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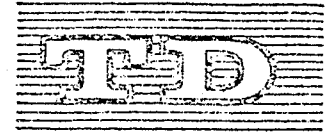
TRADE AND DEVELOPMENT BOARD
Twenty-ninth session
Geneva, 10 September 1984
Item 2 of the provisional agenda

SPECIFIC MATTERS ARISING FROM THE RESOLUTIONS, RECOMMENDATIONS
AND OTHER DECISIONS ADOPTED BY THE CONFERENCE AT ITS SIXTH SESSION
REQUIRING ATTENTION OR ACTION BY THE BOARD AT ITS TWENTY-NINTH SESSION

Conference resolution 159 (VI) - International trade in goods
and services: protectionism and structural adjustment and
the international trading system

Services and the development process

Study by the UNCTAD secretariat



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Corrigendum

Page 3

Foot-note 11 should read TD/B/1012, TD/B/1013, TD/B/1014 and TD/B/1016.

Page 14

Paragraph 61, line 18: For output required by between 75 and 77 read output
was required by 75-77.

Page 23

Paragraph 92, line 6: Delete and after services.

Page 26

Paragraph 111, line 5: For provisions read producers.

Page 28

Paragraph 121, last line: For development read development 50a/

After foot-note 50 add the following foot-note:

50a/ Transborder Data Flows and Brazil, Brazilian Case Study (ST/CTC/40),
United Nations publication, Sales No. E.83.II.A.3.

Page 41

Foot-note 102: For foot-note 126 read foot-note 122.

Page 55

Paragraph 232, line 1: For Commission officials read Commission officials 129a/

After foot-note 129 add the following foot-note:

129a/ See "The development of a Community view on international trade in services", speech by Mr. Leslie Fielding (Director-General for External Relations, Commission of the European Communities) to the Conference of the Chambers of Commerce of the North Sea Ports, London, 21 October 1983.

Page 57

Paragraph 237, penultimate line: After are used insert as a device.

Page 60

Paragraph 249, line 6: For article VI read article IV.

Annex I

Page 2

Foot-note 10, line 10: For relative size of the "informal sectors" read relative size of services in the "informal sector".

Page 6

Paragraph 24, line 1: For chapter IV read chapter V.

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* Issued separately as TD/B/1008 (Summary)

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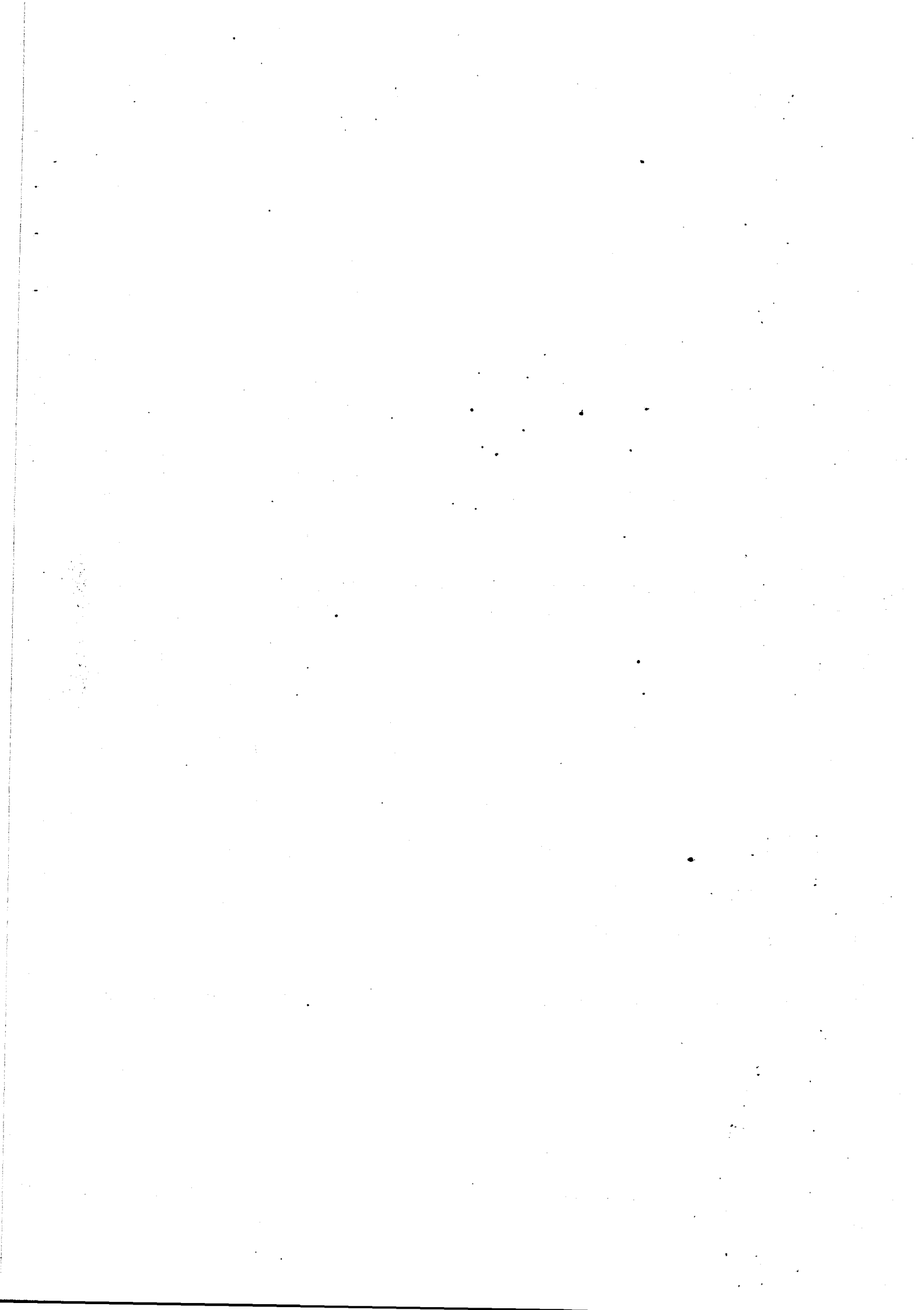
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INTRODUCTION

A. OVERVIEW

1. Since its establishment, UNCTAD has been deeply involved in specific service sectors (notably transport, insurance and financing related to trade) and in service issues related to the transfer of technology. This work has led to the negotiations in UNCTAD of certain instruments, particularly in the area of maritime transport,¹ and transfer of technology, as well as resolutions and guidelines in this and other areas. The UNCTAD secretariat has also been executing technical co-operation programmes with respect to these services, including those for the least-developed countries. Service issues have also been addressed in the context of UNCTAD's work on restrictive business practices, and are covered by the Set of Principles and Rules.²

2. UNCTAD's role with respect to services intensified in 1982 as a result of the Trade and Development Board's decision 250 (XXIV) in which it was agreed that when dealing with factors of relevance to the issues of protectionism and structural adjustment and policies influencing structural adjustment and trade, commensurate attention should be paid to services. The first study undertaken by the UNCTAD secretariat in this context was presented to the twenty-sixth session of the Board.³ In turn, this led to the overall issue of services being dealt with in the documentation presented to the Conference under the item on international trade⁴ and in the report to the Board at its twenty-eighth session.⁵ The Trade and Development Board decided in resolution 286 (XXVIII) that in its future annual review of problems of protectionism and structural adjustment, "commensurate attention should be given, in accordance with Board decision 250 (XXIV), to the situation in all sectors, including agriculture, manufactures and services...".

3. Within the United Nations system a number of organizations have been dealing with issues in specific service sectors, some of which (i.e. the International Telecommunications Union (ITU)) had been active in the area of a particular service activity long before the establishment of the United Nations. Many United Nations Organizations (e.g., International Civil Aviation Organization (ICAO), International Maritime Organization (IMO)) have responsibility with respect to certain services, while others (e.g. World Intellectual Property Organization (WIPO)) deal with issues pertinent to a variety of service sectors.⁶ Issues relating to particular services such as transport and banking, have been addressed in the context of regional and sub-regional integration movements and in regional and multilateral forums such as the Latin American Economic System (SELA) and the Organization for Economic Co-operation and Development (OECD).

¹ See for example "UNCTAD activities in the field of shipping" (TD/278 and Corr. 1).

² Multilaterally Agreed Equitable Set of Principles and Rules for the Control of Restrictive Business Practices, adopted by the General Assembly on 5 December 1980. (For the text see TD/RBP/CONF/10/Rev.1, United Nations publication, Sales No. E.81.IID.5).

³ "Production and trade in services; policies and other underlying factors bearing upon international services transactions" (TD/B/941 and Corr. 1).

⁴ "Protectionism, trade relations and structural adjustment" (TD/274).

⁵ UNCTAD secretariat report "Recent developments in the context of global trends in production and trade" (TD/B/981 (Part II)).

⁶ The Secretary-General of UNCTAD has circulated a letter to other United Nations Organizations requesting information as to their activities which could be considered relevant to a study of the role of services in the development process. The responses to this letter have been circulated in TD/B/1009, "Replies from international organizations concerning their activities pertinent to the consideration of the role of services in the development process".

4. Recently, however, countries have placed the international debate on services in an overall rather than a sectoral context.⁷ The underlying motives would seem varied, but some countries appear to be seeking to establish a multilateral framework for liberalizing regulations affecting international trade in services, as well as for facilitating foreign investment in the service sector. Certain developed countries pressed for the inclusion of a Work Programme on Services in the GATT Ministerial Declaration of 1982. While agreement was not reached on this aspect, the Declaration recommended that Contracting Parties undertake national studies on services and exchange information on such matters, *inter alia*, through international organizations such as GATT. In addition, Contracting Parties were to review the results of these examinations along with the information and comments provided by relevant international organizations at the 1984 session, and to consider whether any multilateral action on these matters was appropriate and desirable.⁸

5. The developing countries have examined service issues in various forums including the Fifth Ministerial Meeting of the Group of 77 as well as in different regional groups. In the Buenos Aires Platform the developing countries sought specifically to set up a major study programme in UNCTAD to identify and establish priorities regarding services of particular importance to developing countries and to devise a programme which would enable the developing countries to participate to a greater extent in international service transactions and to make recommendations for mechanisms for multilateral cooperation to this end.⁹

6. The consideration of service issues in a universal and interdisciplinary forum is welcome and timely. Recent technological developments have given rise to entirely new services and to interlinkages among services and between goods and services. These developments may have a revolutionary impact on the production and trade of both goods and other services as well as on world patterns of trade and development, thus justifying their examination in a universal and interdisciplinary forum where the overall trade and development aspects could be taken into account. Its timeliness also derives from the fact that there is an urgent need to reassess the development process, and the international community's commitment to that process. In this context, a detailed examination of the role of services in the development process would seem to constitute an essential component of the formulation of overall development strategies at the national, regional and multilateral levels.

7. At Belgrade, the Conference, in its resolution 159 (VI), directed the UNCTAD secretariat to continue its studies of service issues and agreed that UNCTAD would, *inter alia*, consider the role of the services sector in the development process, keeping in view the special problem of the least developed countries. The Trade and Development Board was invited to consider, at its twenty-ninth session, appropriate future work by UNCTAD on services.

8. The present study is being conducted in response to that mandate. It should be seen as an initial effort to establish a basis for considering services in a framework which is both of an interdisciplinary and a development-oriented nature. It has attempted to build upon previous UNCTAD documentation (notably TD/B/941)¹⁰ and to take into account, to the extent feasible and practicable, recent studies, publications and governmental positions on the services issues. The conclusions drawn

⁷ Services as a general issue have been discussed in such meetings as the GATT Ministerial Session, the OECD Ministerial Meeting, the Latin American Council, the Latin American Economic Conference, the Group of 77, not to mention UNCTAD VI, from whence this specific mandate emerged.

⁸ GATT Ministerial Declaration, GATT, *Basic Instruments and Selected Documents*, twenty-ninth Supplement, (Geneva, March 1983), pp. 21 and 22.

⁹ See Buenos Aires Platform (TD/285), p. 26.

¹⁰ This study assumes that the reader is familiar with TD/B/941, *op cit*, in this respect, it was not felt desirable to reproduce the statistical analysis or definitional discussion contained in that document. However, a revised and updated version of the material contained in the annex to that study will be prepared.

are of a very preliminary nature, intended primarily to provide a greater focus to the ongoing international debate, and to suggest areas for further study at the international, national and academic levels.

9. A number of background documents dealing with specific services sectors¹¹ (maritime transport, insurance, technology and transborder data flows) have also been prepared, pursuant to paragraph 22 of Conference resolution 159 (VI), which requests the Secretary-General of UNCTAD to continue his studies of the issues involved.

10. Parallel to this exercise of preparing for the Twenty-ninth session of the Board, a number of countries are conducting national studies of the role of services in their own economies both with a view to reexamining their development strategies and preparing themselves for discussions in international forums. Pursuant to Conference resolution 159 (VI), a questionnaire circulated by the Secretary-General of UNCTAD in September 1983 had the dual objective of collecting information and of stimulating the interest of governments in service issues. The UNCTAD secretariat has received requests to collaborate with other international bodies, in assisting countries, particularly the least developed countries, in the preparation of national studies on services.

B. Summary of replies of member countries to UNCTAD's questionnaire

11. At the time of writing this report, 29 replies had been received to the note/questionnaire of the Secretary General of UNCTAD.¹² All of them responded to section A dealing with statistics on production and trade in services, while only 18 countries replied to section B dealing specifically with the role of services in development. Most governments were unable to provide detailed information on the aggregated figures for certain service activities in their national accounts statistics. In the case of balance-of-payments statistics, very few countries could provide any detailed information on the composition of "other services", or on the service component in the import and export of goods.

12. Out of the 18 replies concerning section B of the questionnaire, many developing countries emphasized the need to strengthen the development of social services, such as health and education. Tourism, transportation and communications were also regarded as very important by several developing countries. Some countries made specific reference to the inter-linkage-criteria in selecting services which are pivotal to their economy. In general, external factors as well as the lack of sufficient capital were regarded as the main impediments to the development of the service industries of the responding countries. Many countries, indicated the need for an infant-industry criteria in the formulation of a services policy at the national level.

¹¹ See TD/B/1012, 1013, 1014.

¹² The following countries have responded to the questionnaire: Australia, Austria, Bangladesh, Botswana, Canada, Colombia, Chile, Cyprus, Czechoslovakia, Denmark, Finland, Guatemala, Guyana, Iran Islamic Republic of, Malaysia, Maldives, Malawi, Norway, Panama, Philippines, Republic of Korea, Saudi Arabia, Spain, Sri Lanka, Thailand, United Arab Emirates, United Kingdom, Uruguay, Yugoslavia.

CHAPTER II

MAIN ISSUES

13. This paper basically concentrates on two issues, the role of services in the growth and development of the domestic economy, with emphasis on the situation in developing countries, and issues relating to services in the international context, which may be relevant to the development process. It was also considered desirable to examine the rationale behind regulations on services, at the national and international levels, as well as to summarize the current international debate on services, in both governmental and non-governmental circles, in order to provide delegations with the background information to facilitate the deliberations of the Trade and Development Board.

14. The paper begins by recognizing that owing to the very special nature of their production processes, most services have to be produced and consumed domestically. In fact, some services even have to be consumed while they are being generated, or "rendered" (e.g., transportation, entertainment, etc.). This would account *inter alia*, for the relatively low level of "tradeable" services when compared with that of other economic activities. Out of total world production of services, only 8 per cent was "traded" internationally in 1980.¹³ Comparable figures were 45 per cent for agricultures' GDP, and 55 per cent for mining and manufacturing's GDP.

15. It is further recognized that many services play a far more important role in the development process than is indicated by their direct contribution to gross domestic product (GDP). Due to interlinkages with other activities several services generate substantial externalities which can dramatically affect the overall development performance of countries. In this context, expanding and improving the understanding of their role in the development process is of crucial importance. Traditionally, however, the main focus of development efforts has concentrated on the strengthening of the goods-producing sectors, mainly agriculture and manufactures, while insufficient attention has been paid to the tertiary sector as a whole.

16. In addition, although most services are "non-tradeable" at present, the technological changes of the last two decades are rapidly changing that situation. As a result of an improved international telecommunication infrastructure and new developments in the handling of information, many services are in fact becoming "tradeable". In addition, such changes have also facilitated enterprises in developing their operations world-wide. This has not only affected trade flows but has also opened up new opportunities to enterprises for the direct supplying of goods and services in foreign markets through foreign investment.

17. The recent international debate on services has dealt primarily with the "trade" aspects of the services question. At the same time, some confusion has been added to the discussions by attempting to treat foreign investment issues in that context. This debate has so far failed to address development issues. Both the complex linkage of many services with the rest of the economic and social apparatus of countries, as well as the rapid pace of technological change affecting the structure and import of services in the economy, requires careful understanding. As a result, international matters, such as trade and foreign investment in services, will have to be addressed from this overall development perspective. As countries become more aware of the developmental implications of alternative service policies and regulations in such a rapidly changing context, potential for coherent international co-operation in this area should develop.

18. No consistent explanation exists of the determinants of the role of services in growth and development. The so-called three step theory (Fisher/Clark theory) in which the process of development moves from agricultural production to manufac-

¹³ This figure represents non-factor services debits as a percentage share of domestically produced services.

turing, and finally to a service economy (a "post-industrial state"), appears at best a partial explanation. Recent studies have emphasized the importance of certain services as inputs into the productive process (i.e., production of goods, both industrial and agricultural, and other services), and the overall impact of "integration" or "interlinkages" among services.

19. The contribution of this latter phenomenon to growth and development is also not clearly understood. To a certain extent these are producer services, often taking the form of the so-called "new" or "information based" services, as well as more traditional infrastructural services. On the one hand, the appearance of those services may be a result of the reorganization of firms, which find that their efficiency is enhanced by contracting outside independent suppliers of such services rather than relying on their "in-house" provision. On the other hand, there would seem to be an opposing tendency of directly incorporating internally, within enterprises services founded on information-based technologies. This process has contributed to the growing capacity of firms to offer a greater variety of services and an "integrated package" of a range of services and of goods combined with services.

20. Within this context, no clear-cut relationship has been established between services and productivity. Traditionally, the shift of employment to the services sector has been seen as a "drag" on productivity growth in the economy as a whole. On the other hand, the appearance of certain services appears to provide a stimulus to the efficiency of firms and it would appear that productivity is more a result of the interlinkages among services than a contribution by individual services operating in isolation. In some cases, the service sector has also been seen in terms of employment as a "buffer" in times of recession.

21. Any serious attempt to analyse the contribution of services to growth and development must somehow overcome the problems arising from the inadequacy of statistics, especially the lack of disaggregation in national accounts. For example, the most dynamic services are lumped together in the "financing, insurance, real estate and business services" category, which constitutes a "basket item".

22. It seems unquestionable, however, that the service sector plays a different role in developing than in developed economies. While the percentage of GDP and employment arising from the services sector is comparable among developed market-economy countries, it varies, to a greater extent, among developing countries, although the overall average is lower. Figures for the socialist countries of Eastern Europe are not comparable because of differences in accounting methods.

23. It seems possible, however, to conclude that the role of the various service sectors within domestic economies differs between developing and developed countries. In particular, the "other services" category has been steadily growing in developed countries while remaining stagnant in developing countries. In addition, the existence of a large "informal" sector in developing countries, mainly devoted to the production of services, further distorts the comparability of figures.

24. Since many services are believed to play a multifaceted role in the economic development of countries, with complex interlinkage networks touching many areas of concern to the development process, studies of services in economic development need to examine such relationships. A fuller understanding of the true impact of key service industries in the overall efficiency of the economy, as well as on the ability of countries to meet important social and cultural objectives, is a necessary condition for the formulation of any coherent policy geared to improving their contribution to growth and development. Policies with respect to services have to contend with many and sometimes conflicting goals such as economic growth, employment and foreign exchange generation, national sovereignty, protection of the consumer and improvement in standards of living. The impact of different policies needs to be systematically studied at the individual country level.

25. There is an urgent need for a better understanding of the contribution of services to the development process in developing countries, not only to enable developing countries to take part effectively in the current international debate on services issues, but also, even more importantly, as part of a general reassessment

of development strategies. While such an understanding could be facilitated by more intensive study at the international level (in both governmental or non-governmental bodies), the most important contribution will likely come from examinations conducted by individual developing country governments of their own national economies. For this reason, the carrying out of national studies, as advocated by the GATT Ministerial Declaration for example, would seem to be a prerequisite for any intensification of the continuing international debate. Such national studies could be complemented by studies at the international level, such as those within UNCTAD. It would also seem desirable that specialized agencies of the United Nations system continue to focus on the development aspects of the services falling within the area of their responsibility.

26. The determinants of trade flows in services are also areas requiring further study. While some writers and governments have taken the position that the conventional trade theories apply equally to trade in goods and services, a number of economists are questioning this from an economic and conceptual perspective. More research should be encouraged, given the major contribution which such studies could make to an improved understanding of the services issue in the international context, as well as to the assessment by individual governments of the role for services in their own economies.

27. Complications also arise in the analyses of the international market for services. Such analyses have to rely largely upon balance-of-payments figures which suffer from the same, if not greater, inadequacies as those of national accounts.

28. As defined by the International Monetary Fund (IMF) for balance of payments purposes, "trade" in goods and services involves only those transactions which take place between a resident and a non-resident of a country. Only the items commonly referred to as "non-factor services" (i.e. "shipment", "other transportation", "travel", "official services" and "other private services") are considered to be traded services. Factor services (i.e. "direct investment income" and "other investment income") represent financial flows which result from payments to factors of production (capital and labour) and are not considered as constituting "trade". In respect of "non-factor" services, there is again the problem of lack of disaggregation, since the most dynamic service industries fall into the residual item. As in the case of national accounts, the improvement of "trade" statistics in services should be a matter of priority for the international community.

29. Balance-of-payments figures indicate that developed market-economy countries dominate world service credits and debits, and that some experience large surpluses on service accounts. Developing countries generally show deficits, although notable exceptions exist with respect to individual developing countries in respect of specific categories of services, often attributable to geographical and historical factors.

30. Analysis is complicated by the inclusion of factor and non-factor services in balance-of-payments statistics, and the non-inclusion of private transfers (i.e., a return on the labour factor) within the former category. In general, however, the exclusion of factor services does not alter the overall situation. However, differences do arise at the level of individual countries, for example, the United States' position is far less dominant if only non-factor services are considered.

31. The fact that many services are non-tradeable, or traded with difficulty, is one of the considerations which has led to an emphasis on foreign investment to supply certain services in foreign markets. Advances in technology, including information technologies, are increasing the "tradeability" of services. They have also facilitated the supply of services in foreign markets, thus leading to increased incentives to invest abroad in services production. From the point of view of the major suppliers of services in the world market, the transnational corporations, "trade" and "investment" (which they tend to lump together in the term "transactions") are both alternative and complementary components of their overall world market strategies. Regulations which restrict their freedom either to trade or to invest are in consequence viewed as "barriers to trade" in services.

32. Though interrelated, some governments, however, tend to view trade and investment as two entirely different questions, not to mention the third issue of labour mobility which inevitably arises in both contexts. In addition, the concept of "barriers" to trade in services may also be viewed differently. For example, rather than equating regulations with barriers, governments, in particular of developing countries, may find that restrictions on access to technology, on access to information systems or other practices engaged in by enterprises in a dominant position of market power present formidable obstacles to their participation in the international market for services.

33. The implications of the technological revolution, telematics and the increased tradeability and internationalization of services, have both economic and political dimensions. This is further supported by the fact that most of the industries in which transborder data flows are important are those which are considered to be the main growth industries of the future. Policy makers must become aware of both the positive and negative effects that telematics can have on their country's development strategy.

34. It is evident that transnational corporations are dominant suppliers of many services in the world market. While, traditionally, certain banks and insurance companies have been active on a worldwide scale, recent years have seen a rapidly accelerating process in the transnationalization of services. The result has been the emergence of corporations supplying an "integrated package" of services, or of services and goods to the world market as a whole. Often the major customers of such transnational service corporations have been other transnationals. The "life blood" of such corporations are information services and transborder data flows (e.g., telematics).

35. The dominant position of transnational corporations (TNCs) in the supply of services is based on their ownership of factors such as technology, acquired knowledge and international information networks and their easier access to capital. A greater participation of developing countries in the world market for services would seem dependent on access to these factors. The TNCs could also make a major contribution to stimulating and increasing the efficiency of key service sectors in developing countries, while, for their part, benefiting from economies of scale in their activities and a better knowledge of local conditions. It would be in such an interdependent context that an appropriate framework at national and multilateral levels should be considered, the purpose of which could be to ensure that access to domestic markets (whether through trade or investment) by TNCs is balanced by appropriate commitments on their part, for example, in the areas of transfer of technology, use of informative systems and access to foreign markets.

36. It would seem that a much greater understanding of the role of certain key services in the domestic economy of developing countries is required, as well as a clearer idea of the difficulties to be overcome in obtaining access to the world market for services. Given the dynamic role of technology, especially information technology, in increasing the tradeability of services, a much clearer idea of the effects of new technologies on service trade is also required, as well as the cost effectiveness of these technologies in order to promote a framework, both at the domestic and international level, adequate for the services and service trade of the future.

37. Attempts have been made to stimulate trade in services among developing countries on a subregional, regional and inter-regional basis, with a certain degree of success. While preferential arrangements could contribute to this process, greater attention should be given to developing an infrastructural base to promote such trade.

38. Strengthening the contribution of services to development should be a major focus of international co-operation in the years ahead. Supporting dynamic and well-balanced development of the service sector, in all countries and regions and through such means increasing trade in services, offers wide potential for multilateral co-operation. Training and research, technical co-operation, external financing (via loans, and foreign direct investment), improved labour mobility and access to transfer of technology, are just a few of the components to be included in

any multilateral effort to develop the service sector especially of developing countries, including both the "traded" as well as the "non-traded" components. Also, service trade in the international as well as in the regional contexts offers ample room for international co-operation.

Chapter III

SERVICES IN THE GROWTH AND DEVELOPMENT CONTEXT

A. The role of services in the economy: changing views

39. The conventional theory of the role of services in the economy has tended to suggest that the growth in the services sector has been a result of the development process.^{14 15} This has been explained by a number of factors, including the higher income elasticity of demand for services as compared to goods. In the industrialized countries, the process of development has been described as being composed of three main phases: (a) the "pre-industrial" phase, in which the economy is primarily extractive, based on agriculture, mining, fishing, timber and other natural resources including natural gas and oil; (b) the "industrial" phase, in which manufacturing plays the dominant role: in this phase, a significant shift occurs from agriculture to industry; and (c) the "post-industrial" phase in which the economy becomes mainly a "service economy". In addition, this theory stressed the inherent low productivity of the service sector. The shift of employment from the manufacturing sector to that of services was seen as contributing to a loss in productivity growth for the economy as a whole, a "drag" on the economy, which explained to a large extent the slowing down of growth in the main industrial economies during the 1970s.

40. The implication of this conventional theory was that (a) growth in the services sector (in employment and GDP) would occur automatically, as a result of the process of development, mainly due to higher *per-capita* incomes, (b) there was no need for a services policy, or any policy measures to encourage the expanding of the services sector, in fact, such expansion might even be undesirable as it could reduce productivity and lead to a deceleration of the development process, and (c) a logical international division of labour would emerge with developed countries specializing in the production of services and developing countries in the exporting of goods.

41. Recent analyses, however, have called this theory into question. First, the idea that the growth in services production and employment was led by the demand created by higher personal incomes has been qualified by studies showing that during the 1960s and 1970s, changes in the occupational distribution of employment have resulted more from changes in occupational structure within economic sectors than from changes in demand patterns between them. These studies also showed that increased demand for professional, technical, clerical and other specialized service occupations relative to other employees within each sector accounts for much more of the increase of employment in these types of occupations than does the increase of demand for the products of services industries.¹⁶

¹⁴ The question of the role of services in the economy has been addressed as far back as Adam Smith and Fredrick Lutz. The major contribution to the theory, however, has been made by Allan Fisher (see "Capital and the Growth of Knowledge", *Economic Journal*, September 1933. Other references include: *The Clash of Progress and Security*, London, MacMillan, 1935; "Primary, Secondary and Tertiary Production", *Economic Record*, June 1939; *Economic Progress and Social Security*, London, MacMillan, 1945) and Colin Clark, *The Condition of Economic Progress*, London, MacMillan, 1951.

¹⁵ Other more recent contributions have included Simon Kuznets: *Modern Economic Growth: Rates, Structure, Spread*, Yale University Press, New Haven, 1966, pp. 96-97 and *Economic Growth of Nations*, Cambridge, Harvard University Press, 1971; Fuchs, V.R., *The Service Economy*, National Bureau of Economic Research, New York, 1968 and *Production and productivity in the service industries*, New York, National Bureau of Economic Research, Inc., Studies in Income and Wealth, Vol. 34, 1969.

¹⁶ J. Gershuny and I. Miles, *The New Service Economy*, Frances Pinter, London.

42. Other studies have emphasized the growth of producer services. It has been observed, for example, that firms have recently been undergoing a process of reorganization, not only in terms of adjustment to changing economic conditions but, more importantly, to technological innovations in the informatics area. This process has involved what has been a double movement of externalization and internalization of services¹⁷ On the one hand, firms were divesting themselves of non-productive "in-house" services relying on outside contracts, a process which has led to the creation of independent service firms. On the other hand, firms were incorporating new, information-based services within their own structures and were diversifying the services they could provide to customers.¹⁸ The establishment of information networks enables firms to widen the range of service offered.¹⁹

43. A recent study of this process in the United States economy, concludes that the "tertiary economy" cannot be reduced to the idea of a "service" or a "post-industrial" economy, and observes that "productivity" has become less and less adequate as a means of measuring the efficiency of an economy. This "efficiency" depends, to an ever increasing extent, upon the interlinkages which are established among the different productive activities, and not only the productive conditions in the activities themselves.²⁰

44. In some developed countries, while employment in the manufacturing sector dropped sharply during the recent decline in world economic activity, employment in the service sector continued to grow, albeit at a reduced rate.²¹

45. The increasingly rapid pace of technological development faces national planners in developing countries with a difficult range of choices in regard to the pace at which these technological advances should be accepted or promoted. Different societies will adapt at different rates to the realities of "informatics" as the dominant component in new services.²² To some extent the results of research and development can be imported from the industrial countries which are responsible for most basic research and product development. On the other hand, without broadly based, thoroughly staffed research and development cadres spread broadly through the industrial structure, developing countries are unlikely to make significant progress.

46. The impact of the application of the new technologically advanced services to the production of goods and other services could well reduce labour-cost per unit of output and thus, undermine the competitive position of developing countries in the production of labour intensive goods and services. Data has been collected to show that this effect is already evident in regard to the production of textiles

¹⁷ Robert B. Cohen, "Research into the Service Economy at the Corporate Level", Columbia University, September 1979.

¹⁸ Mark Stevens describes this process with respect to the major US accounting firms in *The Big Eight*, New York, Macmillan, 1981. It has also been studied by the United Nations Centre on Transnational Corporations (UNCTC) with respect to advertising agencies in "Transnational Corporations in Advertising" (ST/CTC/8), United Nations Publication, Sales number E79:II:A2.

¹⁹ A pertinent example is the manner in which supermarket chains have used the data network established for inventory control, to support a variety of other service activities (e.g., travel).

²⁰ Anton Brender, Agnes Chevallier and Jean Pisani-Ferry, *Etats-Unis: croissance, crise, changement technique dans une économie tertiaire*, CEPPII, Paris 1980. This debate continues, see International Herald Tribune, 27 June 1984, article by Leslie Wayne which implies that recent recovery of the United States economy can almost entirely be attributed to growth in the service sector.

²¹ U.K. Ranga Chand, "The Growth of the Service Sector in the Canadian Economy", *Social Indicators Research*, No. 13 (1983), D. Reidel Publishing Company.

²² For an important early discussion of these issues, see Nathan Keyfitz: "The Interlocking of Social and Economic Factors in Asian Development", *Canadian Journal of Economics and Political Science*, XXV, No. 1, Feb. 1959.

and clothing.²³ Given that this competitive advantage is likely to be further reduced as a result of the adoption of new technologies in the developed countries, developing countries may well be required to reexamine certain aspects of their trade policies and development strategies.²⁴

2. Production and services in developed and developing countries

47. The service sector accounts for the largest share of GDP in most countries.²⁵ Its share in 1979 ranged from around 40 per cent in least developed countries to almost 67 per cent in developed market-economy countries. Moreover, the variation in the share of the service sector amongst country-groups is much smaller than in the case of agriculture and industry. The share of agriculture ranged from 4.0 per cent for developed market-economy countries to 49.0 per cent for least developed countries, while the combined share of manufacturing, mining, construction and utilities ranged from 9.3 per cent for least developed countries to 45.7 per cent for oil-exporting developing countries.²⁶

48. While there may be less of a difference in the aggregate size of the service sector between country groups, there are clear distinctions when this sector is viewed on a disaggregated basis. Two services industries, "trade and finance" and "other services", are most noteworthy in this regard. "Trade and finance" is the largest service activity in developed and developing countries alike. However, while this activity as a share of total services has remained relatively constant throughout the 1970s at 44.7 per cent to 44.4 per cent in developed market-economy countries, it has grown in developing countries from 44.6 per cent to 50.6 per cent. On the other hand, the category "other services" has shown a completely different trend. The share of these activities has increased in developed market-economy countries from 26.4 per cent (1970) to 28.0 per cent (1979). The share in developing countries as a whole, however, has declined from 26.4 per cent (1970) to 19.2 per cent (1979).²⁷

49. A cursory look at the available data therefore reveals the following points. First, the size of the service sector is large and growing in both developed and developing countries alike. Moreover, its share of GDP does not appear to vary significantly between country-groups, an observation which appears to be in contradiction with the "three-stage" theory of development which suggests that the ser-

²³ See discussion in Juan F. Rada: "Advanced technologies and development: Are conventional ideas about comparative advantage obsolete?", *Trade and Development - An UNCTAD Review*, No. 5, 1984 (United Nations publication, Sales No. E.84.II.D8):

²⁴ In fact, the so-called "new services" are believed to be the conditioning element behind the global international competitiveness of industrialized economies. See Jacques Nusbaumer, *Les services: nouvelle donne de l'économie*, Paris, Ed. Economica, 1984, p.34.

²⁵ Services are generally defined as consisting of all economic activities excluding agriculture, mining, manufacturing, construction and electricity, gas and water (utilities). Based on the International Standard Industrial Classification of All Economic Activities (ISIC), services, therefore, consist of trade and finance, transport and communication, public administration and defense, and other services. This last catch-all category includes a vast array of activities including educational services, medical and other health services, religious organizations, welfare institutions, legal services, business services, motion picture production, distribution and projection, domestic services, restaurants, hotels, laundry services, etc. See TD/B/941, *op.cit.*, Chap. III, Sect. B.

²⁶ These figures are drawn from TD/B/941, *op.cit.*

²⁷ For a further discussion on the composition of the service sector in developed and developing countries, see annex I of this report, as well as document TD/B/941, *op.cit.*, Chap. III, Sect. D.

vice sector grows in importance as economies develop and incomes rise. What differs among countries is the composition of the service sector. Although one would *a priori* suspect that the importance and size of "trade and finance" would grow as an economy develops, this is not borne out by available data. On the other hand, the category "other services" shows differing tendencies in developed market-economy countries and developing countries.

50. The above situation would seem to suggest the need for an indepth examination of the contribution of services to growth and development. A possible approach to such a task might be to identify and measure the "interlinkages" between the production of various services and between these services and the production of goods, rather than attempting to measure the productivity of an individual service.

51. Services play a multifaceted role in the economic development of countries, with complex interlinkage networks touching many areas of concern to the development process. Ideally, a coherent services policy should be designed to take into account the many and sometimes conflicting goals such as economic growth, employment and foreign exchange generation, national sovereignty, protection of the consumer and standards of living. Also, in designing development strategies the levels of productivity of various sectors, as well as their rates of change, constitute important elements in decision-making. A full understanding of the true impact of key service industries on the overall efficiency of the economy, as well as on the ability of countries to meet important strategic, social and cultural objectives, is a necessary condition for the design of any coherent policy geared to improving their contribution to the development process.

C. Inter-linkages

(1) *The concept*

52. Services are interlinked with the rest of the economy in several ways. Services such as transportation, telecommunications and radio, and utilities are a key part of the general infrastructure of a country. Other services which can be provided in-house (i.e. legal services, advertising, accounting) play a key role in the vertical integration of corporate activities. Similarly, the horizontal and conglomerate expansion of corporate activities are also facilitated by certain services. Telecommunication and telematics, for example, have facilitated the international finance industry to expand into other service activities, such as real estate and insurance. As will be stressed throughout this report, services also provide significant employment opportunities as well as allow for a better use of the existing capital stock. Services are therefore inextricably linked with the rest of the economy.

53. Although a great deal of empirical work still remains to be done, the newer theories with respect to the link between services and growth and efficiency can provide a point of departure in an effort to identify key issues with regard to development strategies, recognizing that the importance of services goes beyond that which can be captured by measures of labour productivity. While in many cases development of tertiary production may not be a result of growth (or even its concomitant element), it may be one of its preconditions. An efficient and well-run banking system, transportation sector, insurance industry, telecommunication network and public administration, are all conditions indispensable for growth and development.

54. Bottlenecks in the supply of services retard economic progress, especially if these services are, by their nature, non-tradeable and cannot be imported. Ian Little, Tibor Scitovsky and Maurice Scott observed in their study of industry and trade in developing countries, that "...in some countries, the development of

industry has been handicapped by underprovision, with a prevalence of rationing and delays.²⁸ It should also be kept in mind that since services are frequently "public goods", a special responsibility lies with governments to ensure the right balance.

55. Many services are oriented to final consumers, while others are used as an input in the production of goods or in other services.²⁹ The first category refers to "marketed" services which are final consumer products.

56. The second category of services are those which serve as inputs into productive economic activities. These include services used in the physical production of goods and other services, as well as those which facilitate their distribution from the point of production to the point of consumption. These services would seem to warrant further attention, as their contribution to growth and development might not be accurately assessed by productivity alone without taking into account the interlinkages among them.

57. Likewise the production of goods is destined for intermediate or final consumption. What makes services so essential to the productive sector, as well as to the economy as a whole, is that products cannot reach consumers without the support of services. Transportation, distribution, informing potential buyers of what is available and letting producers know what buyers want are service activities. Designing and deciding how to produce what buyers want are service activities. Moreover, as trade expands (and production with it) risk is likely to increase which is offset by the purchase of insurance and by obtaining legal and marketing advice. In addition, capital requirements increase, as does the need for more sophisticated communications technology.

2. *The role of input-output analysis in identifying important interlinkages in an economy*

58. Understanding the role of services in the development process should be viewed as a continuous exercise. The changing nature and socio-economic impacts of many services is being accelerated by the rapid technological changes which affect many service industries. The role and scope of traded services is also changing. As a result, continuous reassessment of the institutional and regulatory treatment of many services is thus required. As referred to in the following chapter, for many new services, such as those derived from the informatic revolution, no explicit national policy exists at the domestic level in many countries. As a result, in many cases, there is no national regulation dealing with such industries. Once their impact on the development process is fully understood, policies and regulations can be formulated; including those dealing with its international components.

59. To investigate the role of any intermediate input (good or service and tradeable and non-tradeable alike), a useful starting point would be the input-output tables of relevant economies. The information contained there would allow estimation of the importance of the input in question and hence would permit a first approach to the question of how a change in the conditions of its supply might impact comparative advantage and structural change in the development process.

60. In the case of services, however, the use of input-output analysis confronts major difficulties. The most obvious is that of obtaining sufficiently detailed input-output data. (Even where detailed input-output tables are available, for example in the United States, there are only 13 aggregated service categories (ex-

²⁸ Ian Little, Tibor Scitovski and Maurice Scott, *Industry and Trade in Some Developing Countries*, Development Centre of the Organisation for Economic Co-operation and Development, Paris, 1970.

²⁹ Greenfield, H.T., in his book *Manpower and the growth of producer services*, New York, (1966) analyses producer-service activities, and outlines their differences in relation to consumer services.

cluding construction and services supplied by public agencies). For most developing countries the categories are between 2 and 4.

61. The 1972 United States input-output data provide some insights into the distinction of "consumer" versus "intermediate" services. For instance, 82 per cent of the output of business services was purchased by other industries as inputs. Obviously, health, educational and social services are extremely important inputs in an economy since they maintain the quality of the work force. However, the input-output data do not capture the importance of such linkages for two reasons. First, to the extent that these services are not directly financed by the industry, they are not recorded as inputs. Second, input-output data only captures a static picture of the situation. For instance, skills acquired in education prior to employment are rewarded in the form of higher wages/salaries following employment. Hence, this appears in the input-output data of the latter period in the wage/salary component of the value-added. Input-output data also reveal the total output requirements in individual service items - direct and indirect - per dollar of delivery to final demand in various industries. For example, to deliver one dollars worth of final products, 74 sectors (out of 77 sectors covering agriculture, mining, construction, manufacturing and services) required more than 1 cent of output in the transportation and warehousing sector. Again more than 1 cent of output required by between 75 to 77 sectors for electricity, gas, water and sanitary services, wholesale and retail trade, finance and insurance, real estate and rental, and business services. Furthermore, to deliver one dollar's worth of final products, between 40 to 60 sectors required more than 5 cents of output from transportation and warehousing, wholesale and retail trade, and business services.

TABLE I

INTERMEDIATE PURCHASES OF SERVICES AND OUTPUT REQUIREMENTS IN SERVICES
FOR SECTORAL FINAL DEMAND IN USA, 1972

Service Sector (in parentheses percentage share in total value-added)	Total intermediate purchases as per- centage of output of the sector	Total output requirements in services - direct and indirect - per dollar of delivery to final demand (at producer's prices) in agriculture, mining, construc- tion, manufacturing and services (total 77 sectors)	
		Number of sectors requiring the output of the service	
		Over 1 cent	Over 5 cents
Transportation, Communication and Utilities			
Transportation and warehousing (3.8)	59.5	74	40
Communications, except radio and TV (2.2)	43.1	40	1
Radio and TV broadcasting (0.2)	100.0*	1	1
Electric, gas, water and sanitary services (2.1)	58.2	75	14
Wholesale and Retail Trade			
Wholesale and retail trade (14.0)	26.1	75	53
Finance, Insurance and Real Estate			
Finance and insurance (3.7)	45.6	77	1
Real estate and rental (11.9)	33.1	77	24
Services			
Hotels and lodging, personal and repair services (except auto) (1.5)	27.8	13	1
Business services (4.0)	82.0	77	60
Eating and drinking places (1.8)	24.9	52	1
Automobile repair and services (1.0)	41.9	18	1
Amusements (0.6)	32.2	4	2
Health, educational and social services and nonprofit organiza- tions (4.9)	5.4	1	1

* Since radio and TV broadcasting in the US is financed by firms, not directly by consumers, it appears to be solely an intermediate input.

Source: Table 1, The Use of Commodities by Industries, and Table 4, Commodity-by-Commodity Total Requirements; in The Input-Output Structure of the US Economy, US Department of Commerce, 1979.

62. The apparent picture which emerges from studying the United States input-output data is that while some services are used as inputs in most industries, their share in the value of the final product is often small. First, this is not the whole picture. In any particular industry, firms' purchases of services from outside suppliers (which is the information that will at best be supplied by official statistics) are likely to be a fraction of total purchases of services. Firms in the manufacturing sector, for example, will typically maintain a variety of in-house staff, and will go out-of-house for only part of their total need for services.³⁰

63. Secondly, input-output data conceal the key role of services since, even if some service inputs constitute only a fraction of the value of the final product, the possibility of substituting other inputs for these services are limited or practically impossible.

64. Thirdly, service inputs affect the quality of output and service requirements may depend on the scale of production. Successful export firms, in one country, for instance, are likely to use such services as air transport; maritime transport; telecommunications; insurance; legal services; advertising or marketing agencies; design consultants or R and D; and probably a variety of other services much more intensively than domestic oriented firms in that and other countries. Hence the analyses based on the input-output data of the latter countries would underestimate the importance of services - whereas inadequate supply of services may be the major problem to remedy. Conceivably some services - perhaps accounting - will be used roughly in proportion to output. Nevertheless, this is unlikely to be true for most service inputs.

65. In using the input-output approach there are other statistical and methodological problems in addition to the lack of detailed data. One such problem is that objective measures of the quantities of services are not normally available. It is only possible to measure the value of the services sold and the costs and quantities of the inputs used in their production. Next, in measuring the effects of protection or other interventions, there is the difficulty of estimating the tariff equivalent of quantitative restrictions on imports, and the tax-equivalent of regulation and of other controls on domestic transactions. Finally, the statistics for some services - especially financial services - are particularly imperfect.³¹

66. Despite all of these problems, input-output analysis and effective protection remain a relevant conceptual framework. Because certain services have important interlinkages with the rest of the economy it is important for countries to be able to identify and rank these activities with regard to their level of economic importance. The input-output conceptual framework allows countries to identify those particular service activities which have the greatest linkage and to rank them accordingly. Because of the differing structure of each country's economy, analysis must focus on the input-output relationship particular to that specific economy. The limited disaggregation in a country's input-output tables, along with the other above-mentioned limitations, may make it impossible to use existing

³⁰ The proportion of out-of-house services purchased, moreover, is likely to vary with specific national conditions, such as tax structures and unionization. But as firms switch from internal to external sources of supply of services, the measured role of services in value-added will rise without any real economic change having taken place. Further, when protection or regulation of a domestic service sector causes a firm to choose in-house provision where it would really prefer to buy from an efficient outside source, the statistics will record the role of services as less important than they actually are, and hence will lead to an underestimate of the negative effects of protection or regulation of services on the user industry.

³¹ In the banking sector, the non-factor services of banks as financial intermediaries are not separated from the factor service income of banks as lenders. In the insurance sector, statistics of flows of premium income, investment income, and payment of claims are very hard to disentangle so as to reflect the cost and value of insurance services provided to customers.

tables for the analysis of service interlinkage. Nonetheless, countries can apply the input-output conceptual framework by obtaining input-output data from a few important industries and analyzing which services are key to the countries' domestic production and international trade.

67. While services are integral to the development process, this does not carry with it the implication that each developing country should aim to develop a full range of indigenous service industries. On the contrary, recognition of the importance of services as an intermediate input implies that it is important that services be provided to users on the best possible terms. An inefficient, protected or over-regulated domestic service sector may slow down the development of more important and efficient sectors. This includes domestic industries supplying non-traded services which may find themselves starved of scarce resources as a result of the protection of suppliers of traded services. This is not to suggest, of course, that availability of such services at the most favourable possible combinations of prices and qualities is a sufficient condition for the success of industries with an underlying comparative advantage. The availability of services can only facilitate the exploitation of comparative advantage which might lie fallow for a variety of other reasons.

68. Different countries and industries, however, are unlikely to require either the same composition or the same level of services. If a country succeeds in moving up the development scale, it will continue to require the skills and know-how needed to establish new industries. It will also need a full range of services to support and facilitate the trading and producing operations of its established industries. Some of these needs may be met by the development of domestic service industries, in particular those services which are non-traded. However, the country will probably continue to find it advantageous to import some skills.

3. Interlinkages: Examples

69. The following paragraphs illustrate interlinkages between various services and production, and the vital role of services in the production and distribution of commodities.

(a) Shipping

70. The interlinkage of shipping with the process of development through trade is clearly established by the fact that shipping services will not be demanded unless there is cargo to be moved. More important, however, is the inverse relationship that no trade can take place unless adequate shipping services are at the disposal of the trading community. Consequently, the shipping industry has not only reacted to trading requirements but, in many cases, has created pre-conditions for the expansion of world trade based on an intensified international division of labour.

71. However, it is not only the existence of a shipping industry as such that is a pre-condition of the expansion of world trade, but rather the provision of services adequate to the different needs of various trading interests. Such adequacy refers to all facets of the qualitative characteristics of shipping services, i.e. the availability of physically suitable ships responding to particular transport needs, the frequency of services offered to avoid undue interruptions in commodity flows, the pricing of such services in line with the ability of the goods traded to bear the cost of transport. Experience has shown that countries which, for one reason or another, have not been or have ceased to be provided with such adequate shipping services have in consequence faced considerable setbacks in their foreign trade coupled with corresponding interruptions of their development process.

72. Apart from providing a service to trade, shipping as an independent industry has a direct bearing on the development process of a country. It helps to improve the foreign exchange situation, creates employment, fosters technology transfer and economic integration. Apart from these direct effects, shipping investment contributes substantially to the diversification of the economy of the investing country as it requires a whole range of support industries and services. These

include shipbuilding and repairing, supplies, equipment, insurance and banking services, telecommunications, etc. The role of shipping in the development process is examined in greater depth in a recent study (TD/B/1013).

(b) Insurance

73. While insurance shows certain characteristics of a final service with a high income elasticity of demand, it is also an essential producer service with interlinkages with other parts of the economy. In an economy where the production of goods and services is carried out by independent entities with limited financial strength, insurance becomes a basic component of the production and distribution process. Indemnification of losses by the insurer is made possible through the pooling of a great number of similar exposures and the collection of corresponding premiums. What would be a large and irregular loss for the individual or the firms becomes a regular and relatively small premium, which can thus be incorporated in the production costs. The role of insurance, however, does not stop there. Insurance also plays a crucial interlinkage role through the promotion and channelling of savings, in credit facilitation, in the promotion of new economic activities and the utilization of new technologies and materials whose vulnerability to losses is not exactly known.

74. The function of insurance in matters such as the promotion of non traditional exports (through export credit insurance schemes) and of rural activities (through making possible the use by farmers of new techniques and the cultivation of new crops, as well as facilitating rural credit so vital in agricultural production) has a direct bearing on foreign trade and on the balance-of-payments. Indeed, so important is insurance in the trade and development matrix that the Conference at its first session, in 1964, formally acknowledged that "a sound insurance and reinsurance market is an essential characteristic of economic growth".³² The role of insurance in the development process is further explored in a separate study (TD/B/1014).

D. Primary Commodities

1. Introduction

75. For most developing countries, primary commodity production is not only still the most important source of national income but is also generally the principal (and in some cases the only) generator of export earnings/foreign exchange resources for development. Various services facilitate the production process and can contribute to realizing the full potential that exists in the production of primary commodities in particular countries.

76. As finance plays an important role in investment and production decisions, the services of banking and financial intermediaries (including marketing boards, *caisse de stabilisation* and informal sector finance) are crucial in primary commodity production, whether in agriculture or mineral production. In minerals, since production decisions usually involve large capital outlays (often with a large foreign exchange component) a major service is the intermediary role which domestic financial institutions (e.g., commercial and development banks) can play in mobilizing both domestic and international financial resources. In agriculture, given the nature and character of this sector in most developing countries, specialized financial services are of major importance for the full realization of productive potentials. Typically, production is undertaken by a fairly large number of peasant farmers in rural areas. Outside his own savings, a farmer may lack access to finance - especially for purchase of inputs such as seeds, fertilizers, pesticides, gas and oil, etc. If the farmer is not able to obtain access to finance, this would constrain his ability to undertake worthwhile investments, whether this be to

³² Recommendation A.IV.23 to the Final Act.

expand acreage or to increase productivity. Rural development/agricultural development banks can provide an important service by providing finance where it is needed.

77. Even where ordinary access to credit may not be an obstacle, investments and productivity improvements may still be hindered by the uncertainties arising from the instability of earnings, especially in agricultural export commodities. The vagaries of the weather or crop disease may reduce drastically a farmer's output causing his earnings to decline sharply; or international prices may collapse after investments have been undertaken, again resulting in an unexpected decline of earnings. If measures to reduce price instability or to deal more directly with earnings instability are not available, excessive income instability may deter farmers who are unwilling to take risks from undertaking worthwhile investment in production and productivity improvements.³³ In several cases, governments in developing countries have had to set up marketing boards, *caisses de stabilisation* or undertake other measures which have acted to reduce the price instability faced by producers and to provide them with bridging (or rehabilitation) finance in the face of sharp temporary earnings declines. However, government efforts (especially in the case of developing countries) have been limited because of the lack of funds. A government could, in principle, seek funds on international financial markets; however, as discussed earlier, it is unlikely that private financial institutions would be prepared to provide such finance at special (i.e. more favourable) rates of interest. Yet, this specific type of financial service may be of considerable importance.

78. In addition, there are infrastructural type investments such as in regional irrigation or flood control systems, road and transportation networks, and R and D investments to improve crop yield or resistance to disease which often require financial services that private financial operators would not have incentives to provide. Again, reliance on private markets may not be sufficient and government initiatives may be important.

79. Apart from finance, there are the specific services that money can buy which make efficient, or rather profitable, commodity production possible. These include, for example, legal services for the negotiation of contracts (both investment and sales), managerial services for operating production units, as well as the services of agronomists, agrobiologists, irrigation engineers and other specialists in the agro-industry sector, or mining engineers and other technical specialists in the extractive industries - mining extraction in some cases requiring highly specialized engineering and technological services.

(ii). *Marketing and distribution of primary commodities*³⁴

80. Historically, international trade on a global scale indeed began as an exchange of primary commodities. European merchants were the early prime movers in this largely overseas trade. As demand for overseas products grew, the early merchant-adventurers gave way to joint-stock companies which also became directly involved in overseas production - in agricultural plantations (e.g., sugar, tobacco, coffee, tea, etc.) and in extractive industries (mining). With colonization of territories and the advancing industrialization of Europe, trade in primary commodities experienced an extraordinary expansion on a global scale and has remained the largest component of international trade (as a proportion of the value of world trade) right down to the mid-1960s. Although in the seventeenth and eighteenth century all major European port cities (e.g., Venice, Genoa, Antwerp, Amst-

³³ Any measure that would tend to reduce the income instability of the producer, thus allowing him to invest optimally in productive activities, could be thought of as a kind of insurance service.

³⁴ Descriptions of the marketing systems and related services for a number of individual commodities can be found in the series of studies prepared for the Permanent Sub-Committee on Commodities by the UNCTAD secretariat (TD/B/C.1/PSC 18-22 and 28-32).

erdam, Hamburg, London, Marseilles, etc.) were important commodity centres - largely stapling centres (i.e., breaking bulk, packaging, sorting, curing, roasting, refining, quality control, etc.) - by the close of the nineteenth century, London had become the international commodity trading centre par excellence. Today, London and New York dominate (followed by Chicago, Paris and Amsterdam) as centres for internationally traded commodities. These centres provide two general categories of services important in modern commodity trade: (i) merchanting - that is, arranging the buying and selling, insurance, shipment and financing of raw materials, usually between buyers and sellers in distant third countries all around the world; and, (ii) organized commodity markets - that is, ones where dealing is organized around a specific meeting place. The organized commodity markets are of two general kinds: a few are 'physical' markets, on which commodities are bought and sold; and more are 'futures' markets (called 'terminal' markets in London), whose main function is to provide a mechanism by which those who trade in commodities can ensure (hedge) against future changes in their prices.³⁵

81. Whereas there are specialized commodity trading houses, brokers, etc., (by commodity or groups of commodities - e.g., sugar, cocoa, grains, metals, etc.) involved in the activity of merchanting as such, many, in addition to dealing on the spot or physical market on behalf of clients or on their own account, also provide a range of other services including storage and warehousing, market information, hedging advice and execution (on "futures" markets), contract negotiations,³⁶ option trading, etc. Although arranged through commodity dealers, the actual insurance, financing and shipping services are supplied by firms specialized more specifically in these particular fields of activity.³⁷

82. In the case of commodities there is an important relationship between trade and finance. For example, importers/processors may be willing to carry larger or smaller inventories of raw materials, depending on the availability and costs (i.e., interest rates) of finance. This has a significant impact on both the level of and fluctuation in the demand for various commodities.³⁸ Furthermore, lack of adequate access to finance, especially for financing temporary storage of commodities, may force exporters in producing countries to undertake distress sales, particularly during periods of price decline. Appropriate financial services can therefore have an important impact on market stability in commodity trade.

83. Shipping and marine cargo insurance services are also important factors in commodity trade. The lack of adequate shipping services can be a major constraint on the expansion of commodity trade. For example, the need for specialized vessels in the transport of many commodities, the inconvenience of established routes for developing countries as well as the structure and practices of the world shipping

³⁵ For further discussion of these markets, see, for example, G.L. Rees, *Britain's Commodity Markets* (Elek Books Ltd. 1972) and Chicago Board of Trade, *Commodity Trading Manual* (Chicago, 1980), and UNCTAD, "Commodity exchanges and their impact on the trade of developing countries" (TD/B/C.1/248 and Corr. 1 and 3, May 1983). It should be noted, in addition, that prices established on these markets serve as general reference prices for commodity transactions around the world.

³⁶ See, for example, the report by the UNCTAD secretariat "Contractual marketing of commodities" (TD/B/C.1/PSC/34 and Corr. 1 and 2).

³⁷ Note should be taken though of the fact that some large commodity trading firms are affiliated with banking entities, and insurance and shipping companies. For further discussion, see: UNCTAD *Marketing and distribution arrangements in respect of export and import transactions: structure of international trading channels* (UNCTAD/ST/MD/25, November 1981).

³⁸ As an illustration, the recent weakening of commodity markets due to the economic recession in major consuming countries has been exacerbated by the simultaneous concurrence of high interest rates which have forced importers of many commodities to reduce further their demand (on account of reduced normal stock holding) beyond the usual economic activity elasticity effect. Also, high interest rates have meant high costs of obtaining credit against export sales, thus compounding the difficulties faced by primary commodity producers.

industry.³⁹ (including the existence of differential transport rates for raw and processed commodities) have an important bearing on the potential for trade expansion, especially of the developing countries, and in processed commodities in particular.

84. The internal marketing and distribution system, which brings products to final end-users or consumers in importing countries, is an important element in the overall marketing and distribution of primary and processed commodities. In this connection, product promotion through advertising (whether brandname or generic) plays an important role in market development and demand growth in consuming countries. Traditionally, domestic processors and retailers have been the main providers of internal marketing and distribution services. However, nowadays, transnational trading companies, which are involved not only in the overseas production and international marketing of particular commodities but also in their processing, have also become involved in domestic marketing and distribution to final consumers, worldwide. Indeed, for certain commodities, most of the ancillary services connected with commodity production, trade, processing, marketing and distribution have become internalized in vertically integrated transnational firms.⁴⁰

³⁹ For further discussion of the world shipping industry and services, see TD/B/1013, *op.cit.*.

⁴⁰ For further discussion see, for example, the study by the UNCTAD secretariat, *Fibres and Textiles: Dimensions of Corporate Marketing Structures* (TD/B/C.1/219 and Corr. 1, November 1980, United Nations publication, Sales No. E.81.II.D1), Chapt. II, and UNCTAD/ST/MD/25, *op.cit.*

Chapter IV

PUBLIC INTEREST CONSIDERATIONS AND THE ROLE OF SERVICES REGULATIONS

A. Introduction

85. In previous chapters it was recognized that a strong, well-balanced and efficient service sector can make a substantial, and in many cases, a crucial contribution to the development process. In this context services not only constitute a direct input into a wide range of economic activities, but they also have a major impact on the attainment of a variety of cultural, strategic and social goals. On account of the economic and social externalities as well as the strategic importance of certain key services and their interlinkages with other sectors of the economy, their contribution to GDP in terms of direct value-added understates their real importance to the development process.

86. Services such as education ultimately lead to a more skilled, mobile and productive workforce. The aim of health and housing services is to improve standards of living of the society in general and of the workforce in particular. Thus they also contribute directly to productivity.

87. When dealing with services, however, countries not only face economic considerations, but also have to confront social, political and strategic goals and hence must establish priorities between them. Perceiving employment opportunities as a priority in all countries, whether developed or developing. Many services such as railways, telephone and telegraph, electricity generation and port operations - let alone public administration itself - are major employers and governments sometimes rate employment considerations higher than economic efficiency.

88. In many cases, public policy reflects the balance between various interest group pressures. This is particularly evident in the agricultural sector where employment in agriculture has declined and erstwhile agricultural workers have moved into services, in particular, employment considerations as well as the pursuit of other social goals have led to conflicts which have acted as a break on the process of structural change. Insufficient appreciation of the role of services in the development process, is likely to result in inadequate attention being paid to an assessment of the costs and benefits of employment changes in the services sector. One way in which conflicts between social and economic policies are tackled is through the social welfare system.

89. There are often other reasons for supporting or protecting the production of certain service activities. Among such measures are national security, protection of cultural values, reduction in dependency and infant industry considerations. For certain service industries such considerations may well be paramount in determining public policy. National security reasons are clearly of prime importance in the case of air and maritime transport and communications for many countries and, in particular, for island and least-developed countries. Banking, because of its close links with a country's monetary policy, raises questions of dependency and hence national sovereignty. In attempting to reconcile sometimes conflicting goals, many countries have seen the need for regulating key service industries.

B. Domestic regulations

90. It is very striking that at the domestic level in almost all economies, the service sector is regulated to a degree that is quite different from intervention in other sectors. The motivation and nature of this regulation deserves close scrutiny. First, it may reveal a genuine need for intervention specifically targeted at services or at particular service activities. If this is the case, it is

necessary to investigate whether such interventions should affect international trade to a greater or lesser extent than domestic trade, and, finally, to investigate the implications for international trade of regulation which exists and is likely to continue to exist.

91. Overwhelmingly, it is services which are subject to economic "regulation": control of the rates charged by utilities; control of entry into and of rates charged in, various modes of transport; control by licensing and/or numerical restriction of entry into many services such as the law, accountancy, medicine, hairdressing, taxi-driving; government ownership or control of telecommunications, broadcasting, and other media; detailed supervision of the structure and practices of banks, insurance companies, security traders and other financial companies.

92. One argument advanced is that the advantages of competition are outweighed by public welfare considerations as in the case of transportation services. Another consideration is the large fixed costs and fluctuating demand in certain services which if not regulated would lead to frequent bankruptcy, to a poor availability in the services offered to consumers and given the interlinkages between production services and could generate unsurmountable bottlenecks in the economy as a whole. A related argument is that some firms may supply only the most lucrative markets, and hence deprive the less lucrative markets of these services.

93. The second major argument for regulation turns on the imperfect information available to buyers, a problem that may be greater when it is an intangible service rather than a tangible good which is being purchased. For example, available information can be too complex to interpret (e.g., the balance sheets of insurance companies). In such cases, where certain basic information is required by all buyers, governments or professional bodies (or both) assume the responsibility.

94. A case for regulation exists when it is necessary to inform all potential buyers of the fact that a company's qualifications have fallen below the required levels, for example to take deposits, to sell insurance, to provide a passenger service or to perform certain functions such as a lawyer, architect, engineer or accountant.

95. Whereas a regulatory agency can forbid a supplier of goods to sell "sub/standard" items while permitting it to continue to sell its other items, in respect of many services it is difficult to make the distinction between the standard of the service supplied and the person supplying it. Accordingly, the need arises for regulating entry in specific services industries.

96. A general comment should be made about the cost of regulation. It appears that any system of regulation has certain inherent costs and disadvantages. There is not only the direct cost associated with carrying on the regulatory function, but also the loss of flexibility for the industry, reduction of incentives for cost-cutting and innovation, inducing a resource allocation which is not always consistent with economic optimality, etc. Against this must be set the benefits of regulation in terms of consumer protection or avoidance of the harmful effects of oligopolistic situations.

C. Service regulation in the international context

97. Given the existence of a case for government intervention, the central question is whether international transactions should be treated differently from domestic transactions. On the face of it, there is no such case. If consumers need protection, they require protection independently of the nationality of the suppliers. It must be recognized, however, that this is a counsel of perfection: in practice, even a well-intentioned government will find it hard to regulate service industries in ways that do not incidentally discriminate against foreign competitors. For example, a common requirement in the banking and insurance sectors is that a firm should have an adequate capital base relative to its level of

operation. To require that a foreign supplier show evidence of his assets and, at the same time, to allow him to use his foreign-held assets to meet solvency requirements, exposes one to the danger that if the same assets are used to guarantee the solvency of several independent operations, they may be inadequate as cover against the independent risks to which the transnational bank, as a whole, is subject.

98. The banking sector is extensively regulated in all developed countries and most developing countries. The main controls generally cover entry to the industry, liquidity and reserve ratios, minimum deposits, fixing of maximum interest rates, mergers, restrictions on the type of business to be undertaken and investments that may be made, although there are variations from one country to another. Many countries limit the shares that may be held by banks in industrial enterprises and place ceilings on resident and non-resident shareholdings in the banks themselves. Maximum rates of interest on deposits are fixed in some countries e.g., Japan.

99. An additional aspect is that governments may decide to favour domestic firms, for example to reduce dependency. Extreme dependency in the supply of certain vital services can create serious economic problems, for example, where foreign suppliers do not wish to provide an adequate shipping service. This can both inhibit foreign trade and lead to interruptions in the development process.

100. The most appropriate way of avoiding such disruptions and to ensuring the availability of adequate shipping services has been found by most countries to require a certain minimum engagement in shipping. National carriers usually maintain a closer link with the particular trading interests of their countries than foreign carriers. Furthermore, by controlling substantial tonnage in its national foreign trade, a country can exercise a countervailing power against practices of foreign carriers that are possibly detrimental to its interest in the trade concerned. This is particularly relevant since the incidence of transport costs tends to fall upon developing countries.

101. Another valid reason may be the infant industry argument. For example, until the second half of the twentieth century, banking regulations in developing countries were mainly concerned with the security of their financial systems. However, since about 1960, there has been an increase in measures of an "infant-industry" nature designed to increase the share of banking under indigenous ownership and control. This trend was doubtless the consequence of such factors as decolonisation and the need for a response to the renewed expansion of the foreign networks of banks in developed market-economy countries. As a result, by 1979, 73 per cent of developing countries had regulations which restricted foreign ownership in the banking sector.

102. In the case of foreign ownership in the banking sector, restrictions may apply to both initial entry and the expansion of networks of branches and offices. Restrictions on financial operations have taken many forms applying to both assets and liabilities. For example, access to local deposits is often limited in various ways, and both lending and reserves may be subject to special controls or regulations. However, only a relatively small number of developing countries seem to exclude foreign ownership in the banking industry. Various reasons may explain this situation. For example, where foreign banks have traditionally held dominant positions in developing countries, it clearly takes time for an indigenous banking sector to develop. Furthermore, there may be a link between a country's capacity to attract capital from abroad in the forms of both bank loans and direct investment and the presence of foreign-owned banks.

103. Governments are increasingly finding it necessary to intervene in the services sector to control the use by enterprises of restrictive business practices. Since regulation frequently involves enterprises engaged in similar activities coming together to establish standards for the provision of services (e.g., control over entry into the industry), this can create the opportunity for enterprises to engage in practices restricting trade at both the domestic and international level. To a certain extent, the limited competitive conditions in the world market for services may be attributable to the existence of such practices, which, in turn,

reflect the exercise of market power and are often aimed at excluding competitors from a given market. Restrictive business practices by a single enterprise with dominant market power involve restrictions imposed upon its distributors, the fixing of resale prices, exclusive dealing and other restrictive conditions, such as the prohibition to sell for re-export. All these practices are very common in the wholesale and retail trades.

104. The other important types of restrictive business practices are those which involve a group of enterprises acting in concert. These involve the setting up of domestic, import, export and international cartels which seek to fix prices, allocate markets, and to exclude outsiders from joining the arrangements entered into. A common practice in construction, consulting and engineering services sectors is collusive tendering at both national and international levels. Market-sharing and non-competition arrangements may clearly involve enterprises in banking and finance, insurance, transport, communications, health, motion picture and other service industries.

105. Export cartels in one form or another are permitted in virtually all countries. For example, the "Certificate of Review", recently granted under the Export Trading Company Act 1982 in the United States to INTEX (International Trading Co.), is a joint venture among some 15 specialized consulting engineering firms created for the purpose of joining efforts in identifying and preparing bids for foreign projects.⁴¹

106. Monopoly power with regard to exports at the national level is sometimes translated into virtual monopoly at the international level, especially if the enterprises in the national export cartel account for the bulk of world trade in the goods or services in question. In the field of motion picture distribution, for example, it is known that the three export cartels in the United States (Afram Films Inc., American Motion Picture Company (Africa) Inc., and Motion Picture Export Association of America, Inc.), account for the bulk of world trade in films.

107. Collusion at the domestic level can also have adverse effects on services offered by foreigners, since such practices are intentionally aimed at excluding outsiders from the market in question. Domestic cartels, therefore, are always potentially restrictive as regards imports of goods as well as services.

108. Moreover, domestic cartels involving distributors of goods, in other words the wholesale and retail trade, may clearly adversely affect the imports or exports of such goods. For example, in the Netherlands the Pharmaceutische Handelconventie (PHC), an association which grouped almost all the manufacturers and dealers of pharmaceuticals in that country and accounted for 80 - 90 per cent of total sales of pharmaceuticals, used to fix prices including those of imports, and provided collective and reciprocal exclusivity among its members, making parallel imports by outsiders virtually impossible. PHC was dissolved following intervention by the Commission of the European Communities.⁴²

109. Enterprises in the services sector have also followed the general trend towards concentration of market power witnessed during the last 20 years. Large mergers in the insurance sector include Connecticut General's \$ US 1.9 billion purchase of INA, American General's \$ US 1.5 billion acquisition of NLT and Prudential Insurance Co.'s acquisition of the Bache Group in the United States.⁴³ In 1979 the largest insurance broker in the world, Marsh and McLennan of the United States, bid for C.T. Bowring in the United Kingdom.⁴⁴ These bids followed numerous mergers and joint ventures in the insurance sector between the largest firms in the United States and the United Kingdom and in other countries, including the Netherlands and

⁴¹ Bureau of National Affairs Inc. (USA), *Antitrust and Trade Regulations Report*, Vol. 45, No. 1138, 3 November 1983.

⁴² Commission of the European Communities, *Eighth Report on Competition Policy*, Brussels, Luxembourg, April 1979, p.72.

⁴³ See UNCTAD, "Annual report 1982 on legislative and other developments in the control of restrictive business practices", (TD/B/RBP/11) para. 145.

⁴⁴ Ibid. (TD/B/831), para. 70.

the Federal Republic of Germany.⁴⁵

110. Large corporations have also created an enormous captive insurance market with premium incomes of \$ US 7 billion in 1982 and growing at an annual compound growth rate of 62 per cent since 1970. This market is based on monopolistic conditions on the supply side, as well as on the demand side. Such a situation offers no opportunity to other developed market-economy suppliers, much less to those from developing countries and thus "captures" all benefits from such operations within the limits of the corporation.⁴⁶

D. Regulations and the efforts to liberalize trade in services.

111. Trade in services may often be affected by regulations which are primarily addressed to the domestic, social and economic situation (e.g., consumer protection, competition policy questions, immigration, investment and reduction of dependency). There are internationally-agreed principles or mechanisms such as the customs tariffs for affording protection to domestic service provisions. As a consequence, it is difficult to discuss regulations in international forums by using concepts derived from trade relations. For example, "deregulation" policies could conceivably create pressures for more "protection" as their implementation could make it easier for foreigners to export to that market. Even where there is not specific discrimination in regulations against foreign suppliers of services, the existence of any regulations may be perceived by service exporters in other countries as "protection". Pressures for international negotiations on services are likely to intensify as countries adopt different approaches to the regulation of service industries.

E. Examples of regulation

112. In most industrialized countries, for most of the present century, if not most of the period since the end of the Napoleonic wars, certain important service industries - shipping, banking, insurance, other financial services (e.g., dealers in the stock market), various communications services (e.g., post, telegraph, telephone, radio), railway and other surface transportation, medical, legal, engineering, architectural, accounting services - have been regulated as to establishment, rates, service standards, financial viability, geographical areas of operation and right of entry. The type of regulation has varied with the country concerned and service sector at issue. For many, if not most, of these service sectors, there have been, in the developed countries, severe restrictions on the import of the service, and/or the establishment of foreign-controlled firms competing in the domestic market.

113. In shipping, for example, exclusion of foreign ships (and crews) from inland and coastal navigation has been common. Because of this considerable negotiating effort was devoted to making certain rivers and important inland waterways into international waterways in a legal sense (e.g., the Rhine and the Danube). Similarly, Canada and the United States worked out arrangements (Treaty of Washington, 1871, St. Laurence Seaway agreement) to internationalize effectively the use of the St. Laurence Waterway, subject of course to regulations as to vessel size and equipment. Other than these specific arrangements, many navigable inland waters still remain reserved for national carriers. Most countries have reserved coastal shipping (cabotage), that is shipping between two domestic ports, for national carriers and, in some cases, for national carriers operating domestically constructed vessels with domestic crews (e.g., United States Jones Act).

⁴⁵ Ibid. (TD/B/831), para. 70.

⁴⁶ See *Financial Times*, 9 September 1983.

114. In international shipping, some governments tacitly accept self-regulation, at the industry level, by groups of firms organized into "conferences", which impose rates and service standards. The international community has expressed concern with the monopoly practices of liner conferences, the escalating freight rates, arbitrary decisions on services, and the imbalance in the obligations between shipowners, shippers and conferences. However, developing countries which gained their independence in the 1960s had more deeply ingrained grievances. They felt that the international shipping system that had evolved during the colonial era was so structured as to force on them unacceptable reliance on foreign operators thus preventing them from developing their own service industry and thereby confining their role in the international economy to one of passive suppliers of raw materials without affording them the opportunity to compete freely in the downstream activities which the shipping industry offered.

115. The "common measure of understanding" reached with the developed countries in 1964 concentrated on the liner trades (which were then those services in which developing countries were largely interested), particularly since in these trades a cartel-type system of "liner conferences" existed. This led to the establishment of the UNCTAD Committee on Shipping and to the negotiation of various multilaterally accepted solutions, including the Code of Conduct on Liner Conferences.

116. In banking, early experience with joint stock banks in the United States, for example, led to increased control by the authorities, primarily to protect the interests of depositors in particular banks, and to ensure the stability and credibility of the currency and of the financial institutions. In virtually all jurisdictions banks are regulated as to establishment, financial viability and the range of services they may offer. The techniques of regulation vary widely. In the United Kingdom, for example, an important segment of the overall system of control is operated informally - that is, without reference to statutory authority - by the central bank (the Bank of England). In other countries, control may be exercised by the central bank in regard to certain aspects (the United States and Canada) and by a regulatory commission or government official in regard to others. In Canada, for example, supervision of the establishment of banks, and the viability of existing banks, is the responsibility of the Inspector-General of Banks, operating under the terms of a relatively detailed statute, which is revised every 10 years.

117. Insurance is strictly regulated in all countries. Although insurance costs in developing countries should reflect essentially the domestic cost of insurance and the reinsurance costs, in many developing countries, there are two main elements which distort this situation. First, the internationalization of the insurance industry and the many corporate strategies and financial linkages that make the insurance sector dependent upon the financial transnational entities inside and outside the countries concerned impose strict constraints on the adoption of rational decisions based on relative production costs.⁴⁷ Second, many developing countries regard insurance institutions locally incorporated as an essential element of their economic independence and which should accordingly be given special encouragement. The "infant industry" argument has also been used in this context. Countries may find themselves cut off from international insurance and reinsurance markets in times of international political tensions and hence avoid a total reliance on international insurance in order to prevent the consequences of a total *de jure* or *de facto* blockade. Hence, the importance attributed to the existence of a local insurance market and to the building of such a capacity may be dictated not only by considerations of costs, balance-of-payments and technical capacity.⁴⁸

⁴⁷ Examples and obvious cases of the suggested influences are generally set out in a biennial "Review of developments in the field of insurance in developing countries" which is regularly submitted by the UNCTAD secretariat to the Committee on Invisibles and Financing related to Trade.

⁴⁸ In 1972, Conference resolution 42(III) affirmed that "developing countries should take steps to enable their domestic insurance markets to cover... the insurance operations generated by their economic activities" and considered that this objective might be achieved more easily "by establishing and strengthening domestic insurance and reinsurance organizations...".

118. In the case of consulting and engineering, many countries provide preferential treatment to domestic suppliers. Several Latin American countries, for instance, apply a "Hire National" which can be viewed as an extension of the widely used "Buy National" campaigns. Furthermore, the ANDEAN Pact has established a norm related to "technological package disaggregation" with the following purposes:

- adaptation of the project's design to the national economic, employment, technical as well as natural conditions, thus contributing to higher quality and lower cost;
- maximizing the use of local inputs and labour;
- promoting technical solutions which maximize the value-added generated domestically.⁴⁹

119. There is a growing recognition that information technologies, transborder information flows, constitute a new, revolutionary force in the evolution of national economies. Access to international data "grids" provide the means of supplying a variety, or more accurately, a "package" of services combining banking services, engineering and consultancy services. In fact, some international banks and other corporations appear to be pursuing a comprehensive, all purpose, services capability.⁵⁰ In this context, the existing regulatory structure is gradually losing its relevance and effectiveness.

120. The role and scope of traded services is also changing very rapidly with many services becoming "tradeable" in world markets. As discussed in the previous chapter, such developments might also require a continuous effort to bring up to date the institutional and regulatory treatment of many services. The inadequate and inappropriate regulations of certain key service industries with strong interlinkages with the whole economy, for example transborder data flows may have serious longterm repercussions.

121. Countries, especially developing ones, are having difficulty in responding to these rapid new developments. One exception is Brazil which has introduced a comprehensive regulatory approach dealing with economic transborder data flows (and the role of transnational corporations in those flows), an approach that is embedded in the broader framework of an industrial development policy. The Brazilian regulations are directed to the objectives of (a) maximizing information resources located in Brazil, be they imported or locally produced; (b) acquiring and maintaining national control over the decisions and technologies relating to Brazilian industries; (c) broadening public access to information; and (d) administering information resources in such a manner that they enhance the country's cultural and political standing. A case study conducted by the United Nations Centre on Transnational Corporations, found that the application of the country's transborder data flows policy has eliminated a number of potentially harmful effects of such data flows; that it has led to an increased location of computers, software, data bases and skilled human resources in the country and better national control over them; and that it has contributed positively to the emergence of a national data industry (especially its data-base segment) and to the country's overall socio-economic development.

⁴⁹ "Servicio de Ingeniería de Consulta y Construcción en América Latina", Study prepared for the SELA secretariat by S.C. Seproin, (mimeo, May 1984).

⁵⁰ See Harald B. Malmgren, "Negotiating International Rules for Services", a paper presented to the meeting on "Restrictions on Transactions in the International Market for Services", hosted by the Trade Policy Research Centre, Ditchley Park, United Kingdom, April 1983.

CHAPTER V

SERVICES IN THE INTERNATIONAL CONTEXT

122. One of the problems in dealing with services in the context of international trade is that services have frequently been erroneously equated with "invisibles." This stems in part from the use of balance of payments data. By definition, the balance of payments records all financial flows between countries. The invisibles account covers all transactions which relate neither to goods nor to capital movements, but includes both the so-called "factor services"⁵¹ and "non-factor services".⁵² Only non-factor services strictly speaking constitute trade in services as defined by the IMF.⁵³ "Factor services" are payments to factors of production (i.e. labour, capital and technology) between residents and non-residents. Though they also involve financial flows, factor services do not constitute trade in services and should not be considered as such.

A. The World Market for Services

1. General profiles

123. The size of the world market for services and the identification of the main suppliers to it, can be derived from balance-of-payments statistics.⁵⁴ These are subject to various inadequacies, one being their inability to identify more than absolute levels of payments (without indicating flows), another being the lack of disaggregation, especially in the crucial categories of "other private services".

124. In 1980, world trade in services was \$ US 435.5 billion⁵⁵ This represented an 18.8 per cent compounded average annual growth rate over the 1970 level of \$ US 8 billion. Merchandise trade during this period grew at a slightly higher average annual compounded growth rate of 20.8 per cent, rising from \$ US 261.2 billion (1970) to \$ US 1,724.1 billion (1980). Over the decade, however, the share of traded service payments (as a percentage of current account debits) declined slightly from 20.7 per cent (1970) to 18.0 per cent (1980). This is in contrast to the experience of both factor services and merchandise trade whose respective shares rose from 7.8 per cent and 69.4 per cent in 1970 to 9.6 per cent and 71.1 per cent in 1980.

125. Developed market-economy countries are by far both the largest producer and consumer of traded services, accounting for 86.5 per cent of the credits and 82.5

⁵¹ Factor services normally include "direct investment income" and "other investment income". Private transfers or "labour income" are generally reported separately.

⁵² Non-factor or "traded" services include shipment (freight plus insurance), other transportation (port services plus passenger services), travel, official services, and other private services. This last catch-all category includes diverse activities such as non-merchandise insurance, communications, advertising, brokerage, management, subscription to periodicals, processing and repair, merchanting and professional and technical services. See TD/B/941, Chap. IV, Sect. A.

⁵³ See IMF *Balance of Payments Manual, Fourth Edition*, Washington D.C., 1977.

⁵⁴ See annex I below and TD/B/941.

⁵⁵ World traded service debits were \$ US 435.5 billion while world traded service credits were \$ US 388.0 billion. As discussed in TD/B/941, the bulk of the discrepancy between world credits and debits in traded (non-factor) services is due to the under-reporting of credits, in particular in the case of shipping transactions. See TD/B/941, para. 60 and footnote 14.

per cent of the debits in 1980. The balance in traded services for these countries has shifted from a \$ US 1,324 million deficit (1970) to a \$ US 9,814 million surplus (1980),⁵⁶ reflecting the larger decline in the trend share of debits relative to credits. The member states of the European Economic Community (EEC), the United States and Japan were the largest exporters and importers of services.

126. The deficit in traded services by developing countries rose from \$ US 3,802 million (1970) to an overwhelming \$ US 57,298 million (1980). Oil exporting developing countries have been primarily responsible for these deficits (recording a \$ US 2,300 million deficit in 1970 and a \$ US 51,200 million deficit in 1980). Non-oil exporting developing countries, nonetheless, have consistently recorded deficits (\$ US 1,500 million in 1970 and \$ US 6,100 million in 1980).

127. To put things in perspective, the traded services deficit of developing countries of \$ US 57,300 million along with a deficit of \$ US 29,200 million in factor services, placed their overall "invisibles" account into a deficit of \$ US 86,500 million in 1980. This was offset by a surplus of \$ US 111,900 million in their merchandise trade account which resulted in an overall current account surplus of \$ US 29,400 million for that year.

128. This result is, however, heavily biased by the performance of the oil-exporting developing countries. Their traded services deficit of \$ US 51,200 million together with a small deficit of \$ US 1,100 million in Factor services resulted in an "invisibles" deficit of \$ US 52,400 million. This was overwhelmingly offset by the \$ US 155,800 million surplus in the merchandise account which caused the current account to be in surplus by \$ US 97,200 million. Non-oil exporting developing countries, however, did not fare so well. They not only experienced a deficit in traded services of \$ US 15,000 million, but also deficits in factor services (\$ US 28,100 million) and merchandise (\$ US 43,900 million). Hence, their overall current account balance was in deficit by \$ US 67,800 million.

129. For developed market-economy countries, the catch-all "other private services" was both the largest overall traded service activity (recording credits of \$ US 105,600 million and debits of \$ US 91,400 million in 1980) and by far the largest contributor to the overall surplus in this account (providing a surplus of \$14,200 million). "Other transportation" and "travel" offset this surplus to a small extent by recording deficits of \$ US 4,800 million and \$ US 3,200 million, respectively. These items also accounted for the number two and three position, respectively, for total traded services credits and debits. "Official services" and "shipment" both recorded small surpluses.

130. Developing countries recorded deficits in every sub-item in their traded services account, except for "other transportation" which was in balance. "Shipment" was overwhelmingly the largest deficit item (\$ US 31,200 million in 1980) with "official services" taking second position (with a deficit of \$ US 19,700 million). "Other private services" and "travel" recorded deficits of \$ US 3,400 million and \$ US 2,600 million, respectively. Far more important, however, was the performance of the sub-groups of developing countries. For oil-exporting developing countries, "official services" (a deficit of \$ US 18,800 million) and "shipment" (a deficit of \$ US 16,200 million) were also the two largest deficit items. However, "travel" and "other private services" recorded sizeable deficits of \$ US 8,700 million and \$ US 7,000 million, respectively. "Other transportation" was in balance. While non-oil exporting developing countries recorded a large deficit in "shipment" (\$ US 15,000 million in 1980) and a small deficit in "official services" (\$ US 900 million in 1980), they recorded surpluses elsewhere. "Travel" in 1980 brought in a surplus of \$ US 6,100 million while "other private services" recorded a surplus of \$ US 3,700 million. "Other transportation" was in balance.⁵⁷

⁵⁶ Underestimate of shipping credits leads to a discrepancy in the balance for world traded services, for example, in 1982 both developed market-economy countries and developing countries were in deficit by over \$30 billion.

⁵⁷ The particular situation of Latin American countries has been examined by ECLA in F. Prieto: "El Comercio Internacional de Servicios: El Caso de América Latina y el Caribe", (E/CEPAL/SEM.15/R.3).

131. In sum, while developed market-economy countries recorded growing surpluses in traded services over the decade, developing countries (in particular, the oil exporting developing countries) recorded sizeable deficits. "Other private services" was the largest and growing surplus item for the developed market-economy countries, while "shipment" was the most significant deficit item for developing countries.⁵⁸ Within this context, however, it should be noted that several developed market-economy countries show major deficits in service trade, although this can usually be attributed to large deficits in one or two individual services (e.g., Federal Republic of Germany on travel account). Certain developing countries have major exports of specific services (Singapore - other transport, Mexico - travel, Egypt - other private services); as noted below, relatively few showed overall surpluses on service account as a whole.

2. The importance of traded services to particular countries

132. Though world trade in services may only be a small percentage of world production in services, traded services may nonetheless be important in the case of particular countries. During the period 1979-1981, 38 out of 120 countries reviewed had a surplus in their traded services account.⁵⁹ Of these countries, 17 were developed market economy countries⁶⁰ and 21 were developing countries.⁶¹ In the case of developed market-economy countries, the United Kingdom (\$ US 9,945 million), France, (\$ US 9,662 million), Spain (\$ US 6,067 million), Italy (\$6,053 million) and the United States (\$ US 4,009 million) all ran particularly sizeable surpluses in traded services. Developing countries such as Singapore (\$ US 2,902 million), the Republic of Korea (\$ US 1,425 million), the Bahamas (\$ US 674 million) and Panama (\$ US 436 million) ran smaller, though important surpluses in traded services as well.

133. Most of the countries reviewed are characterized by international specialization in one particular service activity. For developed market-economy countries, "travel" was the overwhelming surplus item for Austria (\$ US 3,337 million or 102 per cent of the surplus in traded services), Italy (\$ US 7,010 or 145 per cent), and Spain (\$ US 5,717 million or 97 per cent). The catch-all category "other services" was the dominant item for the United Kingdom (\$ US 8,348 million or 97 per cent), the United States (\$ US 6,572 million or 98 per cent) and Belgium (\$ US 1,855 million or 106 per cent). "Shipment" was the primary surplus item for Norway (\$ US 4,698 million or 328 per cent) and Denmark (\$ US 990 million or 82 per cent, while "other transportation" was paramount in the case of the Netherlands (\$ US 3,664 million or 447 per cent).

134. For developing countries, "other services" was of prime importance to the Republic of Korea (\$ US 1,234 million or 86 per cent) and to the Philippines (\$ US 419 million or 91 per cent). "Travel" was particularly important in the case of the Bahamas (\$ US 513 million or 76 per cent) and Tunisia (\$ US 577 million or 114 per cent), while "other transportation" is important for Panama (\$ US 480 million or 110 per cent).

⁵⁸ Official services was the second largest deficit item for developing countries as a group. However, oil-exporting developing countries accounted almost entirely for this deficit, with non-oil exporting developing countries having a deficit of less than \$ US 1 billion.

⁵⁹ "Surplus" countries in the context of this report are those which experienced a surplus in their traded service account for at least two out of the three years considered.

⁶⁰ Austria, Belgium-Luxembourg, Denmark, Finland, France, Greece, Iceland, Israel, Italy, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, United Kingdom and United States.

⁶¹ Bahamas, Barbados, Colombia, Cyprus, Egypt, Fiji, Jamaica, Kenya, Lesotho, Malta, Mexico, Netherland Antilles, Nicaragua, Panama, Paraguay, the Philippines, Republic of Korea, Romania, Singapore, Tunisia and Turkey,

135. Very few countries had a broad-based traded service sector. Notable exceptions were France, which had a sizeable surplus in "other services" (\$ US 3,710 million), "travel" (\$ US 2,230 million) and "shipment" (\$ US 990 million), and Switzerland which recorded positive net balances in "travel" (\$ US 2,230 million) and "other services" (\$ US 1,130 million).⁶² Singapore was the primary developing country which had several important traded activities, namely "other transportation" (\$ US 1,696 million), "travel" (\$ US 1,016 million) and "other services" (\$ US 511 million).⁶³

136. Special attention must be drawn to the cases of the least developed countries, and particularly the small island countries. In these countries, traded services play an especially important role. The prime reason for this is that an important constraint imposed by their small size is the limited opportunity to take advantage of economies of scale. While these economies can be exploited through trade in some activities, this is not usually possible in many areas, particularly those of services such as administration, health, education, training, agricultural extension, research, storage and marketing. Small countries thus have to devote a higher share of their resources to providing basic infrastructural services than larger countries. Some of the infrastructural services can be shared by neighbouring countries in the case of small countries which are continental or very close to continents, but for small islands the cost of providing them increases very rapidly with distance; archipelagic countries are particularly disadvantaged in this respect, having to duplicate certain basic services in several islands.

137. The assessment that "the economic characteristics of a mini-state are that goods which are produced tend to be exported, goods which are sold in the mini-state tend to be imported, and those activities which are both produced and consumed within the mini-state tend to be services"⁶⁴ is thus basically correct, with the essential qualification that a number of small developing countries, particularly island developing countries, also export services.

138. A second reason is the observed fact that small countries have a high dependence on trade, and particularly in the case of island developing countries, on exports of invisibles (including emigrant remittances).

139. Empirical studies⁶⁵ have observed statistically significant inverse relationships between the size of an economy (as measured by national income) and levels of international trade. For small developing countries⁶⁶ for which data is available the ratio of visible imports to GNP is 75.9 per cent, and for small island DCs the value of visible imports actually exceeds GNP, whereas for developing countries as a whole imports are 22.7 per cent of GNP.

140. In the context of this dependence on trade, a large proportion of the foreign exchange earnings of island developing countries is made up of invisibles. On average, income from services represents 51.1 per cent of the exports of goods in 41 island developing countries (excluding the 3 major oil exporters among them) for

⁶² Though the United Kingdom had a surplus in "travel" (\$ US 479 million) and "shipment" (\$ US 1,899 million), "other services" was clearly the dominant traded service surplus item (\$ US 8,348 million).

⁶³ The "Centre d'etudes prospectives et d'information internationales" (CEPII), based in Paris, has attempted to quantify the concept of specialization by examining the evolution of the services components of current payments of individual countries and groups of countries, with a view to identifying tendencies toward international specialization among services and between goods and services. This approach has the advantage of considering services in the overall context of all items contributors to the balance-of-payments situation of a given country.

⁶⁴ Khatkate, D.R. and Short, B.K., "Monetary and Central Banking Problems of Mini-States", *World Development*, 1980, Vol. 8, No. 12, p.1018.

⁶⁵ See for example Kuznets, S., *Economic Growth of Nations*, Cambridge, Mass., Harvard University Press, 1971 and Chenery, H.B., and Syrquin, M., *Patterns of Development*, London, Oxford University Press 1975.

⁶⁶ With populations of less than 1 million in 1981.

which data is available, as compared to 37 per cent in all developing countries (excluding major petroleum exporters). For the smaller island developing countries this percentage is even higher (61.6 per cent). This appears to be a characteristic which is related more to insularity than to smallness, since the 10 small non-island developing countries⁶⁷ for which data is available have a much lower percentage (29.7) of exports of services to exports of goods.

141. This large share of service credits is partly due to the well-known attraction of islands as tourist destinations. Thus in about half of the 18 small island developing countries for which information is available, gross receipts from tourism are larger than all visible exports put together.⁶⁸ An extreme case is that of the Seychelles where for 1982 earnings from tourism were almost ten times those of merchandise exports. Another reason is the strategic location of many islands which make them particularly suitable for providing logistic services such as staging posts, refueling stations, siting of communication, meteorological and other observation facilities. This often extends to military or para-military facilities. Other types of invisible export are offshore financial and administrative services, which are concentrated mostly in the Caribbean area. Finally, there is a surprising variety of other export-oriented services, which includes educational facilities, postage stamps (for philatelic purposes), and even the sale of shipping services (Maldives).

B. Conceptual issues

1. Tradeable services

142. The balance-of-payments accounting system, and to a considerable extent, the current international debate on services, have tended to obscure the international dimension of service activities.⁶⁹ The term "international transactions" in services has inappropriately combined activities which involve direct export/import with those which involve foreign ownership but which are provided directly in the domestic market.⁷⁰ While the same service may be provided by both methods, it is essential to draw a clear distinction between these two different forms of exchange.

143. For the purposes of defining export and imports of goods and services, the IMF considers only transactions between residents and non-residents to be relevant. With regard to the specific components in the balance-of-payments, therefore, traded services comprise the following two areas.⁷¹ First, services which physically cross international borders would obviously be included. This would include "shipment", "passenger services" and most of the catch-all category in the IMF balance-of-payments, "other private services".⁷² Second, certain services which are consumed by foreign residents in the "home" country as well as by domestic residents while in a foreign country. For example, in the case of tourism the "customer" travels to his desired consumption location and fulfils his housing,

⁶⁷ Excluding the four small countries which are major petroleum exporters, namely: Brunei, Gabon, Oman and Qatar. If these countries are included the percentage falls to 13.7.

⁶⁸ TD/279 (Part II), table 4.

⁶⁹ The same is true of the UNCTAD secretariat's initial analysis in TD/B/941.

⁷⁰ As noted below, from the point of view of transnational corporations, trade and/or investment in services i.e. "transactions may be interchangeable or alternative means of supplying the world market for services; from the point of view of governments, trade and investment raise different policy questions.

⁷¹ For a detailed discussion of each of the components in the *balance-of-payments* see the IMF Balance of Payments Manual and TD/B/941.

⁷² As discussed below, this includes, *inter alia*, certain activities within accounting, advertising, engineering, communication, data processing and motion pictures.

food and entertainment needs accordingly. In the case of port and airport services, international ships and aircraft temporarily harbored in a foreign country must meet their fuel and servicing needs in the foreign market place. In both cases, it is the location of the customer which designates where and how the provision of the international service activity will take place. While no actual "across-border export" in the traditional sense takes place, the transaction is still between the resident of a country and non-residents. Together these two categories constitute private traded services. To this can be added "official services" which would provide total traded services (private and official). This figure corresponds to total "Non-Factor Services" in the balance-of-payments.

2. Non-tradable services

144. Even though the thrust of this chapter is on services in the international context, mention must be made of the non-traded service sector. Chapter three of this report provides a detailed discussion of this aspect and presents aggregate national data on production and employment in services is presented. For analytical purposes, non-traded services are all those activities which are produced and consumed by residents of the same country. The fact that most services cannot be "stored" in the classical sense of the word (hence, no significant time span exists between the production and the consumption of the service), place most services in a position where they cannot be traded internationally.

145. One cannot argue, however, that these services are inherently non-tradeable activities. In fact, the improvement of international infrastructure, as well as the development of "new" international carriers (i.e., those generated by combining telecommunication and computer science), has contributed to the development of activities which in the past were "non-tradeable", but today have become "tradeable". This increase in the tradeability of services is rapidly accelerating due primarily to developments in the telematic field. Transborder data flows are facilitating the supply of various services "across-borders" to residents of other countries.⁷³

146. There are certain situations in which the differentiation between non-tradable and tradable services may be blurred. However, from a conceptual standpoint, a clear distinction is possible. Take, for example, the case of construction, engineering and consultancy. In one case, the consultant may fly to the consumer-country, become a "temporary" resident, provide his service and then return to his home country. In another case, the amount of business in that country may be such that the consulting firm would prefer to set-up a permanent office so that it could have closer contact with its customer as well as be in a better position to expand its business base. In the former case the transaction would be an export/import or "trade" in the correct sense, while in the latter case it would be considered as a domestic service provided by a resident foreign national and hence would not be a "trade" concern. If, in the latter case, the office was simply a representative arm of the company and the bulk of the actual "service" was produced abroad and simply channelled through the foreign office, then it would be nothing more than a disguised import. The trade/investment distinction is being further complicated by developments in information technology and, in particular, telematics.⁷⁴ There are, therefore, grey areas where activities which might come under the guise of trade, are in fact, really foreign investment issues and should be dealt with accordingly.⁷⁵ Two possible criteria to help in this regard would be: (i) whether the ultimate transactions is between residents and non-residents, and (ii) whether or not the majority of the value-added is exchanged between residents and non-resi-

⁷³ Examples are still limited to a few cases, but the increasing use of the global credit card is another illustration of this phenomenon.

⁷⁴ United Nations Centre on Transnational Corporations (UNCTC): "Services and Development in Latin America": International Transactions in data flows, June 1984. Prepared at the request of the Permanent Secretariat of SELA.

⁷⁵ Pertinent to this discussion is all the literature on internationally agreed principles on "rules of origin".

dents.

2. Determinants of international trade in services⁷⁶

147. The question obviously arises, what determines trade? The determinants of trade flows and international competitiveness in services, long neglected in academic studies, are now becoming the subject of serious analysis, prompted largely by the current international debate on service issues.

148. An approach adopted by a number of writers, (and governments) has been simply to assume that the same economic theory which explains the determinants of trade in goods can *mutatis mutandis* be applied to trade in services. In consequence, unilateral liberalization is regarded as beneficial to the country concerned, and multi-lateral liberalization⁷⁷ would be beneficial to all, as specialization would take place on the basis of comparative advantage.

149. Several economists have chosen to test this approach on the basis of econometric analysis. Notable recent studies are those conducted by Sapir and Lutz under World Bank auspices.⁷⁸ Others have been undertaken with respect to countries and groups of countries.⁷⁹ The major difficulty encountered in these analyses has been the absence of sufficiently disaggregated statistics. The chief problem is that balance-of-payments statistics indicate only payments for services, not trade flows,⁸⁰ and statistics are aggregated to an extent rendering them meaningless in certain cases,⁸¹ in particular, the lumping together of a heterogeneous group of internationally important services in the basket category "other private services". As a result these analyses have addressed those services where data is more meaningful, e.g., shipping and tourism, drawing not surprising conclusions such as the "comparative advantage" of certain countries in these sectors.

150. A third approach, and the most recent, has been to examine seriously the conceptual issues involved, to determine what modifications would be necessary to apply conventional trade theory to trade in services. Several studies in this area have only recently appeared and many apparently are still underway. Some authors argue that the notion of competition itself, as understood by the international trade theory, loses much of its significance, and the theory itself ceases to be fully applicable, to exchanges in services.⁸²

C. Information technology and trade in services

⁷⁶ See also discussion in TD/B/941.

⁷⁷ The Trade Policy Research Centre (TPRC), has combined trade and investment together in the "liberalization concept" using the term "transactions" (see "Draft Statement on the Liberalization of International Transactions in Services", presented to the Conference on Restrictions on Transactions in the International Market for Services, May/June 1984). The United States national study, noted below, draws a distinction between trade and investment issues.

⁷⁸ Andre Sapir and Ernst Lutz: "Trade in Non-Factor Services: Past Trends and Current Issues" and "Trade in Services: Economic Determinants and Development Related Issues. World Bank Staff Working Papers No. 410 and 480, respectively.

⁷⁹ See Nicolas Outton: "International Trade in Service Industries: Comparative Advantage of European Community Countries", TPRC, London (presented to above-mentioned Conference).

⁸⁰ Professor Sapir has also attempted to identify North/South flows in services trade in the paper presented to the above-mentioned TPRC Conference.

⁸¹ See discussion in annex I and proposals for improvements.

⁸² See, for example, J. Nusbaumer *op.cit.*, Louis Reboud "L'importance économique des services" in "Le Marché Commun des services", Centre Universitaire de Recherches Européennes et Internationales (CUREI), Grenoble, 1984.

151. The methods by which traditional service industries (i.e., banking, insurance, consulting and engineering) deliver their products are being revolutionized by the impact of technological developments. These service industries are able to offer a greater range of services, at greater speed, and at lower cost, because of the availability of computers, of specialized programmes and of improved delivery systems involving radically expanded and improved telecommunications links (e.g., satellite transmission, digital networks).

152. The number of transnational computer-communication systems⁸³ as well as the number of network terminal points⁸⁴ has grown rapidly in recent years. These transnational systems are used in two main ways. First, transnational corporations rely on transborder data flows to link their headquarters with their various foreign affiliates. Second, independent firms use transborder data flows to facilitate their operations.⁸⁵ The latter case involves arm's length market transactions and is considered to be "commercial" transborder data flows.⁸⁶ However, commercial transborder data flows are growing and are likely to continue to grow in importance throughout the years ahead.

153. The major effects of developments in information technologies on trade in services are (a) increases in the tradeability of services and (b) changes in the economies of scale of services.

154. Tradeability of services is greatly increased by telecommunications and telematics. Data services such as data processing, software and access to computerized data bases, can be transported through information networks to virtually anywhere on the planet. The tradeability of these services also contributes to the facility and profitability of those international services operations which depend on the supply of these services.

155. The second contribution of information technology is the changes in economies of scale. It is a costly matter to construct a world-wide information grid. However, once such a grid is installed, the incremental cost of transmitting additional data is very small thus, the incremental cost of adding services which are information-based is very low.⁸⁷

156. Transborder data flows and the data industry are heavily concentrated in the

⁸³ According to Karl Sauvart, data on the number of transnational computer-communication systems are scarce. Estimates point to 100 to 150 such systems in Western Europe in 1978. For Japan, the number is 150 for 1979, and for Brazil 21 in 1982. If one takes the conservative estimate that the United States has at least as many systems as Western Europe, then the total number of systems was about 500 for the year 1979. In the last three years, their number has probably at least doubled. See *Transborder data flows: importance, impact, policies*, p.5, 0167-5265/84, Elsevier Science Publishers, Bv. (North Holland), 1984.

⁸⁴ "In Western Europe, the number of network-termination points is expected to increase from about 393,000 in 1979 to 1,620,000 in 1987. Over the same time, the number of terminals is expected to rise from 625,000 to nearly four million. Furthermore, because of improved access to networks, the volume of data transactions on an average working day is projected to increase from 136 million in 1979 to about 800 million 1987. Of these the share of international transactions is expected to rise from 10 to 15 percent." See "Transborder data flows", *Ibid.*, p.8.

⁸⁵ The link between transborder data flows and the role of transnationals in services trade is discussed in the following section.

⁸⁶ In the case of Canada, for example, some 90 per cent of transnational data and information processing consists today of corporate transborder data flows, the rest of commercial TDF. (Sauvant, *op.cit.*, p.5).

⁸⁷ See H. Malmgren, "Negotiating International Rules for Services", paper submitted to the Trade Policy Research Centre, April 1983, J. Rada, *op.cit.* This also effects the barriers to entry to the international market, which may be lowered, if all that is required is to connect or "plug in" to the network, or greatly raised when an independent world-wide information grid is required.

developed market economy countries. At the same time, these countries serve as the home of the vast majority of transnational corporations. Equally important, the geographical distribution of data-transmission networks, network-terminal points, computer services and data bases are also concentrated in these countries.⁸⁸ Since the industries in which transborder data flows are important are considered to be the primary growth industries of the future, the market concentration and revolution in telematics has both economic and political implications. The underlying issue is the future position of each country in the international division of labour and in the international system itself. At the same time, developing countries will soon face a new world radically altered by the revolution in telematics. It is therefore essential for policy makers to study and become aware of both the positive and negative effects that telematics can have on their country's position in the international market for services.

157. These developments also serve to reduce the autonomy of foreign-controlled subsidiaries, whether in the goods producing sector or the "services" sector. Informatics makes detailed control of operations from the centre much more feasible and less costly. The impact of improvements in communications has gradually but steadily increased the scope for centralized control of decision-making. However, what is occurring with the advent of sophisticated computer communications links is an abrupt increase in the scope for control from one central point. This is true in regard to continuous process functions, as in oil refining or chemical production, through the use of real-time systems. It is true in regard to detailed engineering design and project control through computer-aided-design and graphics systems. It is also true in regard to the operation of such services as those conducted in series, such as banking services, insurance sales, airline reservations and hotel room bookings.

158. The sharp increase in centralization raises a number of policy issues. It raises a practical question of whether manufacturing or service industry subsidiaries of parent firms located in other countries can realistically be expected to exercise independent functions, such as research, product design and development and marketing decisions. As described in more detail below, it can also lead to inter-firm division of labour according the less sophisticated tasks to developing countries. The increasing centralization clearly reinforces situations of dependence, including those of access to computer links with the parent company.⁸⁹ The centralization of control derived from the increasing use of computer-communications systems will inevitably heighten dependence and could lead to attempts to insulate the peripheral economy from access to vital information.

D. Transnational corporations and services

159. As has been noted above, the developed market-economy countries, particularly the member States of the EEC, the United States and Japan, are the major "traders" in services. It is also clear that the transnational corporations are major "suppliers" of services either through direct "exports" or through investment abroad to supply foreign markets. This dominant position appears to be attributable to a new dynamism of many corporations, including those which have attained the capability of offering a variety of services on a world-wide basis, as well as other firms, not traditionally transnationals, but which have more recently been projected into the international arena.

160. The observed dynamism of the transnational corporations can be attributed to

⁸⁸ Sauvant, *op cit.*, p.10.

⁸⁹ Their dependence has been recently illustrated by the "Dresser" case, an episode in which the United States authorities required the severance of the computer link between the parent firm in the United States and its subsidiary in France, as a sanction for the French firm having failed to obey an order regarding exports from France of products made in France of technology originating in the United States.

several factors. One is simply the need to seek new markets abroad. The fact that services constitute over 60 per cent of world GNP but only 8 per cent of services produced are traded, gives a clear idea of the attractiveness of foreign markets. While, in certain service sectors, transnationals have had a lengthy involvement in international operations, such as shipping and insurance, recently there has been a growing tendency both to export to and/or invest in foreign markets for the production of services. Notable among these has been the banking sector, where it is reported that several major United States banks, for example, have seen foreign profits, as a percentage of total profits, triple over the last decade rising to over 70 per cent in some cases.⁹⁰

161. As already noted, these foreign operations are greatly enhanced by developments in information technology, especially telematic and the existence of worldwide information networks. Transborder data flows have become the "life blood" of transnational corporations, leading not only to a greater tradeability of services, but also the facilitation of production of services in foreign subsidiaries abroad.⁹¹ In this respect they have led not only to a greater exportability of services, e.g., services can be provided directly from a central data base, but have also encouraged transnational corporations to seek to establish to a greater extent in foreign countries, given the increased ability to serve the foreign market.

162. This process of internationalization has accelerated because many service corporations have found it necessary to expand their international operations to be able to continue to serve their major clients. This phenomenon has characterized not only the operations of banks and insurance companies but also advertising companies⁹² and has extended to professional services such as accounting.⁹³ Needless to say, such services depend on transborder data flows, which also provide the medium for interlinkages on a global scale.

163. A further contributory factor to the dominant position of transnationals in the world market for services has been their ability to offer a wide range of services. As noted in the discussion of the domestic context, this has been prompted by a more competitive situation, and has been facilitated by information technologies that enable firms to offer an integrated package of services once the necessary data network has been established.⁹⁴ This need to offer a variety of services has been one of the factors behind the tendency toward mergers between service companies or between goods and service companies. What is new about these mergers is their hybrid nature, involving banks, other financial institutions, companies normally associated with goods (e.g., mining) construction and consultancy engineering firms, etc. Such mergers have enabled these transnational service conglomerates to acquire a capacity to penetrate new foreign markets with a variety of services or a combination of goods and services. These mergers diversify risks, help to obtain new expertise, and acquire better access to finance. Another consideration has been the possibility of maximizing the utility of information systems or the ability to integrate sales of turnkey projects, engineering services

⁹⁰ E.g., Chase Manhattan and J.P. Morgan, 70 and 72 per cent respectively in 1982. See F.F. Clairmonte, J.H. Cavanagh "Transnational corporations and services: the final frontier", *Trade and Development an UNCTAD Review*, No. 5 (United Nations Publication, Sales No. E.84.II.D.8).

⁹¹ See United Nations Centre on Transnational Corporations (UNCTC) *Transborder data flows: Access to the International on-line data-base market* (ST/CTC/41), United Nations publication, Sales No. E.83.II.A.1.

⁹² See (ST/CTC/8), *op.cit.* This study notes the extent to which the large United States-owned transnational advertising agencies are dependent on foreign earnings, e.g., McCann-Erikson operates in 58 countries, gaining 70 per cent of its income (of \$ US 162 million in 1977) from outside the United States.

⁹³ Mark Stevens (*op.cit.*), describes how the major United States accounting firms have won or lost major accounts in relation to their ability to convince their transnational clients of their international capabilities. It is estimated that the firm Peat, Marwick, Mitchell employs over 23,000 people in 66 different countries, with total fees slightly less than \$ US 1 billion.

⁹⁴ It is estimated that over 1,000 such intra-firm networks currently exist. UNCTC: "Services and Development in Latin America, *op.cit.*

with comprehensive financing.⁹⁵

164. It has been reported that the most successful corporations with respect to their ability to offer an overall package of goods and services have been the Sogo Shoshas of Japan. These nine large corporations offer a variety of services, trade and financial and each deal in over 20,000 products. Their combined sales in 1982 have been estimated at over \$ US 340 billion, with Mitsubishi, Mitsui and C. Itoh accounting for half of this total.

165. It is difficult to estimate how much of the returns on investment actually constitute returns on investment in services. Figures collected by the United Nations Centre on Transnational Corporations on foreign direct investment on services by the United States, the Federal Republic of Germany, the United Kingdom and Japan, have shown a higher rate of growth in investment in services than in investment as a whole, particularly with respect to the latter two countries.⁹⁶

166. Experience shows that, as in the case of agriculture and manufactures, a strong domestic service sector is the basis for developing a strong service position in the international market. This would be the case of most services which lend themselves to international trade or what have been described as "tradeable" services. Strong service sectors are generally inter-linked with a strong primary and secondary sector. In this case, "absolute advantages" would then arise from an overall higher level of development in the national economy as a whole.⁹⁷ In turn, the inherent strength of many service industries in developed market-economy countries is further reinforced by the utilization of relatively new forms of organization and management in the international operation of some key service industries (i.e., transnational corporations), and their ownership of essential technology and acquired knowledge.

167. The dynamism of the TNC's in the service sector can provide opportunities for developing countries, particularly in the field of data technologies. Such opportunities can be seized through the adoption of appropriate policies and measures to strengthen the domestic data base, offering a sharing of economies of scale with foreign firms through the linking up of these respective operations.⁹⁸ In turn, these economies of scale should be reflected in smaller unit costs for both parties. Hence, the main concern here would be to assure that these lower unit costs not only reward the producer of such services but also benefit the users. The same argument can be made in support of regionally integrated service industries in the case of developing countries. Integration might be the best means to achieve adequate economies of scale in the provision of key services.

168. On the other hand, this process of transnationalization of services operations includes serious risks for developing countries, one of these being the danger of their being allocated the "bottom rung" of the intra-firm and international division of labour, as suppliers of relatively unskilled labour (i.e., card punching) and merely as marketing and distributional outlets for transnational corporations. Given the high skilled labour involved in traded services, an approach designed to avert such a situation would have to depend not only on a regulatory structure to deal appropriately with the activities of transnational corporations but also policies aimed at upgrading the domestic technical and educational infrastructure.

⁹⁵ Methods by which developing countries can counter the more unfavourable effects of this latter approach are suggested by Hernando de Soto in "The Importance of Engineering and Financing Services for the Developing Countries", (mimeo).

⁹⁶ See United Nations Centre on Transnational Corporations: Services and Development in Latin America, *op.cit.*

⁹⁷ The idea of "absolute advantage" has also been developed in J. Nusbaumer, *op.cit.*

⁹⁸ From United Nations Centre on Transnational Corporations: Services and Development in Latin America, *op.cit.*

E. Observations

169. As noted in chapter IV, there is an essential difference between "trade" in services (involving transactions between residents of a country and non-residents) and transactions between residents of the same country which might fall into the category of "investment in services". Some confusion between these two concepts still appears to exist in the international debate on services, which seems to reflect the perceptions of the transnational corporation, for which, as has been noted, the decision to supply a given foreign market through investment or export from the home country or a third country should be a matter of corporate strategy taking into account the tradability of the service, recalling that the large majority of services are still not tradeable. Therefore, any regulations which interfere with such decisions can be considered to constitute "restrictions to international transactions in services". From the point of view of governments, however, especially host governments, foreign investment raises a wide set of questions having to do with its impact on domestic productive and export capacity and on the role of domestic entrepreneurship in economic development.

170. A further complication is introduced by the impact of new technologies. One major effect of information technologies is their role in greatly increasing the transportability of services. The development of world wide information "grids" and of telematics have made it possible to provide an ever increasing number of services to customers throughout the world. These technologies led to increased tradeability of services on a scale previously unknown, affecting traditional international services such as shipping and insurance as well as those which in the past had been relatively localized (e.g. legal and medical services). In addition it has led to trade in "new" services such as data processing, computer assisted design (CAD), etc.

171. A second feature is the extent to which such information systems permit firms which have access to them to offer a great variety of services, extending beyond that traditionally associated with a particular service "sector". Once a world information grid is built, the incremental cost of processing or transmitting additional information in that grid is very small. Thus, the incremental cost of adding services which are information based is very low. Examples given are the offering of non-banking services by banks and the undertaking by other transnationals of activities generally associated with banks.

172. It has been pointed out that these phenomena add a new dimension to international trade in services, for which neither the international legal system nor policy makers are yet prepared.⁹⁹ One of the implications is that transnational corporations can greatly increase their scope of operation and their competitiveness in markets around the world. It also means that their subsidiaries established in other countries, especially developing countries will, so long as their links to the international data grid are not interrupted, retain a tremendous edge over local competitors attempting to offer the same services without access to the said grid. Such a situation would oblige the domestic producers of services to secure links to such international systems. This, however, could lead to problems of dependency which will be discussed below.

173. Another implication of this situation is that it is likely to become rather difficult to continue to speak of "trade" or "trade relations" in specific services in the intergovernmental sense referred to above, as it would seem that policies would have to be directed more to the activities of firms regardless of whether they were established in the domestic market or not. In a large number of cases it would appear that the only "service" being "traded" is pure information, the transborder data flows, which constitute the "raw material" which is "processed" into a service.

174. As has been noted by several authors and in studies by international organizations such as the United Nations Centre on Transnational Corporations (UNCTC),

⁹⁹ Juan Rada, *op.cit.*, "Advanced Technologies...".

the trade in data also has serious implications for developing countries. A tendency to depend upon data provided from data banks organized and maintained in a few developed countries can lead to a serious situation of dependency and even an undermining of national sovereignty.¹⁰⁰ The ever-diminishing cost of telecommunication has made it more economic for many firms located in developing countries to have their problems of design, calculations and routine research data processed in the developed countries, leading to what has been described as an "electronic brain drain".¹⁰¹

175. Such a situation places developing countries in a dilemma. On the one hand they require inputs of certain services for their development, to retain their competitive position in the production of manufactures and even agricultural products. On the other hand, acquisition of efficient, modern services from abroad can exacerbate their already dependent position. A necessary response to this challenge would seem to call for a more complete understanding of the role of services in the development of the national economy, and an improved awareness of the effect of technology and other factors on the rapidly changing world market for services and how their efforts can be reconciled with development needs.

176. It should be noted that the expansion of trade in advertising and accounting and other professional services, and the major position of a relatively small number of firms in these areas, have implications different from the more strictly economic affects of the existence of the same phenomena in more traditionally international sectors such as banking, shipping and insurance. Advertising has obvious cultural implications which have led to disputes between countries.¹⁰² The power of the accounting firms is their intimate knowledge of the workings and financial situation of major companies which give them their unique access to financial and economic knowledge.¹⁰³

177. Two other observations arise from this discussion. One is in respect to certain ideas which have been put forward suggesting that the new division of labour should be based upon the "export" of services from developed countries in return for the continued growth in the exports of manufactures from developing countries. This approach would seem to flow from the three stage theory of economic development and the idea of a "post-industrial society". As has been noted however, most traded services consists of intermediate services required by developing countries to retain their capacity to compete on world markets for manufactures and even agricultural products. The scenario implied by this theory might entail, in certain cases, developing countries losing control over the inputs into their own development process as well as their ability to export manufactured products,¹⁰⁴ while, on the other hand, the need for access to these services appears unquestionable.¹⁰⁵

178. The preceding discussion gives rise to the question of the extent to which trade or foreign investment in services contribute to the development process, or more specifically, the type of considerations which could lead developing countries to adopt a "services-development" policy supportive of their overall development strategies. As noted above a much clearer idea than generally exists at present would have to be obtained of the role of various services in the domestic develop-

¹⁰⁰ See, for example, (Paris, La Documentation française, 1978), S. Nora and A. Minc, *L'informatisation de la société*,

¹⁰¹ Juan Rada, *The impact of micro-electronics and information technology: Case studies in Latin America*, UNESCO, 1982.

¹⁰² E.g., the United States, Canada, see reference footnote 126 of this report.

¹⁰³ See Stevens, *op cit*.

¹⁰⁴ Andre Sapir, "The role of services in the international division of labour between the industrialized and the developing countries". Paper submitted to the Trade Policy Research Centre, June 1984.

¹⁰⁵ Brazil is one developing country which seems to have successfully developed an appropriate regulatory mechanism for dealing with this dilemma, at least in the areas of transborder data flows, see UNCTC, "Transborder Data Flows and Brazil". *Brazilian Case Study* (ST/CTC/40), United Nations publication, Sales No. E.83.II.A.31.

ment context, and a conception of the extent to which technological and other factors could be expected to influence the world services economy. Given this clear understanding it would seem that the supply aspect should be accorded priority, i.e. how to obtain those services capable of making the greatest contribution to various growth policies in the economy. The preceding discussion has implied that their are key infrastructural and producer services which are required to increase and even to maintain the competitive position of key sectors of the economy.

179. Whether these services are supplied through "trade" or through other options, including foreign investment, could be decided in light of other factors, such as the share in the longterm costs for the balance-of-payments, the employment effects, the impact on national sovereignty and the extent to which the supply of the service could lead to an effective transfer of technology to the national economy as a whole. In other words the developing country government would look at a series of factors in deciding its strategy in the same fashion as the transnational corporations with which it would inevitably be dealing.

180. Such a development policy in the service sector would have to take into account the possibility of exporting services from the developing country. In the absence of peculiar natural or historical factors (which have resulted in certain developing countries earning substantial credits) an understanding would have to be gained of the factors contributing to comparative advantage in this area, as well as an assessment of other barriers to entry to the world market. From the point of view of developing countries (or any new entrants to the world market for services) "barriers" to such entry may not only be foreign regulations but also such other factors as lack of access to technology and information networks, restrictive business practices, the dominant position of TNC's, and lack of necessary skills.

181. Certain developing countries have demonstrated their competitiveness in the supply of a limited range of services such as consultancy engineering and construction. To a large extent these may have benefited from their high labour content (i.e. workers supplied with construction projects), or their special familiarity with tropical conditions; neither factor presents solid advantages in "exporting" to developed market-economy countries or to the socialist countries of Eastern Europe. However, the limited number of "success stories" among developing countries deserve to be studied in detail. But, as noted above, any strategy by developing countries to penetrate the world market for services would have to be drawn up in full recognition of the importance of technology, information, and of acquired special knowledge in competing in the international market for various services, and the way in which information-based technologies have enabled transnational corporations to expand greatly their competitiveness and the geographical scope of their activities by developing the capacity to supply an integrated package of services for the world market.

CHAPTER VI

POLICY ISSUES: THE EXISTING FRAMEWORK AND CURRENT PROPOSALS FOR FUTURE ACTION

A. A review of existing bilateral and multilateral frameworks.

182. While no comprehensive multilateral contractual or normative framework exists to deal with services in general, countries have in specific, limited cases followed certain guidelines and accepted particular obligations in this area. The purpose of this section is to comment briefly on the existing structure of obligations and rights concerning trade in services as well as those affecting foreign investment in the domestic production of services. There is already a substantial body of literature, essentially of a descriptive character, covering this subject.¹⁰⁶ This section attempts to be analytic and critical.

1. Existing bilateral arrangements dealing with trade and foreign investment in services

183. Many bilateral treaties addressed to economic and commercial issues deal with aspects of services trade and foreign investment. While bilateral treaties apply primarily to goods and consist of little more than a simple most-favoured-nation clause with consultation provision, the detailed bilateral treaties negotiated by the United Kingdom and the United States, the two principle service economies among developed countries, are of particular importance, especially those negotiated recently.

184. The Treaties of Friendship, Commerce and Navigation (FCN treaties) negotiated by the United States, contain broad "national treatment" provisions, both for persons and for companies. They do not provide for right of establishment, but rather that persons and firms of the one country doing business and being present in the other shall be treated on the same basis as national persons and companies. In these treaties such provisions typically apply to service activities as well as to persons and firms engaged in other types of activities. The United States Study reports¹⁰⁷ that there are eleven treaties signed by the United States since 1953 providing for national treatment with respect to the operation of business firms. However, it is of importance that certain of these bilateral FCN treaties, to which the United States is a party, specifically exclude such major service sectors as banking, communications, transportations.¹⁰⁸

185. Various bilateral treaties with some relevance to services are in force between the United States and certain developing countries (Egypt, the Republic of Korea, Liberia, Argentina, Bolivia, Chile, Costa Rica). The Liberian treaty appears to be the broadest in that it refers to freedom of investment. The United States is negotiation of a series of bilateral investment treaties, three such treaties have been signed (Panama, Egypt and Senegal).¹⁰⁹ These bilateral investment treaties are cast in terms of the exchange of most-favoured nation (MFN) rights and national treatment. For example, the treaty with Panama gives Panamanians the right to invest in the United States under the same terms as United States

¹⁰⁶ The two most substantial descriptive reviews are to be found in Ronald Kent Shelp: *Beyond Industrialization/Ascendency of the Global Services Economy*, (New York, Praeger, 1981), and in the *United States National Study on Trade in Services*, Office of the United States Trade Representative, Washington D.C., December 1983 (referred to in this report as the "United States GATT Study").

¹⁰⁷ United States GATT Study, *op.cit.*, p. 76.

¹⁰⁸ Shelp, *op.cit.*, p. 155-156.

¹⁰⁹ United States' GATT Study, *op.cit.*, p. 76.

persons, and similarly, for United States persons the right to invest in Panama on the same terms as Panamanians. The form of the Treaty, however, provides for the exclusion from the scope of national treatment provision of various key sectors, many of them in the services sector. The need for this exception arises because the relevant United States and Panamanian legislation specifically prohibits or limits participation or ownership by foreigners. The service industries excluded from the national treatment obligation on the United States side are: banking, insurance (in these two areas there is partial or complete regulation at the state level in the United States), air transportation, shipping (cabotage and international); radio and television broadcasting, submarine cable services and satellite communications and customs brokers.

186. The United States has indicated that attention will be given by the United States authorities to extending the scope and number of investment treaties that provide ownership rights and FCN-type treaties that provide national treatment rights in regard to persons and firms, including those in services sectors. It is clear, however, that both types of treaties deal with aspects of direct foreign investment and almost no mention is made to *trade* in services.¹¹⁰

187. The United Kingdom has also used the MFN concept and national treatment concept in regard to persons and firms including those in the services sectors, in bilateral treaties. The most notable is the Treaty of Commerce, Establishment and Navigation negotiated in 1955-1962 with Japan. Considerable attention has focussed on this treaty because of its special discriminatory "safeguards" arrangements, which was the main subject dealt with in the United Kingdom government statement explaining the treaty.¹¹¹ However, the treaty covers many other matters in great detail, including such issues as freedom of worship and the burial or cremation of the dead, the latter being subject only "to any non-discriminatory, sanitary or medical requirements laid down by the authority of that territory". The whole thrust of the treaty is to ensure MFN treatment, when appropriate, and, in regard to persons and companies ("all legal persons except physical persons") national treatment to the extent feasible (e.g., cabotage, Article 20 (5)). Establishment issues are dealt with on an MFN basis. Article (1) provides that "the companies of one Contracting Party shall in any territory of the other be accorded treatment not less favourable than that accorded to the companies of any other foreign country in all matters relative to the carrying out of all kinds of business, including finance, commerce, industry, banking, insurance, shipping and transport, as well as in all matters relative to the establishment and maintenance for such purposes of branches, agencies, offices, factories and other establishments appropriate to the conduct of this business". If no rights of this sort have been granted to others, then the MFN clause conveys no substantive right; except that it is a guarantee of non-discrimination for the future.

2. The Existing multilateral framework

188. An important category of international agreements or arrangements in the services sector is that which set out standards or norms of behaviour (perhaps only in the form of recommendations) which all signatories are to follow. Such an approach is regarded as necessary in order to ensure the functioning of international trade in certain services - e.g., maritime and air transport and telecommunications. These arrangements may also go further and create specific rights, which are called into existence because of broad agreement that such rights should be created for functional purposes. An example of this is the right of cargo-sharing in the Convention on a Code of Conduct for Liner Conference, which treats rights related to the equitable distribution of carriage division of conference cargoes.

¹¹⁰ United States GATT Study, p.77.

¹¹¹ London, HMSO, *Government Statement on the Anglo-Japanese Commercial Treaty*, Cmnd. 1875, Nov. 1962.

189. The International Civil Aviation Organization (ICAO) (the "Chicago Convention", as revised)¹¹² and the International Telecommunications Union (ITU) are important examples of services sector agreements that are drafted with the objective of setting norms of conduct in the sector and promulgating standards for adoption by national governments. Much of the work of ITU is of this character. For example, the ITU originates standards which govern the interface of computers with other computers linked by telecommunications systems. These "interface" standards are promulgated by domestic legislation. In the air transport area, there is a four-way functional split. The ICAO agreement lays down a number of basic standards of conduct necessary to ensure that there will be functionally effective international air transport. Like the ITU provisions, these do not normally involve MFN or national treatment formulations, but rather are cast in the form of rules which signatories adopt to govern their own conduct. At the level of the carriers, standards or norms (for example, what are to be standard charges for cabin services) are agreed in the world-wide industry association: the International Air Transport Association (IATA). These are primarily private rules to regulate or limit competition. A third component is the bilateral air route and air service allocation agreement, negotiated as between governments, allocating routes and prescribing the number of national carriers on each route. These agreements are frequently re-negotiated, given the changes in the pattern of air transport, and are usually described in terms of reciprocal or "balanced" packages of air route and service rights of comparable value. Given the growth of air transport, these special service sector agreements are considered by governments to involve major negotiating considerations. The fourth component is national regulation. Such regulation covers a variety of international aspects: the licensing of foreign-produced aircraft, and the approval of foreign airline fares for services to the country concerned.

190. On 9 April, 1984, the Secretary-General of UNCTAD wrote to the executive Heads of eighteen international organizations of the United Nations system,¹¹³ requesting information about their respective activities, including technical assistance, that are pertinent to an examination of the role of services in the development process. As of 21 June 1984, ten answers had been received by UNCTAD. These replies emanated from the Food and Agricultural Organization (FAO), International Labour Organisation (ILO), International Monetary Fund (IMF), International Maritime Organization (IMO), United Nations Educational, Scientific and Cultural Organization (UNESCO), Universal Postal Union (UPU), International Atomic Energy Agency (IAEA), General Agreement on Tariffs and Trade (GATT), the International Bank for Reconstruction and Development (IBRD), International Monetary Fund (IMF) Joint Development Committee, World Health Organization (WHO) and United Nations Centre on Transnational Corporations (UNCTC).¹¹⁴ The following organizations indicated that they considered certain of their activities pertinent in this context.

191. The International Monetary Fund does not have a particular work programme or study in preparation on services. Trade in services, although naturally dealt with by the Fund, is not treated any differently than other forms of trade.

¹¹² *Convention on International Civil Aviation, Sixth edition*, ICAO document 7300/6.

¹¹³ The organizations contacted were : Food and Agriculture Organization (FAO), International Civil Aviation Organization (ICAO), International Finance Corporation (IFC), International Fund for Agricultural Development (IFAD), International Labour Organisation (ILO), International Maritime Organization (IMO), International Monetary Fund (IMF), International Telecommunication Union (ITU), United Nations Educational, Scientific and Cultural Organization (UNESCO), Universal Postal Union (UPU), International Bank for Reconstruction and Development (IBRD), World Health Organization (WHO), World Intellectual Property Organization (WIPO), World Meteorological Organization (WMO), International Atomic Energy Agency (IAEA), United Nations Industrial Development Organization (UNIDO), General Agreement on Tariffs and Trade (GATT), and the IBRD/IMF Joint Development Committee and the United Nations Centre on Transnational Corporations was also contacted.

¹¹⁴ These replies are reproduced *in extenso* in document TD/B/1009.

192. The reply from GATT was to the effect that, in response to the invitation of the Contracting Parties at their 1982 Ministerial Session, a number of Contracting Parties were engaged in a process of national examination of issues in the area of services, and that an informal meeting of delegations was held in March 1984 to exchange views and clarify information about the two national studies made available on Canada and the United States, respectively.¹¹⁵

193. FAO, through its activities in research, training, policy and planning assistance, public administration in agriculture, marketing, credit, information networks and early-warning systems often had to deal with service-related issues.

194. UPU was devoting its activities almost entirely to the area of services. As far as technical assistance was concerned, these activities concentrated on training, personnel management and technical improvement of postal administration. Special efforts were also directed towards financial instruments and savings, and the highest priority was given to the needs of the poorest countries.

195. ILO activities have led this organization to deal in significant detail with several service areas : maritime transport (focusing on the development of manpower resources and maritime labour legislation, with technical assistance projects in Cyprus and Mauritius) , new technology (which was an object of particular attention by ILO's Joint Committee on Public Services in 1983; the effect of new office technologies, including word-processing, on the employment of women was also studied; another study¹¹⁶ was completed that discusses the possible implications of new information technologies on the pattern of the international division of labour with special reference to services) , tourism (including hotel and catering services; three aspects were stressed: co-operation with international, regional, national and professional bodies, standard-setting and research activities, technical co-operation activities), public administration, banks, commerce and insurance.

196. UNESCO confirmed that some of the sectors concerned might have some future activity in the area of services. Should this be the case, UNCTAD would be informed.

197. WHO underlined that its activities could be considered to be, in their entirety, aimed at extending technical co-operation and services to the member States in the development process in the field of health, but did not relate to trade policies and practices.

198. UNCTC indicated that since its first session, the Commission on Transnational Corporations has requested the Centre to carry out studies in the area of services, and especially on banking, insurance, shipping and tourism, and, more recently on "computers and related services". In order to fulfil this mandate, the Centre had completed a number of technical papers and studies, including those on advertising, shipping, tourism, reinsurance, banking and transborder data flows. Several major on-going projects of the Centre related to services; they concerned banking (nature and extent of transnational banking, local operations of transnational banks in host developing countries, with particular emphasis on regulatory aspects), transborder data flows (including case studies in Brazil, Poland, the Federal Republic of Germany, Mexico and the United States); the Centre has also collaborated with other organizations like the Conference of Latin American Authorities in Informatics and SELA in their on-going work concerning Transborder data flows (TDF), construction and engineering, international computer-service industries, and international telecommunications industry as areas of significant involvement by transnational corporations. The Centre was also focusing on the regulatory environment of the service sector, as requested by the Commission. Certain parts of the on-going project of a code of conduct for transnational corporations (the finalization of which was currently one of the main objectives of the Centre) were partic-

¹¹⁵ Subsequently, the national studies of the United Kingdom (described in chapter V) and the Netherlands have also been received by the GATT secretariat.

¹¹⁶ J. Rada *International Division of Labour and New Information Technology with Special Reference to Services* , ILO Geneva 1984.

ularly relevant to the service sector (national treatment)). Within the context of its technical co-operation programme, UNCTC provided training and advisory assistance through a number of projects of which many were service-related (foreign investment, international loan agreements, tourism).

(a) Shipping

199. UNCTAD's activities in the economic, commercial and trade-related aspects of shipping are designed to contribute to the orderly development of the world merchant fleet and consequently of world seaborne trade, to provide the necessary environment conducive to increasing developing countries' participation in world shipping commensurate with the comparative advantage they enjoy in producing such services and to the protection of shippers' interest.

200. For this purpose the activities of UNCTAD have addressed the subjects of protection of shippers' interest, merchant fleet development, port development, multimodal transport and containerization and related legal regimes. The problems related to these issues were addressed from a universal perspective as well as taking into account the specific needs of developing countries. In its early years the main thrust of the work of the Committee on Shipping was directed towards providing a framework for developing countries vessels to operate in liner services and to share in the formulation of conference policy, for their shippers to participate more meaningfully in consultation procedures. Attention was also given to the improvement of port operations and connected facilities and to the reduction of the costs of cargo-handling in ports. The overall economic aspects of shipping and its practices, and their impact on the economy and development of developing countries fleets, were studied in parallel and in greater intensity from the early 1970s onwards. The relative priority of investment in shipping, the facilitation of funds for building and acquisition of vessels, the net effect of shipping operations on balance of payments, and shipping as a factor in national employment policies and as instrument for the promotion of exports, formed important subjects of investigation and research.

201. The work was deliberately directed to assisting all parties interested in shipping to obtain a clearer insight into the economics of the industry. Greater transparency of its inner workings - in particular of the rate-making process and its underlying principles - was aimed at in order to dispel the general apprehension which prevailed on the subject, and to prepare the ground for greater mutual trust between the suppliers and users of shipping services in negotiations. The Committee acted primarily through resolutions. These were, of necessity, addressed to governments, and for efficacy had to rely on the willingness of the appropriate national authorities to accede to the requests that were made, and in turn on the success of efforts to persuade conference and shippers to respond to the Committee's requests. The outcome of the resolutions was found to be largely ineffective in terms of specific expectations. Persuasion and voluntary compliance having failed, the developing countries felt constrained to act through the Committee so as to make its decisional procedures more concrete. Hence a subsidiary body, the Working Group on International Shipping Legislation, was created in 1969 and from the early 1970s worked through the medium of international conventions and model rules or norms to bring about the recommended changes in law or practice.

202. To date three Conventions have been adopted under the auspices or with the participation of UNCTAD. The first multilateral agreement was the United Nations Convention on a Code of Conduct for Liner Conferences which was adopted in 1974 and entered into force in October 1983. The United Nations Convention on the Carriage of Goods by Sea (Hamburg Rules) was adopted in 1978 and the United Nations Convention on International Multimodal Transport of Goods in 1980.

203. Instability, restrictive practices, structural overtonnaging in the shipping industry and barriers to the free and fair entry of developing countries to shipping continue to present problems for governments and the industry in the current decade.

204. At its Sixth session, in 1983, UNCTAD took stock of the situation in world shipping, reviewed the activities of UNCTAD in this field and adopted without dissent resolution 144 (VI). This resolution provided a forward-looking approach to new areas of vital interest to developing countries and the maritime community at large in that it launched a process to study and investigate certain areas particularly with regard to protectionism and monopolistic practices, investment behaviour and support policies (subsidies) in world shipping industry and an indepth analysis of ship and ports financing. Through this resolution the Conference also lent its support and provided an impetus for the on-going work programme of UNCTAD in the field of shipping, ports and multimodal transport. In so doing, the Sixth session of the Conference has made a contribution towards diffusing the existing tensions in the shipping service industry by reaffirming its faith in the supremacy of international negotiatory processes for settling major points of dispute among states.

(b) Insurance

205. The objectives which the work of the SPI seeks to attain are those established for it by the resolutions adopted by UNCTAD and the Committee on Invisibles and Financing related to Trade. At the most fundamental level, the SPI, in accordance with UNCTAD resolutions seeks to help developing countries in creating and strengthening their national insurance.

206. To accomplish this the SPI attempts to help developing countries in:

- devising insurance systems better adapted to their fundamental needs, taking into consideration the diversity of their culture and socio-economic environment and not merely copying what is being done in the industrialized countries, and
- improving the terms and conditions of insurance and reinsurance services that these countries have to buy on the international market.

207. Two UNCTAD resolutions are of importance here. The first, adopted in 1964, formalized the belief that a "sound national insurance and reinsurance market is an essential characteristic of economic growth" (recommendation A.IV.23). This recommendation called upon developed countries to: give their full co-operation to the developing countries to encourage and strengthen their national insurance and reinsurance markets; and to continue and increase the technical assistance and training facilities which they provide. It further stipulated that technical reserves and guarantee deposits of insurance and reinsurance companies or institutions should be invested in the country where the premium arises and called on developed countries to encourage such investment by removing all obstacles to the achievement of this aim.

208. The second resolution, adopted without dissent in 1972, was addressed more to the developing countries and invited them to take a series of measures geared to promote two objectives. The first was the need to minimize, to the extent feasible, the dependence of developing countries on international insurers and reinsurers. Second, it was implicitly recognized that total independence of foreign insurance and reinsurance markets was not possible and, therefore, that efforts should be made to secure the most appropriate terms and conditions at the lowest cost commensurate with the risks involved.

209. The resolution specifically:

- affirmed that developing countries should take steps to enable their domestic insurance markets to cover in these markets - taking into account their national economic interest and the insured interest - the insurance operations generated by their economic activities, including their foreign trade, as far as technically feasible;
- considered that developing countries might achieve these objectives

by establishing and strengthening their domestic insurance and reinsurance organizations, where the size of the insurance market permitted it;

- recommended that developing countries should take steps to ensure that technical reserves accruing from insurance and reinsurance operations carried out in their countries were invested in the same countries, taking into account all the relevant characteristics and technical requirements of the risks involved and the kind of insurance and reinsurance cover provided, as well as the criteria of security, liquidity and income;

- recommended that nationals of developed countries, when investing in developing countries, should, while observing the requirement of national legislations, call upon the insurance services of these countries' national insurance markets, whenever these markets could provide appropriate cover;

- recommended that developing countries should establish closer co-operation between their insurance and reinsurance institutions on a regional and/or sub-regional basis; and

- invited governments of developed countries to continue, and where appropriate, increase the technical assistance and training facilities which they provide to developing countries in order to assist in developing their domestic insurance and reinsurance systems. Insurance and reinsurance institutions of member countries were also invited to continue and, if possible, expand their technical assistance efforts.

210. To assist developing countries in achieving the above objectives, the Special Programme on Insurance undertakes studies, provides technical assistance and participates in and organizes training and educational activities. Furthermore, the SPI regularly follows current insurance issues that may be of importance to developing countries, such as insurance legislation supervision in developing countries, reinsurance problems, insurance of large risks in developing countries etc.

(c) Technology

211. A brief description of various research, technical assistance activities and international negotiations on issues relating to technology having a bearing on services is given below.

212. First, work relating to technological services covers primarily design, consultancy and engineering services in the context of strengthening the technological capacity of developing countries. Emphasis has been placed on the link between consultancy firms and capital goods producers in order to determine the role of the former both as a support to the national capital goods industries and as promoters of exports of machinery and equipment. This is an ongoing programme. Attention will also be devoted to technological co-operation and interlinkages among developing countries in design and engineering services.

213. Secondly, work on technological information services covers three inter-related areas: namely: (a) assistance to developing countries in obtaining access to relevant information on the range and sources of technologies available from small and medium-sized public and private enterprises in both developed and developing countries; (b) examination of ways and means whereby developed and developing countries can obtain the fullest and freest possible access to technology in the public domain; and (c) utilization and commercialization of United Nations system funded research and development results as well as those funded or supported by Governments.

214. Thirdly work on the question of international flow of skills in terms of (a) the outflow of skilled manpower from the developed to developing countries, a phenomenon known as the "reverse transfer of technology" or in more popular terms "the brain drain"; and (b) the skill flows that take place among developing countries referred to as "co-operation exchange of skills".

215. Fourthly, work is being initiated concerning the incidence of frontier or newly emerging technologies on the provision of goods and services and international trade. The studies published so far relate to technology issues in electronics and on renewable energy; a major programme is planned to examine new issues and areas arising from technological advances in micro-electronic technologies, bio-technology and genetic engineering and material technology.

216. Another facet of UNCTAD's activities in the domain of technological service transactions relates to the work on the regulatory and promotional aspects of technology both at the national and multilateral level. The negotiations on an international code of conduct on the transfer of technology under the auspices of UNCTAD falls within this framework. The code of conduct will, *inter alia*, facilitate an adequate transfer and development of technology so as to strengthen the scientific and technological capabilities of all countries, particularly the developing countries. For the purpose of the code, transfer of technology is conceived as the transfer of systematic knowledge for the manufacture of a product, for the application of a process or for the rendering of a service. It flows from the very definition of transfer of technology that the code has a wide scope of application covering all or almost all technological service transactions.

217. With the exception of the chapters dealing with restrictive practices and applicable law and settlement of disputes, agreement has been reached on almost all the provisions of the other chapters of the code. The agreed portions of the international code of conduct constitute a significant body of principles relating to international transfer of technology transactions, including rights and obligations of parties, as well as a broad framework for international collaboration in this area. In this respect, the code of conduct will represent an important multilateral arrangement dealing with broad areas of trade in services.

(d) Restrictive business practices

218. It should be noted that the set of multilaterally agreed equitable principles and rules for the control of restrictive practices adopted by the General Assembly in 1980, applies equally to goods and services. Moreover, the Intergovernmental Group of Experts on Restrictive Business Practices; set up to monitor the implementation and application of the set, is undertaking a study on restrictive business practices in relation to the design and manufacture of plant and equipment by consulting firms and other enterprises.

(e) Services and economic co-operation among developing countries (ECDC)

219. Economic co-operation in services has been a matter of concern to developing countries. The report of the Mexico City Conference on ECDC included a specific chapter on services and it was also dealt with in the Caracas Programme of Action, paragraphs 12 and 13. More recently, in the Buenos Aires Platform it was sought to set up a major study programme, in UNCTAD, to identify and establish priorities regarding services of particular importance to developing countries and to devise a programme which would enable developing countries to increase their participation in international trade in services and to make recommendations on mechanisms for multilateral co-operation to this end.

220. Programmes and schemes for economic and technical co-operation have been adopted and implemented by developing countries at the regional level in Asia, Africa and Latin America, especially in transport and communications. Under the auspices of the Economic Commission for Latin America (ECLA), the subject of inter-

national trade in services for the Latin American countries and the Caribbean has been identified as an important issue for discussion. Furthermore, the Quito Declaration and Plan of Action adopted by the Latin American Economic Conference (Quito, Ecuador, 9-13 January 1984) devoted an entire section to strengthening economic co-operation in the services sector,¹¹⁷ with particular reference to transportation, insurance, reinsurance and engineering consultancy.

221. At the Group of 77 level, the Guatemala Export Group Meeting on Services related to Trade¹¹⁸ was the first interregional gathering among developing countries entirely devoted to discuss the issues of South-South co-operation in the priority service areas of transportation, insurance (reinsurance) and communications, in accordance with the provisions of the Caracas Programme of Action. In addition, the Group was able to identify four additional service activities of key importance for the development of developing countries: banking, engineering and consultancy services, computer services and computer data flows, and communication media and advertising.

222. Economic co-operation among developing countries on services is a two-dimensional proposition. The first one relates to the identification of priority sectors for further research work as well as the drafting, negotiation and implementation of specific proposals and schemes for enhancing their mutual co-operation at the subregional, regional and interregional levels. The second dimension is more concerned with the drafting, negotiation and adoption of concerted regional positions - and their coordination at the interregional level - in order to strengthen developing countries' bargaining power *vis a vis* developed countries in international negotiations in multilateral forums.

223. To reach the first goal, the undertaking of national studies in priority services sectors - and their interlinkages with other services and production activities - including an analysis of an expansion of these activities on the gross domestic product, income distribution, employment and balance-of-payments of each individual country and of the group as a whole, is a pre-requisite. This would also allow for the formulation at the national level of an integrated and coherent set of policies for the services sectors as a whole, and in particular, for the priority areas chosen for co-operation, as well as their coordination and/or harmonization at the subregional/regional levels. It may also imply the exchange of information and experiences, the joint undertaking of R and D, the organization of workshops and seminars and the provision by the international community and, particularly, the relevant United Nations organizations, of technical assistance and training activities for human resources development.

224. The second goal - the adoption of concerted regional positions and their coordination at the interregional level - might be pursued, e.g., through the sponsoring and organization of intergovernmental expert group meetings, negotiating conferences and informal group contacts.

B. Proposals for negotiation

225. Since the end of the Tokyo Round, the United States Administration has pursued, at both the domestic and international levels, the objective of liberalizing trade in services and pressed for international negotiations. In April 1981, the Trade Policy Committee announced a services work programme which included (a) the full use of existing bilateral arrangements with other governments to resolve current trade problems brought to the government's attention by the private sector;

¹¹⁷ See A/39/118, annex, Section V of the Plan of Action.

¹¹⁸ Guatemala City, Guatemala, 23-28 January, 1984.

(b) domestic and international preparations for future multilateral negotiations on services; (c) review of domestic legislative provisions relating to the achievement of reciprocity for United States Service industries.¹¹⁹

226. The announced policy of the United States Government is "to develop both the domestic and international consensus required before trade officials can effectively negotiate international agreements on services". On the domestic side this approach has been manifested in various forms including government industry advisory groups (most notably a Services Policy Advisory Committee in which chief executives of major service corporations participate), support for seminars, private working groups, etc., on service issues.¹²⁰

227. Several bills dealing with trade and negotiations in services are currently before Congress. Some of these bills aim at setting a requirement for bilateral reciprocity between the United States and its trading partners.¹²¹ Such legislation has been described by United States officials as constituting a "bargaining chip" in negotiations on services.

228. One of these proposals was aimed at expanding significantly the scope of Section 301 of the Trade Act of 1974. This section authorizes enquiry into any complaint that a foreign government is indulging in an "unfair trade practice". Section 301(a) directs the President to "take all appropriate and feasible action within his power to obtain elimination of any act, policy or practice of a foreign government which is determined to be unjustifiable, unreasonable or discriminatory, and which burdens or restricts United States commerce". This provision is not, of course, confined to goods; commerce presumably includes trade in services. A common feature of a number of recent proposals for legislation has been to amplify and extend this provision; one obvious proposal for change is to extend the power to take retaliatory action to United States services imports. At present, section 301 encompasses complaints about other countries' practices in the services area, but the retaliatory power has been limited to imports of goods.¹²²

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¹¹⁹ A clear insight into the United States' position regarding trade in services is provided by the statement of Senator Brock before the Sub-Committee on International Finance and Monetary Policy of the Senate Banking, Housing and Urban Affairs Committee (November 1981).

¹²⁰ On the international side, a major effort to establish the "consensus" advocated by Ambassador Brock has been made by the Trade Policy Research Centre of London, which has organized at least two high-level conferences on "Restrictions on Transactions in the International Market for Services", the latest held in May/June 1984.

¹²¹ For example, Section 205b, presented to the 97th Congress, was aimed at fully integrating the service sector trade issues into overall United States economy and trade policy, and identified barriers to trade in services such as "barriers to the right of establishment in foreign markets", and "restrictions on the operation of enterprises in foreign markets", including "transfer of information" and "use of data processing facilities".

¹²² Section 301 has been used in a number of situations involving services. One was the case (Docker 301 - 15) involving action by Canada inhibiting Canadian firms from advertising on United States television stations which directed their broadcasts to a Canadian audience; there are a number of such stations in the United States close to the border with Canada. Hearings were held under the authority of Section 301 into complaints by United States television companies and proposals were formulated for compensatory action. Because of the limitation in 301 on compensatory action which can be taken by the President to the area of traded goods, most of the proposals in this case involved legislative action. Another case involved a complaint against the marine insurance practices of the Soviet Union. After the hearing, which found the complaint justified, an agreement was worked out with the Soviet Union; the investigation was then "suspended" (not "terminated") pending the first annual joint review of the agreement, which was never held.

229. The current bill before the United States Congress for extension of the United States generalized scheme of preferences (GSP)¹²⁴ might also be considered to be relevant to the international services debate, given the link that would be drawn between "competition levels" for "graduating" countries and the access provided by the latter countries for United States goods, services and investment.^{125 126 127}

230. The proposal to negotiate some sort of "improved" framework of rules regarding traded services, and possibly regarding the foreign investment issue in relation to service industries, is, essentially, a proposal of the United States although other developed market-economy countries appear to have accepted the proposition that the United States proposal should be studied effectively in various multilateral forums. The clearest statement of this proposal was that presented by the United States Special Trade Representative in a personal statement published to coincide with the holding of the 1982 GATT Ministerial Session. The summary in Ambassador Brock's article¹²⁸ is the fairest way of presenting his views:

"Objectives: The basic goal of any future negotiations should be to

¹²³ Another case involved a complaint as to the marine insurance practices of Argentina. The published report stated: "The investigation revealed that a number of developing countries with incipient insurance industries maintain policies which are similar or identical to the Argentine Practice". The investigation was "suspended" when Argentina "agreed to participate in multi-lateral negotiations, one of the objectives of which would be to work towards an agreement to apply the principle of national treatment in the insurance sector. The Government of Argentina's undertaking is conditional upon the willingness of a significant number of less developed countries to participate in such a negotiation". More recently Section 301 has been invoked against the satellite launching services provided by the European Space Programme (Ariane).

¹²⁴ Section 171b, 98th Congress.

¹²⁵ An experienced Washington observer, one-time Deputy Trade Representative, Ambassador Harald Malmgren, commented recently as follows on Administration views:

"The Administration also proposed to introduce a new concept of reciprocity to the eligibility tests (for GSP treatment). Developing nations that liberalize protection of their own home markets would be given more favourable consideration than those nations maintaining high levels of import protection. Thus, the Administration wants authority to negotiate eligibility not only on a product-by-product basis, but also a country-by-country basis, to seek improved access for American goods *and services* in developing country markets. (Text continued in following footnote.)

¹²⁶

Included in the new Administration objectives would be reduction of tariff and non-tariff barriers, but also elimination of performance requirements on foreign investment, improved protection of American intellectual and technology rights in those countries, and non-discriminatory treatment of American firms providing such services as insurance, banking and accounting. It is hoped that this carrot and stick approach, offering potential for increased American exports, will persuade Congress to grant continuation of GSP on imports from developing countries. What this boils down to is that eligibility for GSP will be harder to gain and harder to keep. (Text continued in following footnote.)

¹²⁷

It means that advanced developing countries will have to negotiate for eligibility by offering liberalization of their own treatment of foreign goods, foreign services and foreign firms that want to establish operations locally."

See, Harald Malmgren: *World Trade Outlook*, No. 1, 1984, Washington, D.C.

¹²⁸ "A Simple Plan for Negotiating on Trade in Services", *The World Economy*, Vol. 5, No. 3, November 1982.

expand the opportunities for trade, making possible the economic gains that can be obtained from trade based on comparative advantage. A closely related objective should be to ensure that barriers to trade in services do not become a major obstacle to trade in goods. In order, then, to expand the opportunities for trade, such negotiations should focus on, first, the development of a stable institutional environment for trade in services, providing "predictability" in governmental actions and an orderly way for dealing with the problems that arise; and, second, the development of a negotiating process for reducing or eliminating barriers to trade in services, which to a large extent means addressing government regulations that discriminate between domestic and foreign suppliers or services.

"We should recognize the right of every government to establish its own social objectives for the regulation of services and the obligations of foreign suppliers of services to adhere to such regulations. At the same time, though, governments should assume an obligation to minimise the extent to which such regulations distort trade beyond the minimum necessary to achieve legitimate social objectives. Where such regulations are meant to protect domestic service industries, they should be clearly notified as trade restrictions.

"Principles: Future negotiations might be guided by some of the following principles. Restrictions on trade in services should be made explicit and should be negotiable. All government regulations that are not notified as barriers should be applied on a "national treatment" basis. Where national treatment is difficult to apply for technical or regulatory reasons, governments should commit themselves to minimise the distortion of trade inherent in such regulations. Government monopolies should operate on a commercial basis where they are in competition with foreign commercial enterprises and they should offer foreign and domestic customers the same reliability, quality and prices; that is, they should observe the principle of national treatment.

"Procedures: Governments should be willing to consult with each other when problems arise with respect to their mutual trade in services and if they cannot resolve their differences on the basis of such consultations they should have access to a dispute-settlement procedure. New regulations that offset foreign suppliers should be notified in a timely way and foreign suppliers should be given an opportunity to discuss technical problems related to the application of such new regulations. Foreign suppliers of services should have the same access to government officials and to local courts as domestic suppliers of services.

"Rights and obligations: Commitments entered into by governments as a result of negotiations should result in contractual rights and obligations. Governments should agree not to take other actions that would deny foreign countries the benefits of negotiated concessions, except under agreed circumstances. Where governments act in violation of their commitments, efforts should be made to reach a new understanding on the issues involved; otherwise, affected countries should have the right to take compensatory actions that would re-establish a balance of commitments.

"Organization of Future Negotiations: A considerable amount of staff work is needed before we can develop any concrete propositions for future negotiations. Within a common framework of principles, rules and procedures, negotiations could be organised either along sectoral lines or in terms of issue-oriented codes such as the GATT standards code negotiated in the Tokyo Round deliberations. We might be able to develop, for example, a regulatory code that could be patterned on the standards code."

231. Another proposal for negotiations is contained in a policy statement by the International Chamber of Commerce (ICC). The ICC Commission on Trade Policy and

Trade-Related Matters issued their "Position Paper on Liberalization of Trade in Services".¹²⁹ This was the most sweeping proposal that has yet been formulated. The ICC proposed that:

- (a) All services trade be "conducted according to the principles of fair and open international competition".
- (b) Traded services be treated on an MFN basis.
- (c) Restrictions on the purchase of foreign source services be reduced "in as far-reaching and as reciprocal a manner as possible".
- (d) Derogations be subject to review and negotiations.
- (e) New restrictions be avoided "as far as possible", and any new restrictions "be temporary and subject to prior consultation and negotiation".
- (f) The extension of the GATT to include trade in services; specifically, barriers to trade in services "should be tackled in a similar manner to the non-tariff barriers discussed during the Tokyo Round".
- (g) "Industry-specific" negotiations to provide liberalization in the shorter term.
- (h) Service contracts to be covered by the Tokyo Round Government Procurement Code, and the list of procurement entities made "as wide as possible".
- (i) "National treatment" be accorded to foreign service firms.

1. Statements by the Commission of the European Communities (EEC)

232. Statements by Commission officials and a report to the Commission by an "Interservice Group on International Trade in Services" indicate that in drawing up its position the Community is guided by the following considerations: (a) the difference in views among member States and the regulation of services; (b) the dominant position of the Community (36 per cent) and other Western European countries (18 per cent) in world service exports and the uncertainty as to whether so-called liberalization would strengthen or undermine this position; (c) the importance of the link between trade in goods and trade in services; (d) the need to differentiate between trade in services and investment issues, and (e) the growing importance of telematics.

2. The Latin American Position

233. At the Latin American Economic Conference held at the level of Heads of State in Quito in January 1984, the Latin American and Caribbean countries reaffirmed decision 153 of the Latin American Council which called for a joint regional position with respect to discussions on services in multilateral forums. The Quito Declaration also contains agreements with respect to intra-regional co-operation in key service sectors such as engineering and consultancy, transportation, insurance and reinsurance. A Latin American Co-ordination meeting will be convened by SELA in August 1984 to arrive at a joint position for the consideration of service issues in UNCTAD and GATT in September and November 1984 respectively.

¹²⁹ International Chamber of Commerce, Paris, Document No. 103/34, Rev. C1, 1981.

3. ASEAN/Australia

234. The ASEAN-Australia Joint Research Project has addressed itself to service issues in Australia-ASEAN trade, examining the situation in specific services such as aviation and consultancy services as well as services within the economies of several ASEAN countries.¹³⁰

4. Non-governmental views

235. In addition to these (and other) official statements, a variety of ideas regarding negotiations on services have been put forward by private authors. For example, two United States lawyers have advocated a "services code". Michael Cohen (Manager for Public Affairs of the American International Group, the American insurance group of companies) and Thomas Morante, at one time an American Express fellow at the Georgetown University Law Centre, argue that much of the difficulty in initiating discussion is due to the lack of an agreed definition of services, to the absence of a proper catalogue of barriers to trade in services, and to the absence of adequate data. They go on to argue that the United States should act to improve its bargaining position: the anti-dumping and countervailing duty laws should be extended to services, and Section 301 of the Trade Act of 1974 (dealing with other unfair trade practices of governments) should be expanded. The essence of their proposal is that: "Such measures would indicate to the United States' trading and negotiating partners that the United States recognizes the importance of its services sector and is prepared to engage in protective practices, similar to those employed by other countries, to promote and direct its services sector. If the United States demonstrates to other countries its interest in promoting its services sector... negotiations will more likely be undertaken and successfully concluded", and later: "Because few developing countries can realistically make major advances as exporters of services to developed country markets, the developed countries may have to adopt a policy of making concessions that favour goods exported by developed nations in return for reductions of non-tariff barriers (NTBs) to services exports from developed nations".

236. Over the years, the United States Council on Foreign Relations has been a source of pronouncements on trade policy. In a seminar held in Washington, D.C. in 1982, a paper ("Negotiating issues in international services transactions") was presented by William Diebold, a senior Fellow of the Council, and Helena Stalson, on the services issue.¹³¹ Diebold and Stalson say: "It should be an American objective to keep services issues, both in general and so far as possible in regard to particular services practices, from being treated as items in the North-South agenda". And later: "The United States should not let the pursuit of the liberalization of services ... divert attention and energies from work on trade in goods". They also address the issue of "unfair" practices in services and the question of reciprocity, stating that: "There may be times when retaliation against foreign restrictive practices in services will be the best course, and when some degree of reciprocity will be a reasonable formula for arranging the mutual removal of restrictions".

237. Mr. Jeffrey J. Schott, then of the Carnegie Endowment for International Peace, and now with the Institute for International Economics, argues that GATT, not OECD, should be the forum for services negotiations. He attributes the reluctance of developing countries to become engaged in a new round of negotiations to three considerations: (1) other trade issues are more important - safeguards, tex-

¹³⁰ This project is co-ordinated by the Economic Planning Unit of the Prime Minister's Department, Kuala Lumpur, Malaysia, and the Australian National University, Canberra. The studies prepared under the auspices of the Project include: K. Tucker, G. Seow, M. Sandberg, "Services in ASEAN-Australian trade".

¹³¹ Subsequently published in William R. Cline (ed.): *Trade Policy in the 1980s*, (Washington, D.C., Institute for International Economics, 1983).

tiles, agricultural products; (2) new rules regarding traded services may put many developing countries into a permanently inferior position; they want to protect their "infant" service industries; (3) restrictions on trade and investment in services by developing countries are used to obtain technology from developed countries.

238. An economist, Professor H. Peter Gray, has argued in favour of negotiations in selected services sectors, of "national treatment" on a basis of reciprocity, and that negotiations should, in the first and prior stage, take place among developed countries, and therefore not in the GATT but rather in the OECD. In his view, if a number of nations can agree on national treatment as between themselves, excluded countries will have a powerful incentive also to agree to national treatment.¹³²

239. The most detailed analysis of services negotiating issues by a private writer is the book by Ronald K. Shelp, a vice-president of American International Group, the United States insurance group of companies,¹³³ which essentially constitutes a survey of the literature, the state of play, and the issues. He concludes by arguing for what he calls a "shotgun approach" - in doing what can be done in OECD, in GATT, in specific services sector bodies, in order to move gradually to detailed and comprehensive rules. However, he does not address the question of the role of services industries in the development process, nor examine whether developing countries could realistically be expected to undertake meaningful obligations in regard to traded services, or the establishment of foreign firms. Mr. Shelp notes, however, that barriers to trade in services imposed by developed countries, and a few of the more advanced developing countries, are the most significant. He says: "The assumption that barriers to services originates almost exclusively in developing countries is misguided..."¹³⁴

240. A proposal of a different sort, calling for bilateral sector negotiations, is advanced by a Canadian writer, Rodney de C. Grey. In a recent study, he assesses the advantages and disadvantages a common market in transborder data processing between Canada and the United States.¹³⁵ He asserts that the proposal makes sense for Canada and the United States and perhaps for certain other developed countries, because the interests of users of modern data processing, who need access to information and processing on the widest possible scale, are more important than the interests of firms in the computer services sector. He arrives at this conclusion, of course, only in regard to Canada, and his proposal is essentially addressed to Canadian interests. He emphasizes that, given the role of data processing as an intermediate input to other service industries, such as banking, insurance, consulting engineering, dealing with this sector is dealing with a good deal of the "services issue". He notes that two difficult issues could arise, first, the threat of the extension to this and other service sectors of the contingency apparatus designed to deal with unfair trade practices (anti-dumping, countervailing duties, Section 301); and proposes that Canada drop any plan for a Canada/United States traded computer services agreement if it is proposed to extend these devices to this service area. Second, Grey notes the relevance of the United States position on services (both in regard to data processing as a service and in regard to

¹³² H. Peter Gray, "A Negotiation Strategy in Trade in Services", *Journal of World Trade Law*, No. 5, Sept/Oct. 1983.

¹³³ Ronald K. Shelp, *Beyond Industrialization Ascendancy of the Global Service Economy*, New York, Praeger, (1981).

¹³⁴ *Ibid.*, p.124.

¹³⁵ Rodney de C. Grey: *Traded Computer Services*, (Montreal, Royal Bank of Canada, 1983)

establishment of service companies) to the United States assertions of extra-territorial jurisdiction in the anti-trust, security regulation and export controls area; he states that, in his view, these assertions are at complete variance with the United States services proposals.¹³⁶

241. A recent article by Messrs Geza Feketekuty and Jonathan Aronson addresses the question of international negotiations on services in the context of transborder data flows.¹³⁷ Their main concern appears to be that in the absence of an international framework of principles, rights and obligations, governments will introduce regulations in this area, which intentionally or unintentionally will provide protection to domestic producers. The authors suggest that the problem be addressed in the ITU, OECD and GATT (e.g., through a GATT Code covering trade in services).

C. Debate in international Forums

1. OECD

242. OECD instruments contain certain commitments relevant to trade (and investment) in services. These are embodied in: the Code of Liberalization of Current Invisible Operations, which provides for freedom of transactions and transfers and directly covers a number of service sectors; the Code of Liberalization of Capital Movements, which provides for freedom of financial operations of the goods and services sectors; and the National Treatment Instrument, which provides national treatment for foreign-controlled firms operating in member countries, in the goods and service sectors.

243. The Invisibles Code and the Capitals Code are based on the objective of liberalizing the operations covered by their provisions (free trade), coupled with member governments' commitment to comply with their obligations. They embody the concept of non-discrimination (in the unconditional sense). In both Codes, liberalization measures are supplemented by a provision covering internal measures liable to frustrate liberalization and thus damage another member's interests. In some sectors, the provisions with regard to the liberalization of the transactions specified are accompanied by provisions concerning access and the treatment of foreign sellers under certain internal regulations.

244. The Invisibles Code coverage mainly concerns transactions (transfrontier trade), but for certain sectors it also provides for the eventuality of trade based on establishments in the specific form of branches. The Capital Movements Code covers the admission of foreign investments (goods and services). The liberalization obligations of the Code with regard to direct inward investment have just been extended to cover certain elements of the right of establishment and those most closely related to inward foreign investment. It may be noted that the initial establishment of a subsidiary would be covered by that Code. The national treatment instrument covers enterprises already established and also new investment by those enterprises.

245. For several years the OECD has been conducting studies on individual service sectors,¹³⁸ particularly since the decisions taken at its Ministerial Meeting of 1982. These studies have been conducted in a "trade policy" context aimed at mak-

¹³⁶ On the other hand, the Consultative Committee on the Implications of Telecommunications for Canadian Sovereignty has estimated that the importation of data processing and computer services will cost \$ Can 1.5 billion and result in a loss of 23,000 jobs in 1985. See *Telecommunications and Canada* (Canadian Government Publishing Center, Ottawa, March 1979).

¹³⁷ Geza Feketekuty and Jonathan Aronson: "Meeting the Challenges of the World Information Economy", *The World Economy*, 1984.

¹³⁸ See, for example, *Trade in International Services: Insurance*, Paris, OECD, 1983.

ing "progress in the investigation of obstacles and problems and in the consideration of approaches that would improve international cooperation, given the fact that it is in countries' interest to ensure that conditions conducive to the dynamic development of trade in services should prevail".¹³⁹

246. The OECD Trade Committee itself, which was responsible for initiating the global approach, concentrated on the question of whether a general framework applicable to trade in services could be defined that would include certain concepts and criteria to study the relevance and applicability of a range of fundamental concepts which might serve as a reference for the liberalization of trade in services (such as those relating to market access, transparency, non-discrimination and national treatment).

247. In carrying out this examination, OECD has encountered the inevitable difficulty of applying concepts which related to trade in goods, to issues more properly belonging in the area of investment or even of immigration. It proved difficult to conceptualize the idea of "access" to markets in services without resorting to concepts such as "right of establishment" which relate exclusively to investment, and in identifying the point "trade" in services becomes "investment" in service industries. Problems also arose with the concept of national treatment, where it was recognized that "National Treatment" in the OECD sense applied to firms and not actual services,¹⁴⁰ while "National Treatment" in the sense of GATT article III, is a means of ensuring the validity of negotiated levels of tariffs applied at the border and thus could not be transposed to services. As a result, some attempt has been made to identify new concepts, such as "right of presence", "equivalent treatment" or "reasonable regulations". Work in OECD continues in this area.¹⁴¹

248. At the OECD Council of 18 May 1984, the Ministers adopted the following statement:

"Recognizing the importance of the issues raised by international trade in services, Ministers noted that as further analysis proceeds, the Organization would increasingly focus its efforts on ways to remove unjustified impediments and improve international co-operation. They expressed support for the efforts, under the aegis of the Trade Committee, to relate broad concepts relevant to trade in services to the problems identified in specific sectors. They also encouraged continued work to strengthen existing OECD agreements applicable to services. Ministers requested the Secretary-General to submit a report including action proposals to Council within two years."¹⁴²

¹³⁹ OECD Activities, Paris, OECD, 1983, p.16.

¹⁴⁰ It must also be noted that a fundamental contradiction exists between the latter principle of national treatment (under which foreign-owned firms are to be treated on the same basis as those owned by nationals) and that of extra-territoriality, under which foreign subsidiaries are required to conform to the laws of the country in which the parent corporation is established.

¹⁴¹ In the London Economic Declaration, the Heads of State or Government of the seven major industrialized countries agreed, *inter alia*, to accelerate the completion of the 1982 GATT work programme and "to press forward with the work on trade in services in the international organization". (A/39/304, annex. Para. 9(x)).

¹⁴² See para. 31 of the Communique (OECD Press Release A (84) 28).

2. GATT

249. As noted in the introductory chapter, the question of a general role for GATT in the area of services was introduced in the context of the preparatory work for the Ministerial Session of the Contracting Parties in 1983. These initiatives stimulated studies of the extent to which the General Agreement applies to services.¹⁴³ The main services which have been touched upon by GATT include:¹⁴⁴

(a) films: article VI permits screen-time quotas;

(b) insurance: an unsuccessful attempt was made in the late 1950s to develop a set of rules regarding transport insurances. Insurance and freight is also covered by article VII and its interpretative agreement, to the extent that c.i.f. customs valuation is permitted;

(c) services incidental to government procurement of goods are covered by the Agreement on Government Procurement (article 1 (a)) while the possibility for broadening the coverage of the Agreement to include service contracts as presently being considered as provided in its article IX(b);

(d) repairs of aircraft are free of duty under the Agreement on Trade in Civil Aircraft;

(e) items relating to the provision of services on terms more favourable for exports than domestic goods (e.g., taxes and charges, transport and freight charges) are prohibited under the illustrative list of export subsidies annexed to the Agreement on Subsidies and Countervailing Measures.

A number of essentially service issues, relating primarily to shipping and insurance, were included in the GATT Inventory of Non-Tariff Measures but not negotiated during the Tokyo Round.

250. The work undertaken in the OECD context has also examined how various GATT principles could be applied to services. In addition to "national treatment"¹⁴⁵ mentioned above, the OECD Trade Committee has examined "reciprocity" and "non-discrimination". The Committee seemed to favour a framework based on "conditional non-discrimination, that is "conditional MFN", for example, as applied by certain developed countries in the context of several of the Tokyo Round Codes.¹⁴⁶

¹⁴³ As opposed to studies of the extent to which the Agreement could be applied to services, which are described in the following section.

¹⁴⁴ R. Krommenacker, "Trade-Related Services and GATT", *Journal of World Trade Law*, Vol. No. 6, November/December 1979, p.13.

¹⁴⁵ "National treatment" in the sense of article III of the GATT refers to the treatment of imported goods after they have cleared customs. "National treatment" in the OECD context refers to the OECD decisions relating to international investment, which are applicable to firms producing goods and to those providing services.

¹⁴⁶ The International Law Commission has prepared a history of the concepts, analyzed the important international jurisprudence and the national jurisprudence and prepared a draft document of principles regarding the MFN clause. These will be found in *Yearbooks* of the Commission for 1969, 1970, 1973 and 1978, respectively. The "conditional" clause of MFN was condemned by *inter alia* the League of Nations and implicitly in the 1979 Decision of the GATT Contracting Parties on the results of the Multilateral Trade Negotiations (MTN). The implementation of this Decision is being examined in the Work Programme established in the GATT Ministerial Declaration of 1982, (see discussion in UNCTAD secretariat report "Multilateral trade negotiations" TD/B/913).

251. In response to the invitation of the Contracting Parties at their November 1982 Ministerial Session, a number of Contracting Parties are engaged in a process of national examinations of issues in this area. Four of them (Canada, the United States, the United Kingdom and the Netherlands) have made available their national studies which have been transmitted to all Contracting Parties. Two informal meetings of delegations have been held to exchange views and clarify information presented in these studies, as part of the process of information exchange provided for in the Ministerial Decision. Further consultations will be held in the light of information submitted by other interested delegations.

D. "National studies"

1. *The United States "national study": a summary*

252. The extensive United States' submission, prepared under the "direction" of United States Special Trade Representative (USTR), contains five sections. Section One addresses the importance of services in the world economy, emphasizing the importance of new services (e.g. informatics), as well as the link between trade in services and trade in goods. Section Two, the only part of the "national" study addressing itself to domestic issues, examines the role of services in the United States economy, especially the employment and technology aspects, and describes the regulatory regimes applying to various domestic service industries and the rationale behind such regulation. It is concluded that with certain exceptions (notably air and maritime transport and direct broadcast signals) "the United States market is generally open to foreign service providers who are, with few exceptions, accorded national treatment".

253. While Section Three is entitled "Conceptual Issues related to Trade in Services", the discussion therein is confined to the issues of (a) competition between private firms and public service monopolies, (b) distinguishing between trade in services and investment in services, and (c) immigration and labour questions linked to transactions in services. This analysis of concepts, however, does not bring into question the "working assumption" (stated in the introduction) that "trade" in services is governed by the same economic rules as trade in goods.

254. Section Four describes the existing bilateral and multilateral mechanisms applicable or potentially applicable to services trade. Considerable emphasis is given to the treaties of "Friendship, Commerce and Navigation" (FCN Treaties) as well as the new Bilateral Investment Treaties programme which to date has resulted in agreements with a few developing countries. The examination of multilateral agreements mentions ICAO, IATA, IMO, OECD, WIPO, ITU, and examines in considerable detail the possible application of the principles of the GATT and the Tokyo Round Codes to "trade" in services. In particular, the principle of "national treatment" (article III of GATT), and those applicable to state-trading enterprises and subsidies, as well as the Codes on Government Procurement (where the possibility of application to services is specifically provided for) and on Technical Barriers to Trade are mentioned. The application of the MFN principle would take account of the "desirability of allowing countries to undertake higher levels of obligations on services *vis a vis* each other".

255. Section Five considers various approaches for establishing a "services trade regime", examining the combinations of bilateral/multilateral agreements dealing with individual/all service sectors. The main conclusions of this section are (a) that while specialized multilateral organizations with expert secretariats are useful in drawing up specific rules and dealing with "technical problems in a meaningful way", they tend to have "too narrow a focus" which can "produce results that fail to take account of broader national and international objectives"; (b) bilateral sectoral agreements may be inevitable in certain cases but tend to be "trade restrictive" in nature, and thus to the extent possible such agreements should "reflect the greatest degree of competition achievable given the structure of the particular sector", and "be governed by a set of principles under which trade should

be conducted"; much more preferable are (c) bilateral agreements covering all service sectors, no such agreements exist at present but the FCN and Bilateral Investment Treaties could serve as "models". Such bilateral agreements should stipulate the rights and obligations that could be established in an eventual multilateral accord and include such principles as non-discrimination, national treatment, and transparency, and be followed by sector specific arrangements under which the "right of access" would be guaranteed in certain areas. While recognizing that this approach would involve abandoning MFN treatment in favour of "a preferential system based on reciprocal opportunities", such bilateral agreements "might nevertheless operate as models for developing the basic rights and understandings appropriate for a healthy multilateral services trade regime".

256. The final subsection elaborates on the United States' ideas regarding such a "healthy" multilateral regime, which would involve a "multilateral understanding covering all sectors" within which "services trade would operate under a common framework by which countries could resolve individual problems pertaining to different sectors". The United States considers that "structurally the GATT is strongly positioned to manage such a framework". The basic principles of such an "umbrella" understanding would include: national treatment, that regulation be as "less trade restrictive" as possible, "non-discrimination" (defined so as to mean "conditional" MFN), "right to sell", "transparency", "due process". Dispute settlement provisions (based on GATT articles XXII and XXIII) would permit "appropriate compensation action" once a determination were made that a practice did not comply with the understanding: the umbrella (i.e., GATT) agreement would act as an alternative forum to consider issues where the more specialized agreements do not include provision for dispute settlement.

257. The appendices to the United States Study contain a brief analysis of the usefulness and inadequacies of IMF data on services, and describe the efforts being taken by the United States to improve its own data in this respect. They also include a series of sectoral papers on individual services sectors, each of which outline the United States ideas on how to address the key issues in each sector. The "possible approaches" include the application of GATT principles and of the various GATT/MTN Codes. The appendices contain sections on (a) telecommunications, data processing and information services, (b) engineering and construction and related consultancy services, (c) maritime services, (d) banking and related financial services, (e) insurance services, (f) professional services, (g) advertising services, (h) motion pictures, (i) travel and tourism services, (j) franchising services, (k) lodging services, and (l) aviation services.

2. The United Kingdom 'national study': A summary

258. The United Kingdom's submission ("Trade in services: The UK's national examination"), prepared under the auspices of the Department of Trade and Industry, includes four descriptive sections and an annex. Chapter A, the introduction and summary, highlights the importance of trade in services to the United Kingdom and discusses the basis for the United Kingdom's national examination. It stresses that the next step should be the emergence of a "consensus on what problems should be considered further and how their solution could be negotiated," which could point "the way to an internationally agreed framework, similar to that which has been the GATT's purpose to achieve in trade in goods, within which liberalisation in services can take place."

259. Chapter B provides a general overview of United Kingdom service activities. It discusses services within the United Kingdom domestic economy as well as the contribution of internationally traded services to the country's economy. In particular, civil aviation, construction and consultancy, financial and allied services (including banking and insurance), sea transport and travel are listed as

being the most important services in terms of international trade. The chapter concludes with a brief account of the 19 sectors involved in international service trade.¹⁴⁷

260. Chapter C provides an account of the regulatory framework in the United Kingdom and refers to its annex A for an outline of the principal statutes and regulations governing service sectors in the United Kingdom, and the powers of United Kingdom regulatory bodies in that area. The chapter stresses that the main objective underlying the country's statutory framework are the protection of the consumer, the maintenance of standards, the encouragement of competition, the facilitation of sound investment, and in certain areas the protection for national security. It notes that in a number of service sectors these objectives are authorized to some extent by European Community regulation or by other international obligations which are implemented by United Kingdom law. The chapter concludes by emphasizing that many United Kingdom service sectors have a long standing tradition of self-regulation.

261. Chapter D discusses "issues of concern" and notes that the nature of restrictions varies with the type of service and the nature of the market. The chapter divides the different focus of restrictions into the following categories: (a) restrictions on the movement of finance, (b) restrictions on the movement of labour, (c) restrictions on the flow of information, (d) restrictions on customers, (e) discrimination in public procurement and (f) other discrimination in favour of indigenous enterprises. These restrictions apply in varying degrees both to cross-frontier trade and to trading within markets. The chapter concludes that "any international approach to services problems should consider services as a whole rather than simply addressing the special problems of individual sectors" and that "(i)t will be necessary in particular to examine carefully the possible application to trade in services of existing international provisions governing trade in goods and the experience gained in preparing and operating those provisions." It is argued that this overall framework "offers the best chance of progress towards genuine liberalization of trade in services".

262. Annex A (which accounts for 40 per cent of the submission) provides an outline description of United Kingdom regulations and practices in 17 service activities. It also discusses the role of competition legislation, most notably the 1973 Fair Trading Act, the 1976 Restrictive Trade Practices Act, the 1980 Competition Act and the European Community's competition policy.

3. The Canadian "national study". A summary

263. The Canadian national study was carried out by a special Task Force on Trade in Services, whose terms of reference were "to report by early Summer 1982" (i.e., before the GATT Ministerial Session) "on Canada's interests in regard to prospective multilateral negotiations on trade in services". This study is divided into an introduction and seven chapters. Chapter B, on "The Services Economy", by way of definition looks at some characteristics of services. It then discusses the difference between trade in services (where the service is transferred from the home country) and "trade" by way of investment or establishment in a host country. The task force identifies the former as the object of its study, but notes that the latter also emerged as a matter of considerable importance and for that reason was considered in the Report. The relationship of goods and services is then examined and four categories of relationships are posited. Major problems in regard to the data on services trade are identified. The last part of this chapter makes a number of observations on services in the economy, including such elements as proportion

¹⁴⁷ These are accountancy, advertising agencies, banking, building societies, civil aviation, commodity traders and other merchanters, computing services, construction services and consultancy services, distribution services, educational services, film and television, franchising and royalties, insurance, legal services, medical services, shipping services, stock exchange, telecommunications and postal services, and travel and tourism.

of GNP, employment, productivity and other factors.

264. The subsequent chapter examines "Canada's Trade in Services"; noting that Canada's international services account includes a number of items other than "tradeable" services - notably income from investment. Recognizing the inadequacies of current account figures of the balance of payments. The chapter also examines the components of Canada's trade in "tradeable" services, i.e., travel; freight and shipping; and "other services", as well as service sector trade orientation and brings out the point that whereas trade propensity of goods has increased significantly in recent decades, that of services has remained constant, resulting in a decline for services as a proportion of Canadian external trade. The fourth part of this chapter examines what would happen if the constant deficit on tradeable services were reduced and, not surprisingly, suggests that there could be some interesting economic effects.

265. Chapter D outlines Sector Profiles of the major sectors examined by the Task Force. Consulting and other business services, engineering, construction and related consulting services, education services, health services, telecommunications and computer services, oilfield services, financial institutions, transport, cultural services, tourism, other service sectors.

266. "Horizontal Issues" are dealt with in chapter E, which notes the imminence of negotiations on services in the context of the Government procurement Code. The second part of this chapter looks at the issues of investment and "right of establishment" which have emerged as major subjects in connection with the issue of negotiating on services internationally, and concludes that Canada should adopt a "carefull" approach to these issues - whether they emerge in the investment or in the services contexts. Parts 3, 4 and 5 of this chapter look at assistance to service exports, taxation questions and immigration issues. Part 6 is a brief review of the Canadian import regime as it touches on services, including the provision in the import policy white paper for an examination of problem imports. Part 7 describes several studies commissioned by the Task Force to deal with statistical issues, in particular the classification of services and the availability of data. Part 8 reports the feeling among certain business groups - and some provinces - that more of a concerted effort might usefully be made to improve domestic policy and programmes on services within Canada."

E. Observations

267. This chapter has attempted to summarize the proposals being put forward with respect to "international trade" in services and to demonstrate the extent of the interest which has been stimulated in the international official, academic and business communities, and the state of play of work being undertaken by national governments and in various international forums.

268. To date, only a few countries have been included in this debate, the services issues have almost exclusively been discussed and analysed in a "trade policy" framework, using the terminology derived from GATT, other trade agreements and conventional trade theory, and rarely focused on the existing policy framework for international transactions in specific services.

269. As has been noted in the two preceding chapters, some studies are available on the role of services or particular service sectors in growth and development of national economies, both developing and developed. Furthermore, as noted in chapter III, services have a critical importance in the overall development context. Trade issues are also important yet they tend to play a rather subsidiary role in the whole services question, as most services are not traded internationally, although the tradeability of services is increasing, stimulated by technological advances. Therefore emphasis should be placed on the search for new ways of improving and strengthening the contribution of services to development. However, the development aspect does not seem to have been taken into account in the current debate on international service issues. The problems of developing countries are

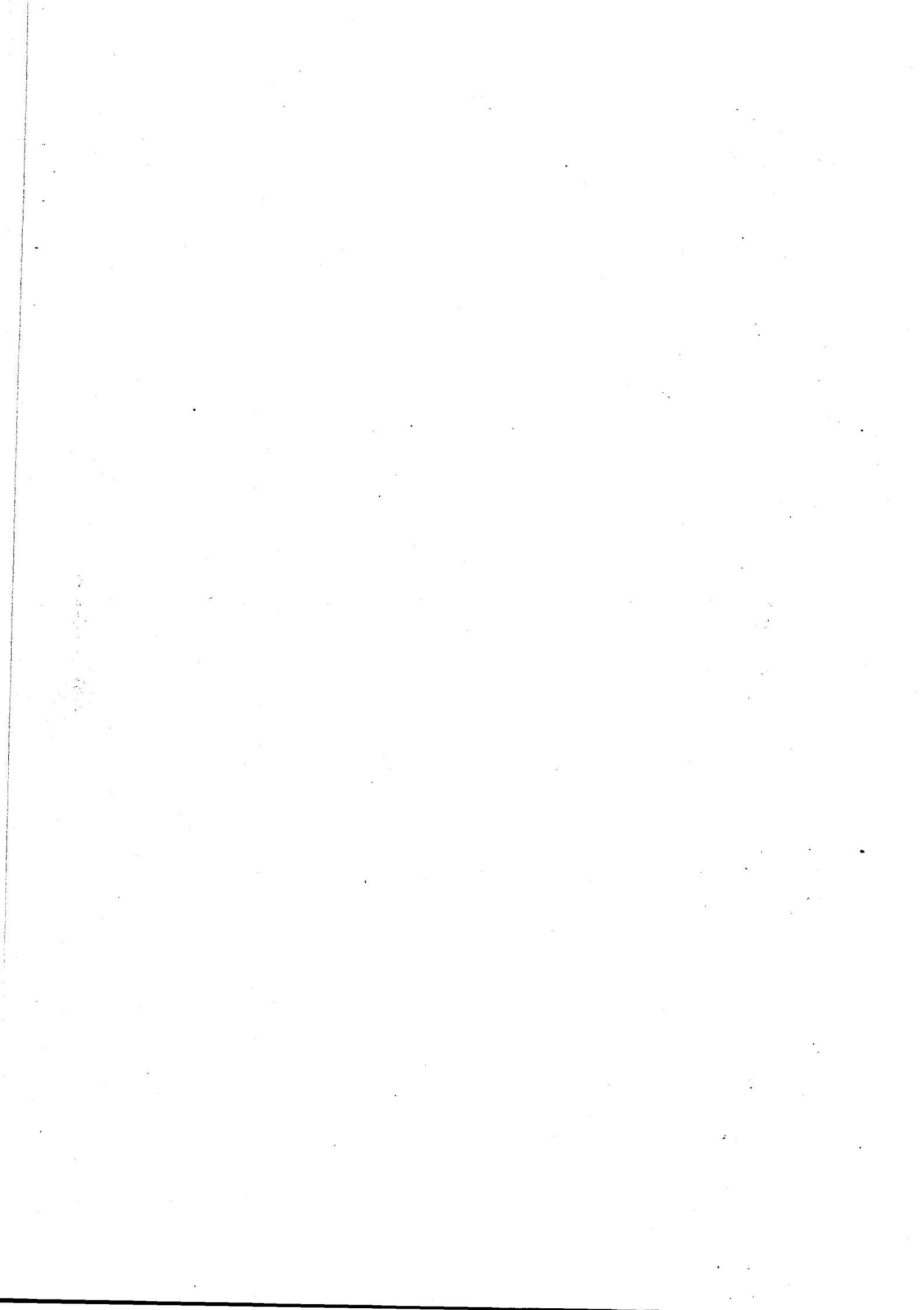
only referred to in the context of the GATT-analogy (i.e., "infant industry", "differential and more favourable treatment"). The following important issues seem to have been virtually ignored: the impact of the various services on the economies of developing countries, the possibilities these countries might have in increasing their share of the world market for services, and the obstacles to trade that these countries may be facing.

270. The same might also be said of the aspects of trade in services relating to technological developments and the role of transnational corporations. While in-depth studies on various aspects have been undertaken by academic, research institutes and international organizations (notably UNESCO and the United Nations Centre on Transnational Corporations), the "trade"-oriented debate has not yet seriously integrated these aspects in its search for a possible negotiating framework.

271. The attempts to introduce services conceptually into a trade policy framework have been unable to delineate trade from foreign investment issues; efforts to equate trade concepts such as "access to markets", with investment concepts such as "establishment" have further obscured the debate. Issues involving labour mobility, and access to capital and technology, have not been examined. As already noted, there is a difference in perception as between transnational corporations which view the world as a single market for services, and governments. To TNCs the issues of trade and investment ("access" and "establishment") are elements of their global strategy. To governments trade and investment are two distinct issues.

272. Furthermore, a number of issues pertaining to the global question of international cooperation in the area of service development have not been covered in the recent international debate on services. A comprehensive multilateral-cooperation framework for the development of the service sector will have to include, among others, specific goals in the areas of training and research, external financing, the transfer of adequate technology, technical assistance as well as agreed principles on migration. The existing international institutional infrastructure and resources will also have to be reassessed.

273. The corresponding function of each of the institutions involved in the implementation of a multilateral cooperation scheme in the area of services, will have to be defined. Hence, there is a clear need for a coherent approach to international cooperation in services, in which the "trade" debate can only form one part.



ANNEX I

DATA ON SERVICES IN THE DOMESTIC AND INTERNATIONAL CONTEXT

1. This annex provides a brief review of the salient data and issues with regard to services in the domestic and international context. In what follows references will be made to the appropriate sections of TD/B/941 for a more detailed discussion of the particular issues involved.¹ In discussing data on national accounts (for services in the domestic context) and the balance of payments (for services in the international context), the following two areas are highlighted: what the accounting systems do and do not cover with respect to service transactions, and what the size of the corresponding service activities are, as well as any relevant trends.

A. Data on national accounts

1. What the system of national accounts reveals about services in the domestic context

2. The System of National Accounts (SNA) provides a comprehensive and detailed framework for the systematic and integrated recording of transaction flows in an economy.² It provides, *inter alia*, a detailed breakdown of final expenditure on gross domestic product into nine sectors.³ Services are most commonly defined as all economic activities excluding agriculture, mining, manufactures, construction and utilities.⁴

Statistical limitations

3. Three statistical limitations with regard to the national income accounts were discussed in TD/B/941.⁵ First, the commonly used national accounting systems⁶ vary considerably in their definition and classification of service activities. In addition, individual countries often adjust the coverage and classification of their system to meet their particular needs. For the purposes of international comparison, however, these differences are a significant impediment. Second, only a few developing countries have adequate time-series data. This, in turn, limits the analysis of long-term trends in the domestic production of services. Third, there is a lack of statistical disaggregation at the sectoral level in the national accounting systems. For example, "other services" includes diverse activities such as education, medical and health activities, religious organizations, welfare institutions, legal services, business services, motion picture production, distribution and projection; domestic services; etc. While adequate disaggregation may be possible at the national level, it is not possible at the international lev-

¹ Production and trade in services: policies and their underlying factors bearing upon international services transactions" (TD/B/941 and Corr. 1), to be issued as a United Nations publication.

² *The Yearbook of National Accounts Statistics*, 1981 (United Nations publication, Sales No. E.83.XVII.3), Vol. I, Part 1, p. ix.

³ Agriculture (forestry, fishing and hunting), manufactures, mining, construction, utilities, transport and communications, trade and finance, public administration and defence, and other branches.

⁴ For a fuller discussion and various possible definitions of services, see TD/B/941, chap. III, sect. B.

⁵ *Ibid.*, chap. III, sect. A.

⁶ The United Nations System of National Accounts, the Courcier System of National Accounts, and the Material Product System of National Accounting.

el. International comparability of data is therefore limited by this lack of adequate disaggregation, as well as by the fact that the definition of services varies from country to country.

4. In addition to the three statistical limitations cited above, three additional limitations are noteworthy. The SNA does not account for the unrecorded activities of the so-called "informal" sector. While there is an informal sector of a certain size in developed market-economy countries,⁷ as well as in socialist countries,⁸ it seems to be far more common and important in developing countries.⁹ It is also generally believed that the share of service activities in the informal sector is somewhat greater than that in the formal sector of the economy of many developing countries, especially in those countries with large urban populations.¹⁰

5. This failure to record the transactions of the informal sector concerns not only "consumer" services such as laundry, food preparation and clothing repair, which usually are generated within the household economy and hence technically not traded in the market. More importantly, it also concerns many other service activities which, though marketed, escape any form of registration. A wide range of services, such as machine and equipment repair, minor transport and removal services, car washing, minor retail trade, many domestic services, fall within this category, being carried out in small workshops or other unrecorded premises.

⁷ Activities not covered by the national accounts have probably been most fully studied in the United States: see, *inter alia*, E.F. Denison, *Is U.S. Growth understated because of the Underground Economy?* (Bureau of Economic Analysis, Washington D.C., 1981). France is another well-studied case: see P. Drouin *L'autre economie, Le Monde*, 21-22-23 June 1982. In developed market-economy countries, the debate on the unreported economy has been somewhat sterilized by sophisticated and inconclusive studies about the problems of its measurement; see V. Tanzi, *The Underground Economy in the United States: Estimates and Implications*, *Banca Nazionale del Lavoro Quarterly Review*, 135 (1980), E.L. Feige, "How Big is the Irregular Economy?", *Challenge*, No. 22 (1979), P. Gutmann, "Statistical Illusions, Mistaken Policies", *Challenge*, No. 22 (1979), and W.W. Pommerrehne and B.S. Frey, "Les modes d'evaluation de l'economie occulte", *Futuribles*, December 1981.

⁸ About the situation of the "economy of the shadow", or "second economy" in socialist countries, see I.R. Gabor *The Second (secondary) Economy*, *Acta Oeconomica* (1979 - N.3-4).

⁹ The methods for evaluating and integrating in national accounts the "informal production" of developing countries have been discussed, for instance, by J. Charmes (*Comment mesurer la contribution du secteur non structure a la production nationale des pays du Tiers-Monde?*, *The Review of Income and Wealth*, December 1983) and Derek Blades, (*The Subterranean Economy and the National Accounts*, OECD, Paris, 1982). The quite special case of India has been studied by P. and S. Gupta (*Estimates of the Unreported Economy in India, Economic and Political Weekly*, 16 January, 1982).

¹⁰ The most extensive study of the "urban informal sector" is the ILO World Employment Programme series of inquiries and analytical papers published in 1981. See, for instance, *The Urban Informal Sector in Developing Countries: Employment, Poverty and Environment*, edited by S.V. Sethuraman, Geneva, ILO, 1981. This study shows that the share of the urban labour force in the informal sector of major cities in developing countries varied from one fifth in Colombo and Singapore to up to one half or more in Lagos, Calcutta and Ascension. A certain number of case studies confirm the hypothesis that the relative size of the "informal sectors" increases with the degree of urbanization services in an economy. See, for instance, *Secteur informel et petite production marchande dans les villes du Tiers-Monde*, special issue of *Revue Tiers-Monde*, vol. XXI, No. 82, April-June 1982. The proximity of industrial areas from large urban areas has also facilitated the fact that, in periods of slower industrial growth, migrants from rural areas unable to find jobs in the industrial sector become active in the informal urban sector. See *Demissoes na industria aumentam numero de trabalhadores autonomos, O Globo*, (Sao Paulo) (6 September 1981).

Hence, in dealing with only the formal or recorded service sector, the SNA understates the true size of the total service sector in developing countries.

6. Fifth, the service inputs in agriculture, mining and especially manufacturing have been rapidly increasing together with the complexity of products, production techniques and the complexity of society itself. These developments have been matched by the increasing number of firms supplying a substantial portion of their own service inputs. Since in-house production of services is recorded as output of the goods sector, the share of services is substantially underestimated in the statistics. However, since these service inputs are critical for production, inability to quantify and analyze them is a much more serious shortcoming than the underestimation of the overall share of services in GDP.

7. Some data on in-house produced services do exist in many countries which undertake a census of industries. These data are, however, rarely used to revise national accounts where an enterprise's output and value-added are allocated to the branch of activity classified according to its major product line.

8. Some rough estimates of in-house production of services may never the less be obtained from the industrial censuses. For instance, there are usually separate statistics on the number of shop-floor employees (or employees directly involved in the production process) and the number of managerial and technical staff in business establishments (or at least a distinction is made between "white collar" and "blue collar" workers). In many countries statistics are available on the educational background and the wage and salary structure of the labour force - from which some inferences can be drawn concerning the magnitude and structure of in-house service production.

9. Sixth, important limitations arise from the difficulties in obtaining adequate and comparable figures for the value-added in many service industries. Unlike the case of manufactures of a given product where total output can be measured in physical terms, the output of most services cannot be so measured. This difficulty accounts for the arbitrary use which different countries make of different and alternative modes of recording output in services. In most cases, however, the value-added of a service industry can only be estimated by summing up all the factor payments made. Such an evaluation method would imply that the greater the inefficiency in the use of factors for a given activity, the greater would be its measured contribution to GDP.

3. The size of, and relevant trends in, the domestic production of services

(a) Production of services

10. The service sector accounts for the largest share of GDP in most countries, ranging from 41.7 per cent in least developed countries¹¹ to 67 per cent in developed market-economy countries. Moreover, the variation in the share of the service sector among different groups of countries is much smaller than for agriculture and industry. The share of agriculture in 1979 ranged from 4.0 per cent for developed market-economy countries to 49.0 per cent for the least developed countries while the share of industry ranged from 9.3 per cent for the least developed countries to 45.7 per cent for oil-exporting developing countries.

11. The variations among country groups are, however, more pronounced when it comes to considering particular service activities. The sectors "trade and finance" and "other services" are most noteworthy in this regard.

¹¹ In the least developed countries, agriculture accounts for the largest share of GDP (approximately one-half).

12. "Trade and finance" is the largest service activity in developed and developing countries alike. However, while the share of this activity has remained relatively constant throughout the 1970s at 38-39 per cent of total services in developed market-economy countries, it has grown in developing countries from 38.8 per cent to 42.5 per cent. For non-oil exporting developing countries this share has risen from 39.4 per cent (1970) to 46.3 per cent (1979). The relatively larger share in developing countries of a sector seemingly important to the development process such as trade and finance appears to be paradoxical. However, in many developing countries, retail and intermediate trade have long been recognized as being an overstaffed and inefficient service industry. It has traditionally served as a buffer for higher unemployment among the relatively well-educated labour force unable to find employment in other sectors of the economy. In addition, the low capital requirements, the importance of family connections in many small scale units and the unregulated entry conditions have enhanced the ability of inadequately educated workers to get better "white-collar" jobs within existing retail trade organizations, or to set up new shops of their own.¹²

13. The share of the miscellaneous category "other services" has increased in developed market-economy countries from 22.9 per cent in 1970 to 24.3 per cent in 1979. The share in developing countries as a whole, however, has declined from 22.9 per cent in 1970 to 16.1 per cent in 1979. Similarly, the share in non-oil exporting developing countries declined from 23.8 per cent to 16.4 per cent during this period. Hence, the relative importance of domestic production of these activities has declined in developing countries.

14. The share of public administration in developed and developing countries alike was approximately 14 per cent in 1979. The share in developed market-economy countries decreased by only one percentage over the decade, while for developing countries as a whole it increased by one percentage point. However, in the case of oil exporting developing countries and the least developed countries, the share was much higher (19.2 per cent and 20.0 per cent, respectively). None the less, these shares remained relatively constant throughout the decade.

15. For "*Transport and communications*" there are no big differences in shares of total services among the different country groupings. Developing countries as a whole appear to have a slightly higher portion of total services generated by this activity, but all country groupings show a moderate downward trend in the industry's share of total services.

4. Services in the socialist countries of Eastern Europe

16. With regard to the socialist countries of Eastern Europe, it should be borne in mind that their national accounts cover only part of total services, namely, "material" services, i.e., transportation, communications, trading and certain other services such as water supply, material utilities etc. There may be some small differences among the individual socialist countries with regard to the concept of material services, but they do not influence significantly the overall picture.

17. The concept of material or productive services is used to reflect primarily the role of services which are associated with the production process and the distribution of goods. Available statistics on material (productive) services do not, however, include those services provided in-house by industry, construction, agriculture and forestry. Hence, if the figures for services in the aggregate output of socialist countries are taken on the basis of their national accounts, not all

¹² In fact, it has been found that in five out of seven Latin American countries for which data are available, the relative output per worker dropped substantially in the "trade and finance" industry between 1950 and 1970. This has been attributed to the impact of labour excess supply-led growth in industry. See M. Mamalakis, "Una Estrategia de Desarrollo Relacionada con los Servicios", *El Trimestre Económico*, June-September 1983.

"material" services will be covered. If allowance is made for this omission, it is probable that the official estimates for (material) services would need to be increased by about 10 per cent.

18. Efforts are underway, at both the national and the international level, to adjust the national accounts of the socialist countries to make them comparable to those of the developed market-economy countries (SNA). In some socialist countries of Eastern Europe - Poland in particular - relevant estimations are available, though in an irregular manner. (For example, in Poland the last year for which estimates are available is 1977.) From this work on the Polish national accounts it appears that if the SNA concept is used, the share of both material and non-material services in GNP comes to over 27 per cent (against 22 per cent on the basis of the MPS). That is still, however, with the exclusion of (in-house) industrial services. If such services are included, the share would be some 33 - 35 per cent. However, an important reservation concerning prices has to be made. For social policy reasons the prices charged for non-material services are kept low and, in addition, most of these services are non-marketed services. Because of such distortions, the contribution to the economy of services in the socialist countries of Eastern Europe is not best measured on the basis of national income/GNP figures. Rather, figures for employment, investment and the balance of payments should be used.¹³

19. Industry and construction remain the largest sectors of economic activity in the socialist countries of Eastern Europe, accounting for more than half of NMP.¹⁴ An increase in the share of industry and construction has occurred in all these countries except Czechoslovakia, where the share fell slightly over the past two decades.

20. There have also been major changes in the relative importance of the other two major sectors. While in 1960 agricultural production played a significantly greater role in the national economies than services (except for the German Democratic Republic), the development of services had, by mid 1970s, displaced agriculture to third in rank. In 1982, material services made up the second largest economic activity, and ranged from a share of 15.2 per cent in Romania to 24.6 per cent in Hungary. Calculations for the intermediate years confirm this trend for services to increase their share at the expense of agriculture.

21. As regards the distribution among the various service sectors, "trade and technical and material supplies" consistently rank as the largest service activity in the socialist countries, varying in 1982 from 6.2 per cent of net material product for Romania to 17.8 per cent for the USSR, followed by "transport and communications" ranging from 4.2 per cent of the net material product (NMP) in Czechoslovakia to 6.8 per cent in Hungary. "Other material services" is the smallest service sector in the socialist countries of Eastern Europe, which varies from 0.4 per cent of NMP in Czechoslovakia to 3.0 per cent in the German Democratic Republic.

22. As noted above, non-material services are not included in NMP but are provided and financed through the re-distribution of net material product. Increased material production is closely interrelated with the consequent increase in the service sectors, accounting for both material and non-material services. A higher technological level of the means of production and development of industrial specialization and co-operation requires a larger network of transport and communication facilities, better trained and educated personnel, more health and leisure facilities, etc. Therefore the CMEA countries have been allocating larger shares of net material product to public consumption funds, with consequent growth of the number of working places in the sectors of educational, scientific, medical and personal services.

¹³ For further statistical information, including the share of material services in national income, as well as a discussion of production of services in the socialist countries of Eastern Europe, see TD/B/941 and Corr.1, *op.cit.*

¹⁴ The data referred to in this section comes from *Statistical Yearbook of the CMEA Member States*, Moscow, 1983.

B. The balance of payments

1. What the balance of payments reveals about services in the international context

23. Countries members of the International Monetary Fund (IMF) report to the Fund their international transactions in services in the context of the Fund's overall balance of payments statistics. The balance of payments is divided into a capital account and a current account. The capital account contains all transactions of a purely financial nature,¹⁵ while the current account is composed of a merchandise trade account and an invisibles account. The merchandise account covers exports and imports of "goods" (i.e. the tradeable output of the agriculture, mining and manufacture sector). The invisible account, on the other hand, covers all other current transactions.

24. As discussed in chapter IV of the present report, there has been much confusion over the definition and measurement of services in the context of international trade, compounded to a large extent by inappropriate references to balance-of-payments data. By definition, the balance-of-payments records all financial flows between countries, comprising both the financial flows which result from trade as well as those which result from payments for factors of production (both capital and labour).¹⁶ Confusion has arisen over the synonymous use of the term "invisibles" with "international trade in services". The "invisibles" account includes both the so-called "factor services"¹⁷ and "non-factor services"¹⁸. Only non-factor services comprise international trade in services as defined by IMF. Factor payments involve financial flows between residents and non-residents, but they do not constitute international trade in services. Many studies have mistakenly included the service-related activities of both factor and non-factor items in the balance of payments as international trade in services. However, factor services fundamentally involve foreign ownership of domestic production.

2. Statistical limitations

¹⁵ The capital account comprises all transactions in an economy's foreign financial assets and liabilities together with some specified changes of other kinds that may affect its foreign assets and liabilities, and the counterpart to those changes. See IMF, Balance of Payments Manual, Fourth Edition (Washington D.C., 1977), p.118.

¹⁶ In the case of "capital", payments arising from foreign ownership of domestic affiliates and receipts from domestic ownership of foreign affiliates (i.e. dividends, interest earnings of unincorporated affiliates and reinvested earnings) are recorded as "direct investment income." Similarly, receipts received by banks and other domestic residents on loans to non-residents and from holdings of foreign equity and debt securities, as well as payments abroad of interest by domestic banks and other residents and dividends paid to non-residents holding domestic equity (and debt) securities are recorded under "other investment income." In the case of labour, income earned by persons working in an economy (and for a resident of the economy) other than the one in which they reside, is recorded under "labour income" or "private transfers."

¹⁷ Factor services include "direct investment income" and "other investment income". Private transfers, or "labour income", are generally reported separately.

¹⁸ Non-factor services include "shipping", "other transportation", "travel", "official services", and "other private services." The miscellaneous category "other services" includes such diverse activities as non-merchandise insurance, communications, advertising, brokerage, management, subscriptions to periodicals, processing and repair, merchanting and professional and technical services.

25. Five statistical limitations with regard to international trade in services and the balance of payments were discussed in TD/B/941.¹⁹ First, there is a wide variation in the reliability of data on specific international service activities. The existence of open-registry fleets, different methods of reporting freight transactions, and lack of distinction between goods and passenger transport, both by sea and by air, impede international comparability of balance-of-payments statistics. In fact, this problem appears to account for the large discrepancy between world debits and credits in traded services. Second, there is a lack of statistical disaggregation at the sectoral level. In particular, the item "other goods, services and income" includes a wide range of important service activities, such as non-merchandise insurance, communications, advertising, management services, brokerage, professional and technical services. This significantly hinders any meaningful detailed discussion of trade in individual service activities.

26. Third, the value of traded services is often incorporated in the date on merchandise exports, since manufacturers often provide services to their foreign clients in connection with their trade activity (e.g., engineering or training activities), but include the value of these services in the reported value of their exports of goods. This tends to understate the size of international trade in services. Fourth, while IMF does provide "direction of trade" data for agriculture and manufactured goods trade, comparable data do not exist for services. This limits the analysis of trade with particular countries, groups of countries or regions, as well as that of general macro-economic and trade policy. Last, as in the case of national accounts data, few developing countries have data covering long periods of time. This, in turn, inhibits any analysis of longterm trends in international trade in services.

27. In addition to the five statistical limitations mentioned above, two additional limitations are particularly noteworthy: First, many services are "unreported" and understate the true value of total traded services. Balance-of-payments data rely largely on "reporting" by governments, customs, firms, etc., rather than on estimates. In the case of shipping, for instance, the existence of open-registry fleets explains part of the discrepancy observed between world credits and debits for this particular activity.²⁰ It is more particularly in the developing countries that there is a large "unreported sector". In tourism areas, for instance, many services are provided "informally" to visitors by residents, and are often a significant unreported source of foreign exchange. Given the characteristics of this unreported sector, it is reasonable to assume that, especially in urban areas, it is essentially service activities that are involved and which are not reflected in balance-of-payments statistics.

28. Second, the socialist countries of Eastern Europe also provide a clear limitation on the use of IMF balance-of-payments statistics for any world-wide economic analysis of service transactions. Apart from Hungary and Romania, who are members of IMF, the socialist countries of Eastern Europe are not included in IMF statistics. National balance-of-payments statistics in these countries generally do not include factor payments or private transfers. Moreover, significant price distortions are induced in these statistics by the existence of specific price arrangements (or barter) for intra-CMEA trade.²¹

¹⁹ One other limitation of the balance-of-payments data was also mentioned there, namely "lack of data on service-related foreign investment." This limitation is not relevant to international trade in services, however, but only to issues involving foreign ownership of domestic production.

²⁰ See para. 60 and footnote 14 in TD/B/941 for a discussion of other statistical problems in the area of shipping.

²¹ For a more general discussion of the comparability of accounting systems, see TD/B/941, para. 53.

ANNEX II

THE NEED FOR NATIONAL STUDIES ON SERVICES

A. The purpose of national studies on services

29. The ultimate purpose of national studies on services is to provide the necessary information to governments to enable them to formulate effective policies influencing or governing supply and demand conditions in individual service sectors, both in the context of the domestic economy and of international transactions.

30. National studies on services should be conceived as ongoing projects for a number of reasons. First, due to the scarcity and low quality of present data on services, conclusions drawn can only be tentative. Hence, the studies should continually be refined, parallel with improvements in the collection and processing of statistics. A further reason is that many services, especially those which are inputs into the production of goods and other services, are changing rapidly in nature as a result of technological innovation. Finally, national policies in services need to take account of the developments and changes in policies of other countries thus necessitating a continuous monitoring and reassessment of policies governing services.

31. Given the longer-term perspective, one of the major issues that national studies should tackle is the identification and solution of problems concerning the measurement of services.

32. National studies of the service sectors can be expected to highlight the following broad subjects:

(a) The "interlinkage" of particular service activities with the rest of the economy and their importance to national development; its importance to the development of the country.

(b) The role of certain service activities in the fulfilment of social goals (e.g., employment, income distribution, dependency, etc.);

(c) The extent to which particular services can only be provided domestically and not through foreign trade;

(d) The importance of foreign investment in the domestic production of services.

- Foreign direct investment and the role of transnational corporations as suppliers, users and exporters of services;

- Intra-firm transactions in services;

(e) The role of telematics in revolutionizing domestic production and foreign trade in services;

(f) Services as a means for technological development: transfer of technology from abroad, its diffusion within the domestic economy, and technology exports;

(g) General information on services:

- Services as a source of employment;

- Services in the context of national income accounts;
 - importance of non-tradeable service activities to development;
 - consumer versus producer services;
 - importance and identification of major activities under the category "other services";
- Services in the context of the balance of payments;
 - payments and receipts in "traded" or non-factor services;
 - importance and identification of major activities under the category "other services";
 - prominence of deficits in particular traded services;
 - import substitution;
 - integrated regional schemes;

(h) The scope for strengthening services domestically, taking into account interdependence;

(i) Determination of a national position on services in international discussions and possible negotiations;

(j) Possible avenues for multilateral co-operation;

B. Issues pertaining to the assessment of the role of services in the development process

33. The following list identifies issues which should ideally be explored in any study of the role of services in the national economy, although it is evident that data do not yet exist to permit many of these points to be addressed adequately.

1. A Statistical profile of services: construction of a consistent (time series) data base from available national accounts, balance-of-payments, industry and trade statistics, with a view to identifying and analyzing the following:²²

(a) Services in gross domestic product (GDP):

- Share of services in GDP; breakdown of the services sector, identifying its main components;

²² In addition to published statistics, maximum use should be made of data already compiled but not reported at a detailed level; such as small sample surveys to arrive at "benchmarks" or to make "level adjustments". The level of aggregation and the applicability of the items listed will necessarily be dictated by data availability.

- Trend of the share of the services sector in GDP and growth rates of its components; sectoral variations.

(b) Services and employment:

- Employment and employment trends in the various sectors of the economy, and in the various service sectors.

(c) The informal services sector:

- Share of the informal sector in GDP and employment, share of services in the informal sector, and trends. (Using results of existing country studies on the informal sector; mapping developments in the informal sector through its inputs to the formal sector.)

(d) Productivity of services:

- Productivity in the services sector as a whole and in its components, trends and comparisons with levels and trends in agriculture, mining and manufacturing;

(e) Investment in services:

- Gross, fixed capital formation in service industries, trends and comparisons with other industries;

(f) Services in the balance of payments:

- Share of services as a whole in the balance of payments current account, and that of individual service items including those related to international labour and capital movements, in particular foreign direct investment;

- Trends in the balance of services. Identification of main deficits and surpluses. Growth rate of payments and receipts and variations in the balance. Relationship between GDP and the balance of services.

2. A mapping of policies and international agreements pertaining to services:

(a) Ownership (public, private, domestic - foreign) of the establishments supplying services;

(b) General policies affecting the domestic supply of and demand for services;

(c) Specific regulations affecting particular service industries;

(d) General and specific regulations concerning foreign direct investments in service industries;

(e) Regulations on the import and export of specific tradeable services;

(f) Bilateral and multilateral agreements which influence trade and investment in services;

3. Assessment of the contribution of individual service items to growth and development:

(a) Consumer versus producer services, and backward and forward linkages pertaining to service sectors:

- Individual service items in final demand, in gross capital formation, and as intermediate inputs in the production of goods and other services in key sectors of the economy. (Using the available input-output tables and case studies, and reliable data compiled for other purposes; as well as small sample surveys);

(b) Incremental GDP/output, GDP/employment, capital/output and capital/employment ratios in major service industries:

- Trends in these ratios;
- Comparisons with other industries.

(c) Consumer vs. producer services in international trade;

(d) Service imports, exports and export potential:

- Services imported or exported and services with unexploited export potential (i.e., services in which the country in question may have a comparative advantage);

(e) Products with export potential and their service components (inputs);

(f) Demand and supply conditions, i.e., price, quantity and quality in individual service items, market structure (including restrictive business practices):

- Domestic demand;
- Domestic supply;
- External supply;
- Export markets;

(g) Services which constitute bottlenecks in investments and in the production and export of goods and other services;

(h) Sectoral and case studies:

- In-depth studies of sectors and firms which produce or use intensively specific "key" services, making maximum use of the results of existing case studies;
- Comparisons using results of studies pertaining to other countries;

(i) Transfer of technology and foreign investment:

- Technology transferred through trade and foreign investment in the production of services as distinct from the production of goods;
- Technology imports and export potential;
- Costs and benefits of capital expenditure on high technology in services.

4. Analyses of targets, goals and policies pertaining to services:

(a) Services to be procured from abroad or supplied domestically for reasons of externality, protection of infant industry, public interest, national sovereignty and security, etc.;

- Cost-benefit analyses, taking into account the potential competitiveness of the country in various service industries, foreign supply conditions, employment and balance-of-payments effects, size of domestic market, minimum optimal scale of production/operation, possibilities of regional co-operation, capital/skill/technology requirements and their availability;

(b) Review of the foreign trade and investment regimes in goods in the context of services;

(c) Optimal forms of supervision or regulation of individual service activities in the domestic context and in international transactions, in particular with reference to foreign direct investment;

(d) Monitoring technological changes and policies of other countries which pertain or relate to service industries (mainly by following the international studies in this field) and identifying the possible impact of such changes, and of transfer of technology, on the international pattern of comparative advantage and on the existing national production structure in the country;

(e) Identification of appropriate national objectives in international discussions and negotiations with respect to individual service sectors;

(f) Remedies to improve the quality and coverage of data on services in the domestic context and in international transactions:

- Explicit and detailed treatment of services by institutions responsible for data compilation, e.g., detailed formats for data compilation in industry censuses, etc.;
- More extensive reporting routines and obligations (especially for banks, financial and clearing institutions);
- Incentives for reporting;
- Large-scale surveys;
- Independent surveys using different samples and methods to check reliability of data.