks) and transportation, largely accounted for by the deficit in manufactured goods: more goods need to be transported into the United States than out of it.[11]

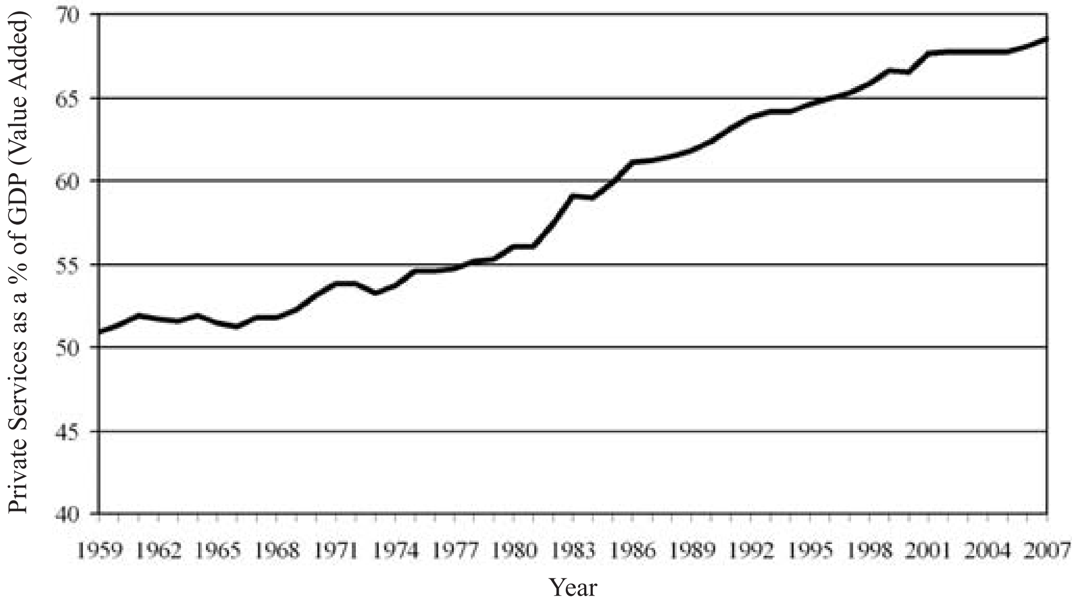
There are a number of reasons for the global growth of the service sector. First, the world is getting richer, and generally the service sector grows as a percentage of GDP as economies develop. A large and vibrant service sector is a sure sign of a prosperous economy. Figure 2 shows private sector services as a percentage of GDP (value added) in the American economy, growing from about 51 percent in 1959 to 68 percent in 2007. Although by no means a necessary progression, the "three-sector hypothesis" of economic progression predicts that an economy will be based mainly on the primary sector of the economy (agriculture and the extractive industries) in the early stages of development, and then an increase in economic activity in the secondary sector (manufacturing) will continue until the economy is dominated by the tertiary sector (services).[12] A dynamic private service sector is a sure sign of growth.

Table 1 shows the composition of employment in various regions of the world, and how that composition has changed over the last decade. The number of people employed in services is increasing in all regions, and is positively correlated with national income. Employment in the agricultural sector has continued its natural decline.

The second reason the services industries are growing is that there are simply more types of tradable services today than there were previously. The Internet was almost unheard of two decades ago, and yet the U.S. Internet service providers, web search portals, and data processing sector employed over 355,000 people in 2007.[13] Marketing and advertising jobs, unwarranted in subsistence economies or those dominated by commodity goods, are likewise more prevalent in complex capitalist economies. Similarly, as people grow richer they are able to outsource jobs such as landscaping to the market sector, whereas previously homeowners would have tended their lawns themselves.

Third, technological progress—particularly in transportation, communications, and information technology—facilitates trade in services across borders (and even oceans) by lowering transaction costs. The phenomenon of outsourcing data processing, call center support, and even X-ray reading work has only become viable now that international telecommunications and information exchange is relatively inexpensive. Cheaper air travel makes international business trips or extended assignments abroad easier and more profitable.

Figure 2
The Importance of Services in U.S. GDP



Source: Bureau of Economic Analysis, Gross-Domestic-Product-by-Industry Accounts, April 29, 2008, www.bea.gov/industry/gpotables/.

Table 1
World and Regional Estimates of Employment by Sector (% of Total Workforce)

	Agriculture		Industry		Services	
	1996	2006	1996	2006	1996	2006
World	41.9	36.1	21.1	21.9	37.0	42.0
Region						
Developed Economies and EU	6.2	4.2	28.5	24.7	65.3	71.2
Central and South Eastern Europe (non-EU) and CIS	27.2	20.3	28.7	25.8	44.1	53.8
East Asia	48.5	40.9	24.3	25.6	27.2	33.5
South-East Asia and the Pacific	51.0	45.4	16.5	18.6	32.5	36.0
South Asia	59.7	49.4	15.2	21.0	25.1	29.6
Latin America and the Caribbean	23.1	19.6	20.7	20.8	56.1	59.6
North Africa	36.5	34.4	19.8	20.0	43.7	45.6
Sub-Saharan Africa	74.4	65.9	7.5	10.0	18.1	24.1
Middle East	21.1	18.1	25.2	25.6	53.7	56.3

Source: International Labour Organization, "Key Indicators of the Labour Market," fifth edition. International Labour Office, September 2007, www.ilo.org/public/english/employment/strat/kilm/index.htm.

Even private tutoring, based on a business model stressing personal attention, has become an online and cross-border business thanks to the growth of the Internet.[14] Service growth and development begets more service growth and development.

Of course, the ease with which some services can now be traded across borders has brought new concerns in some quarters. The possibility that previously nontradable services, like data processing, are now able to be outsourced to ser-

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Increased trade in services is likely to benefit the United States, and fears about mass job losses are unfounded.

vice providers overseas has led to significant fears about "offshoring." But research suggests that the theoretical potential for offshoring overestimates what will eventually be offshored in practice: in a 2007 interview with the *Wall Street Journal*, Alan Blinder suggested that up to 40 million jobs in the United States could potentially be offshored in the next 10 to 20 years.[15] In remarks to the Peterson Institute of International Economics in January 2008, however, Dr. Blinder made clear that those figures refer only to the upper bound of "offshorability," and that the actual number of jobs that are tradable in practice are likely to be lower.[16] The economist Brad Jensen concurs, and at the same forum presented a paper that suggested America's comparative advantage in skilled services is likely to benefit U.S. service workers and firms through increased export opportunities. Dr. Jensen suggests that only about one-third of potentially tradable service jobs will be offshored in practice, and that the United States will gain through the "onshoring" of high-wage, high-skill jobs.[17] While about 40 percent of manufacturing jobs are at risk of being offshored, these job losses will be offset by job gains in the higher-paying, higher-skilled services sector, which will grow as a result of trade. In other words, increased trade in services is likely to benefit the United States, and fears about mass job losses are unfounded.

The fourth factor in services growth, the deregulation of prominent services sectors in developed countries (such as the 1970s deregulation of railways in Britain and airlines in the United States) has exposed those markets to greater competition. Although there is much room for improvement (and many service sectors will probably remain nontradable), the deregulation of the transportation and telecommunications sectors in developed countries and increasingly globalized supply chains have increased the scope for the international flow of services. The growth of the middle class in developing countries offers much promise for developed-country firms that sell services such as banking, which is a largely open and mature sector in developed countries, but is ripe for growth in countries such as India, where most citizens who are not involved in priority sectors such as agriculture must rely on informal moneylenders for credit.

Fifth, the inclusion of services trade in the Uruguay round of multilateral trade negotiations and other services trade liberalization efforts has undoubtedly contributed to more freely flowing services across borders. Certainly service industry groups, whose concerns are given low priority by trade negotiators, have much to be frustrated about—but progress is being made.

Services Liberalization is a Work in Progress

What explains the relatively low attention given to services trade, given its economic importance? It is partly a response to its difference from goods trade, where the products and issues involved have been familiar to trade negotiators since their inclusion in the General Agreement on Tariffs and Trade in 1947. Services, on the other hand, were only integrated into the GATT/WTO architecture in 1994. Trade negotiators, when analyzing the tariff and subsidy cuts on offer, use detailed analyses of members' lists of tariffs to estimate the effects of tariff-cutting formulae on imports, exports, and tariff revenue. These economic effects are relatively transparent and easy to analyze using standard economic tools, which, by definition, apply directly only to foreign goods.

Services, on the other hand, face relatively few—if any—of the conventional border measures such as tariffs and quotas that plague merchandise goods trade. In fact, quantitative restrictions on the number of service suppliers or the amount of output are explicitly banned under WTO rules.[18] Instead, domestic regulations behind the border exert a far stronger impact on services trade flows. The difficulty of converting the economic effect of these regulations into "tariff equivalents" makes their effect more difficult to measure because regulations often apply to domestic and foreign service providers alike, and the import-discriminating effect of the policy is difficult to judge.

The relative lack of clarity about the effects of services trade restrictions is compounded by the lack of data on services trade flows (sometimes called "invisible trade").[19] Although there

are far fewer categories of services than the number of goods—the typical tariff schedule identifies thousands of goods and yet services sectors are generalized in about 10 to 30 different types, depending on the degree of disaggregation—the data on services are not as comprehensive as those for goods.

The only collection of global statistics on services trade is done by the International Monetary Fund, based on balance-of-payments data. The data collected do not neatly fit into the classifications used by the WTO to distinguish between different ways of delivering services. For example, balance-of-payments data do not distinguish between cross-border supply and consumption abroad, which are separate modes of supply according to the WTO. The International Monetary Fund considers that a firm or person is a resident after one year, and so it does not count transactions between the firm or person and their host country as "cross-border" after that time. Customs agents cannot observe and record service flows across borders like they can with goods—perhaps that is good news for free trade, but it adds to the data gap.

Despite these obstacles, efforts to reduce barriers to services trade continue. As is the case with goods trade, many benefits of services trade liberalization are available to countries that autonomously open their markets to overseas providers. In the context of reciprocal trade agreements, however, the general and longstanding debate about the relative merits of multilateral versus bilateral or regional trade liberalization agreements extends to services trade. Services are a relative newcomer to trade agreements, and first became a part of regional trade agreements in the early 1990s, forming part of the WTO architecture only in the last completed round of trade negotiations. Since then, however, it appears that services trade liberalization is easier to achieve through "agreements of the willing" rather than in the multilateral setting of the WTO.

Services in the World Trade Organization: Slow Going

Trade in services in the WTO is governed by the articles of the General Agreement on Trade in Services and the specific lists of commitments (called "schedules") in services submitted by WTO members. Unlike negotiations in agricultural and industrial goods, which are largely driven by negotiations about tariff reduction formulae that are to be applied to all (or most) products, WTO members negotiate the opening of services markets through a process of requests and offers. Those offers are then "bound" (unless explicitly left unbound) in the sense that members may not increase restrictions or impose new ones on foreign service providers, thus giving a degree of commercial certainty. New commitments can be added, or existing commitments improved, at any time so long as they increase market access. The GATS also commits members to continue reforms through successive negotiations on further liberalization.

While the GATS has not so far generated significant liberalization (partly because it is a relatively recent addition to the multilateral trading system), much promise lies in its framework and broad principles, including national treatment and most-favored-nation (MFN) provisions. That is, foreign service providers should be afforded treatment no less favorable than domestic providers, and all WTO members should receive equal treatment.

Countries usually include two types of restrictions in their services schedule: "horizontal" limitations (e.g., those that require all natural persons to apply for a working visa before entry), which refer to limitations on all sectors listed in the schedule, and sector-specific deviations from MFN and national treatment. Members are free to list exemptions from MFN treatment, for example by giving preferential treatment to one of its trade partners.

Most WTO members have listed their services commitments in the GATS using what is known as a "positive list" approach. Under that principle, only those services explicitly recorded as such will be liberalized according to the terms of the agreement; unlisted sectors are assumed to be closed. The services industry is rapidly changing because of advancements in technology and consumers' evolving tastes, therefore, ongoing negotiations are crucial under a positive-list approach in order to cover

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Services liberalization through the WTO may unlock the Doha round talks.

newly invented sectors or service types. A "negative list" approach, on the other hand, presumes that new sectors will be traded freely and is therefore preferable: any markets for newly invented services are automatically open.

In the WTO, services are categorized according to four "modes" of delivery. (The WTO views trade as occurring between countries across political borders, rather than between private actors.) Mode 1 (cross-border supply) refers to services supplied from one country to another, such as international telephone calls and call-center operations. Mode 2 (consumption abroad) occurs when nationals of one country consume the service in another; tourism is the most obvious example. Mode 3 (commercial presence) is when a firm originating in one country sets up a subsidiary or foreign branch in another, as in banking operations, through foreign direct investment. Mode 4 (presence of natural persons) is when nationals of one country travel to another to supply a service; for example, accountants traveling outside their home country for a stint working abroad.

Granting temporary entry of professionals is the most contentious form of service supply because it is essentially dealing with immigration (albeit temporary): some politicians think that the issue should not be included in trade pacts. Barriers to the temporary movement of workers are more stringent than those on other modes of supply. That may account for the relatively small proportion of services trade that WTO researchers estimate is delivered through Mode 4, as shown in Table 2.[20]

The GATS is far from being a "free-trade agreement in services." Government services, for example, are excluded from GATS coverage and are not covered by its disciplines, and there is no compulsion to open government services to foreign competitors under its terms.[21] Air transport, an important service sector, is at present largely excluded from WTO commitments, although many bilateral agreements on air transport services are in force. Most services relating to water distribution, water supply, and energy exploration and ownership are excluded. Therefore, true liberalization has thus far been scant. As a World Bank working paper says, "Virtually all existing GATS commitments . . . reflect a binding of the status quo rather than liberalization."[22] The failure to conclude the Doha round of trade negotiations has not helped on that score.

That is ironic, because services liberalization through the WTO may unlock the Doha round talks: the European Union and United States have indicated that improved access to other members' services markets are necessary for them to improve their offers on agricultural market access and domestic support (i.e., subsidies). In a meeting with WTO Director-General Pascal Lamy in August 2008, the Coalition of Service Industries made clear that its export interests lay in Malaysia, Thailand, and especially, Indonesia. At the same meeting, the coalition also indicated that liberalizing rules on commercial presence (Mode 3)—for example, increasing the equity holdings that U.S. companies could own in firms abroad—was the main vehicle through which it wanted to access markets abroad.[23] The U.S. Trade Representative has publicly entreated U.S. trade partners to lower their barriers to financial services, legal services, telecommunications, express delivery and logistics, energy services, environmental services, and higher education.[24] In turn, countries such as India are asking for improved access in Mode 4—that is, the temporary cross-border movement of labor. Several African countries have also indicated that Mode 4 liberalization is necessary for them to sign off on a deal, too.

The United States Trade Representative office has made it clear that it has very little if any interest in increasing its offer on temporary foreign workers, and indeed it questions the emphasis that developing countries have placed on increased access for their people to work in the United States: "It's hard to understand the urgency of the developing country request [on new temporary entry commitments] with respect to the United States, since our existing temp entry commitments are among the most generous of all WTO members in terms of entry categories covered and the fact that they apply to all services sectors where we have commitments."[25] The only offers the United States has made in Mode 4 are to increase the clarity of procedures for admitting temporary workers

Table 2
International Service Trade by Mode of Supply, 2005

Mode of Supply	Category	Share (%)
Mode 1	Cross-border supply	25–30
Mode 2	Consumption abroad	10–15
Mode 3	Commercial presence	55–60
Mode 4	Presence of natural persons	Less than 5

Source: World Trade Organization.

and to increase the amount of information about the program on the Internet. In any case, WTO members may have to give access to temporary workers on a non-MFN basis because migration flows require some level of cooperation between immigration authorities, which may differ from country to country.

In addition to the multilateral GATS, the WTO is the custodian of certain auxiliary agreements that are products of negotiations between a subset of WTO members conducted in the immediate aftermath of the Uruguay round's conclusion in 1994 in an attempt to increase liberalization commitments in certain service sectors. The Understanding on Commitments in Financial Services was entered into force in 1997 in order to facilitate special liberalization in financial services, such as banking and securities services.[26]

Negotiations to increase liberalization of international shipping and other services and the use of ports were less successful. Slated for conclusion by July 1996, the negotiations (to which the United States was a party) failed, and were eventually relaunched and then subsumed into the general negotiations on services as part of the suspended Doha round. Similar negotiations on basic telecommunications services were, however, successful and the 69 mainly developed countries (including the United States) who signed the Agreement on Basic Telecommunications Services agreed to increased market access through commercial presence (Mode 3) and cross-border supply (Mode 1). So, negotiations through the WTO have not been a complete waste of time.

The Relative Success of Bilateral and Regional Trade Agreements

Although they are in some significant ways inferior to multilateral trade liberalization agreements, bilateral and regional trade agreements can lower prices for consumers and lead to significant market openings in covered sectors. In fact, the North American Free Trade Agreement was a pioneer in this area, being the first trade deal to introduce comprehensive services trade liberalization.[27]

In contrast to the positive listing approach in the GATS, the services sections of the bilateral and regional agreements signed by the United States (most of them modeled on NAFTA) employ the negative listing approach. A recent study by the Organization for Economic Cooperation and Development has shown that the trade agreements signed by the United States in recent years, inspired by NAFTA, have led to more liberalization than GATS-inspired regional agreements (i.e., those that employ a positive listing approach).[28] That is to be expected, since WTO members are bound to liberalize a "substantial" number of sectors and to provide for "the absence or elimination of substantially all discrimination" in the covered sectors in their preferential trade agreements.[29] In order to comply with WTO rules, preferential trade deals need to provide for more market openings than does the GATS itself.

The United States has achieved modest liberalization in some areas through major bilateral and regional trade agreements, but the commitments made by the parties often go beyond that which has been achieved in the WTO and thus represent increased opportunities for

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American firms, workers, and consumers. The U.S. International Trade Commission recently noted that U.S. preferential trade agreements often provide additional regulatory transparency and, in some cases, have even involved the modification of national regulatory regimes that were impeding services trade.[30] Many restrictions remain in place for licensing and qualifications for certain workers (e.g. citizenship or residency qualifications), including psychologists, teachers, and even (in the case of the agreement with Nicaragua) toxic waste handlers. But in audiovisual, insurance, education, finance, and road transport sectors (NAFTA), progress has been made beyond that which could have been achieved through the WTO alone.

Other bilateral agreements not related to broader trade pacts have managed to improve market access where the WTO has not even managed to begin negotiations, particularly in airline competition. The United States has signed bilateral aviation agreements with over 90 countries.[31] Most notably, the EU–U.S. Open Skies Agreement came into effect in March 2008, and allows any airline of the European Union and any airline of the United States to fly between any point in one region to any point in the other, and for airlines of the United States to fly between points in the European Union (a reciprocal right was not given to EU airlines to operate between points in the United States). An agreement with China on liberalized air transport came into effect in July 2007.[32]

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Must Try Harder

The degree of openness in the United States varies by sector. Banking and insurance, for example, are relatively open. In retail, most remaining barriers are in the area of commercial presence (i.e., the setting up of affiliate firms), since for now Internet-based retail is still relatively small. At the federal level, professional and business services are quite open to foreigners, as are entertainment services. But significant barriers remain.

An indication of the effect of U.S. regulations on services is shown in Table 3. The data are from a joint project by the Australian National University and the Australian Productivity Commission that measures restrictions on trade in services for a number of regions.[33] The researchers have converted information about a country's regulations into a "restrictiveness index." The more restrictions and the greater their severity (as measured by weightings), the higher the index number is.

Notwithstanding the WTO's goal of treating domestic and foreign service providers identically, in some cases domestic and foreign firms face different regulations, or else the same regulations place different (usually more onerous) requirements on foreign firms. The degree of discrimination (i.e., the extra burden that falls on foreign firms) can be derived by subtracting the foreign restrictiveness index number in a sector from the domestic restrictiveness index number. Of course, regulations that restrict competition and entry of new firms in the domestic sector exclusively are of concern, too, but they are not the primary focus here.

In the second step, the researchers estimated the effect of the regulations on prices and costs using an econometric model. The price/cost index thus measures the extent to which regulations confer a price advantage on, or add to the costs of, firms in that industry, allowing them to collect economic rents over and above that which would occur in the absence of regulations (or, in the case of raising costs, add to the price paid by consumers of that service, assuming the higher costs can be passed on). It can be thought of as a tax equivalent of the price or cost effect of restrictions in that service sector.

Combining these two indices gives an indication of the total cost borne by consumers of these services as a result of import discrimination. For example, a service sector that had a high trade restrictiveness score (indicating discrimination against foreign service providers) and a high price/cost index score would suggest that the sector would benefit from liberalization. A service sector with low trade restrictiveness and price/cost scores would suggest that a sector is fairly open, and the firms involved do not collect significant rents compared with a no-regulation scenario.

Table 3
United States Restrictions on Foreign Service Providers and Cost Effects

	Trade Restrictiveness		Price/Cost Effect Measures	
	Foreign-Domestic Index	U.S. Rank	Tax Equivalent	U.S. Rank
Maritime	0.43	3 of 35	N/A	
Legal	0.24	16 of 29	N/A	
Distribution	0.16	11 of 38	2.30%	6 of 18
Architectural	0.11	29 of 41	N/A	
Engineering	0.08	20 of 34	3.60%	10 of 20
Banking	0.06	35 of 38	4.80%	36 of 38
Accountancy	0.02	34 of 34	N/A	
Telecommunications	0.00	115 of 136	0%	115 of 136

Source: Author's calculations, based on data from Productivity Commission Studies, 2000.

To help judge how restrictive the United States is compared to other countries in the survey, the rank of the United States appears next to the sector, with a high ranking indicating a less open market (not all countries appear in all indices because of data availability). For example, in maritime services the United States has the third-most restricted market out of 35 countries surveyed. U.S. distribution services and legal services are mid-ranking in efficiency. The United States' regime appears to be the least regulatory in accountancy services. Keep in mind that because rankings show U.S. performance relative to other countries in the survey, the United States may rank relatively well in terms of openness (e.g., in banking) and yet still impose a relatively high tax equivalent of firms in that industry. The U.S. record is mixed at best. For a country that aspires to be the world's most competitive and dynamic, further reforms are needed.

Benefits to Developing and Developed Countries Alike

Although developed countries are the source of many global services firms, the benefits of opening up service markets do not depend on a country's level of development: rich and poor nations can profit. A mercantilist would suggest that only developed countries gain from pursuing open services markets because of their export interests and capacity. But a number of studies have shown that unilaterally liberalizing services can bring enormous benefits to developing countries, too, especially where trade in services involves the spread of technology. While the extent of gains depends on the initial level of regulation and subsequent opening, World Bank economist Aaditya Mattoo and his colleagues found that countries with fully open telecom and financial services sectors grow at a rate of up to 1.5 percentage points faster each year than do other countries.[34] Compounded over a couple of decades, that would make a huge impact on living standards.

It is clear, then, that remaining impediments to growth of services trade are also a limit on economic growth in general. Brown, Kiyota, and Stern (2005), using the Michigan Model of World Production and Trade, find that a completely free global trade in services would increase global GDP by $1.661 trillion (or about $250 per person)—more than 31 times the estimated $53 billion in gains that would come from complete liberalization of agricultural trade, and more than twice the gains from free manufacturing trade ($700 billion). The United States would capture $466 billion of the gains from free services trade, equivalent to about $4,500 per U.S. household.[35]

So, how to capture those gains? In many senses, services trade liberalization and the benefits that flow from it will come automatically where government does not get in the way of

Unilaterally liberalizing services can bring enormous benefits to developing countries, especially where trade in services involves the spread of technology.

Domestic transportation is an obvious early candidate for reform, because so much of it remains relatively closed.

new businesses and technology. As economist Jeffrey Sachs recently noted, "The digital divide [between developed and developing countries] is ending not through a burst of civic responsibility, but mainly through market forces."[36] But there are still some areas where governments can take positive steps to eliminate harmful regulations and special favors to domestic interest groups, and where they can encourage other governments to open their markets to services imports. In fact, most of the remaining barriers to services trade are regulatory rather than explicitly trade related. Thus, there is a limit to the ability of negotiated trade agreements to achieve liberalization without also implementing unilateral regulatory reforms.

The U.S. market for most services is already relatively open, and its exports in many sectors are globally competitive. In telecommunications, for example, American firms make up 3 of the 10 largest global firms by revenue and have their eye on the fast-growing developing countries in the Asia Pacific region, Latin America, the Middle East, and Africa, where market penetration rates are low and regulatory barriers to new entrants are relatively high (e.g.,, many governments jealously guard the issuing of licenses to mobile operators and limit foreign ownership).[37] American trade negotiators are thus usually motivated by a mercantilist mindset and are keen to promote services chapters of preferential trade agreements. They have also been key proponents of WTO agreements that promote further services trade liberalization in other countries.

To the extent that trade negotiators are able to encourage reform abroad, the Coalition of Services Industries, a U.S.-based trade group, identifies five main impediments where the Office of the U.S. Trade Representative should focus its efforts:

- foreign equity restrictions that limit the investment opportunities for foreign firms and the inflow of foreign capital so helpful to the growth of domestic firms (e.g., the 26 percent cap on foreign ownership of insurance firms in India);
- market entry requirements such as high capital requirements that impose a heavy burden for would-be services exporters (e.g., those stipulated for telecommunications firms in China);
- exacting requirements on the form that investments should take when establishing a business, which limit a firm's flexibility and business development (e.g., the economic needs test in Malaysia that allows the government to reject applications, such as those for additional bank branches if the market is deemed to be "saturated");
- regulations that are not "national treatment" compliant, and instead discriminate against foreign firms; and
- unpredictable and unclear implementation of regulations and licensing approval processes that generate a lack of commercial certainty.[38]

We have already seen that the United States, while by no means the most protected services market, can make some improvements of its own. Professional services (accounting, legal services, architecture, and engineering) are to a large extent regulated by the individual states. Although consistent with federalism and the principle of most-devolved jurisdiction, this makes importing to the United States difficult when state-level regulations are vastly different or cumbersome, although in practice there is much commonality between many states' provisions.[39] The United States maintains horizontal discriminatory restrictions on the temporary entry of workers into the United States, on the ability of foreign entities to acquire federal land (and, in some states, private land), on differential taxation measures, and the ability of noncitizens to receive government subsidies and loans.

Domestic transportation is an obvious early candidate for reform, because so much of it remains relatively closed. While American banks, telecommunications, logistics, and express delivery firms are world-class, U.S. rail, road, and air transport industries remain protected, with a predicable effect on costs and competitiveness: although faring well on infrastructure, logistics competence, and other measures of getting goods

quickly to market, the United States ranked a woeful 144th place in domestic logistics costs on a recent global survey of logistical performances.[40]

A lack of domestic freight-rail competition and restrictions on cross-border trucking beyond limited border zones is responsible for much of the low ranking. Antitrust exemptions for railroad firms have led to a high concentration of firms in the railroad services industry, leaving American firms with an expensive service and an unattractive environment for foreign investors.[41] Domestic transport costs are an estimated $200 million to $400 million higher than they would be if the current ban on Mexican trucks on U.S. roads were lifted. That ban remains in place outside of a narrow commercial zone just north of the U.S.–Mexican border, despite NAFTA provisions to grant full access and even though the safety fears of the Teamsters have proved to be unfounded—in 2005, fewer Mexican trucks were deemed out-of-service as a result of failed inspections than American trucks.[42] As the U.S. International Trade Commission argues, allowing Mexican trucks to haul goods within the United States would allow Mexican truckers' wages to rise, and U.S. trucking firms to benefit from lower investment restrictions in Mexico.[43]

Allowing foreign-owned or foreign-operated aircraft to fly domestically (i.e., within the United States) is still barred, even as the government has made impressive efforts to allow foreign airliners to land in American airports. Under the Fly America Act, U.S.-government-financed transport of passengers or cargo is allowed only on U.S. air carriers, similar to the restriction on maritime transport. Allowing a more competitive air service industry would bring benefits to consumers of air transport service, as well as to taxpayers. Indeed, a study available from a link on the U.S. State Department's own website touts the benefits of the 1978 (partial) deregulation of the U.S. airlines market and the gains that have emerged from the EU Single Aviation Market:

> The creation of the Single European Aviation Market in 1993 led to an average annual growth rate in traffic between 1995 and 2004 that was almost double the rate of growth in the years 1990 to 1994. This produced about 1.4 million new jobs.[44]

Presumably, similar benefits would flow from opening the U.S. airline market to overseas competition.

In addition to opening up the woefully protected land and air services industries, maritime transport is one area where the government could immediately save consumers and taxpayers some money. The Merchant Marine Act of 1920 (commonly known as the "Jones Act") stipulates that all cargo shipped between U.S. ports be carried on U.S.-built, U.S.-operated, and U.S.-owned vessels, in order to protect the domestic shipping industry from foreign competition and to encourage the viability of the domestic shipping industry for use in times of war.

Given that a substantial part—over one-third—of U.S. water-borne commerce in 2006 was between U.S. ports,[45] the potential savings from allowing foreign ships to compete for this business would be significant. A 1995 study by the International Trade Commission estimated that the Jones Act alone costs U.S. businesses and consumers $2.8 billion annually (1995 dollars) in increased shipping costs, mainly because of the relatively high cost of domestic labor for maintenance and staffing.[46] In addition, cargo preference laws dictate that most government-owned cargo, military cargo, and most U.S. food aid must be shipped on U.S.-flagged, U.S.-built, and U.S.-operated vessels. Overall, the U.S. International Trade Commission estimates that U.S.-flagged tankers cost over $10,000 a day more to operate than do their foreign competitors, and U.S.-flagged containerships over $12,000 a day more.[47]

Unfortunately, the United States has shown little appetite for making the necessary reforms. During the 1986–94 Uruguay round negotiations, the United States successfully argued that maritime services should be excluded from national treatment rules in the WTO. That misguided intransigence has continued, with the United States walking out of post-Uruguay

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round talks that included maritime services in the GATS and refusing point-blank to make any commitments in the Doha round on maritime services. The United States should reconsider the benefits and costs of maritime transport restrictions.

The United States did not participate in the post-Uruguay round negotiations on improving commitments in the movement of natural persons. Only Australia, Canada, the European Union, India, Norway, and Switzerland offered more access than that which was achieved in the Uruguay round—agreeing, for example, to increase the permitted length of stay for a business person. One study suggests that if OECD countries were to improve access to their markets for foreign temporary workers, both skilled and unskilled, equal to just 3 percent of the labor force, the global gains (shared among the country of origin, the host country, and the migrant workers themselves) would reach over $150 billion.[48] Clearly some liberalization of the temporary movement of workers is in America's interest.[49]

Giving consumers the freedom to increase consumption abroad is a promising source of gains. For example, one study has shown that allowing health insurance to be portable abroad would save Americans over $1.4 billion a year, even if only 10 percent of American patients chose to have treatment abroad for 15 low-risk procedures.[50] There is scope for businesses and consumers to be quite creative in "unbundling" services and shopping around for the best provider.

Conclusion

It is clear that the United States has much to gain from a liberal world services trade. With much potential for growth of services exports, especially in rapidly growing developing countries, many U.S. firms are well placed to take advantage of the growing demand for services that appears, in some areas at least, to be leveling off at home. But equally there are areas of the U.S. economy that are in need of further liberalization and less government control, regardless of what other countries do to liberalize their markets.

The United States should continue to press its trade partners to lower their barriers to services imports, even if efforts so far have been frustrated. In December 2007, for example, the United States submitted a request on behalf of a number of mainly developed WTO members for increased access to the telecommunication markets of 22 other WTO members through the removal of national treatment and market access limitations and by broadening the definition of which services are covered under the "telecommunications" heading. That request was rejected by the recipient members, who even refused to bind current levels of liberalization.[51] As suggested above, however, the gains from an open telecommunications market may become self-evident and, in the end, prove too tempting to obstruct. One hopes that is the case for many other services so crucial to economic development.

So long as global economic growth and trade and demand for services that support development and the functioning of markets continue, the future remains bright for American services firms in diverse fields such as telecommunications, logistics, express delivery, distribution, and finance. But while exports will likely continue to grow largely organically despite the remaining obstacles abroad, American consumers and firms can still benefit from further reforms at home.

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