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Negotiating Strategies for Liberalizing Trade and Investment in Services

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NEGOTIATING STRATEGIES FOR LIBERALIZING TRADE AND INVESTMENT IN SERVICES

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This paper contains preliminary findings from research work still in progress and should not be quoted without prior approval of the author.

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CURRENT ISSUES IN TRADE AND INVESTMENT IN SERVICE INDUSTRIES: U.S.-CANADIAN BILATERAL AND MULTILATERAL PERSPECTIVES

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In one of his more whimsical, yet nevertheless profound moments, John Maynard Keynes wrote "The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back. I am sure that the power of vested interests is vastly exaggerated compared with the gradual encroachment of ideas."

In the case of services, the most powerful impact of economic thinking has been the absence of economic thinking. Services has not been a popular topic in the history of economic thought, and there has been little if any thinking on trade in services.

David Ricardo used the example of English cloth and Portugese wine to make his case for trade. No economist I know uses the example of English Insurance and Swiss Banking. The labor theory of value denied that many services had any value at all, because they were not the product of physical labor. Indeed many still consider services inferior to manufacturing because services do not involve physical labor and services do not result in a product that you can touch and feel.

One of the few examples of services in the economic literature that I could find was a discussion by the French economist and satirist Bastiat. You will remember him as the wit who mocked French tariffs on English cloth. In his widely publicized parody of the manufacturers of candles and waxlights petitioned the government to banish the unfair competition from the sun. In another essay he took on a proposal in the French Assembly to provide a break in the Paris to Madrid railway in Bordeaux, because it would redound greatly to the wealth of the Bordeaux porters, commissionaires, hotel keepers, bargemen and the like, and thereby enrich France. In his essay, Bastiat argued let's not stop at Bordeaux alone. He wrote "If Bordeaux has a right to profit by a gap....then Angouleme, Poitiers, Tours, Orleans... should also demand gaps as being for the general interest...In this way we shall succeed in having a railway composed of successive gaps, and which may be denominated a Negative Railway".

In the absence of scholarly economic writings, economic thinking on the subject of services has been largely dominated by experiences from everyday life. At a recent meeting of the OECD Trade Committee we were treated to an interesting dialogue on the potential gains from trade in the services of hairdressers. A Swiss male delegate opined that if there were trade in hairdressing services it would be unproductive. He was challenged by a woman delegate from Germany, who thought hairdressing services in her country had been significantly enhanced by imports from France.

One has to ask the question why more attention has not been paid to trade in services. First, services have traditionally been produced where they were consumed, and therefore it has been assumed that they were not tradeable.

Second, where services did flow internationally, they were largely associated with trade in goods, and it was assumed that its primary purpose was to facilitate such trade and could be analyzed in terms of trade in goods.

Third, services tend to be heavily regulated by governments as a public good, and it has been assumed that foreign suppliers are unreliable suppliers of poor-quality services. (Of course, there is a great deal of protectionist and mercantilist thinking in such notions of the public good).

Fourth, to the extent international negotiations on services have taken place, as for example a telephone call or an airline flight between country A and country B.

In recent years, a number of fundamental economic changes have been responsible for major changes in the objective economic reality, regarding trade in services, though economic thinking and popular conceptions have been slow to change.

First, major advances in communications and computer technology have made it possible to separate physically the production and consumption of most services. Engineers employed by Bechtel in India can make their services available on line to Bechtel headquarters in San Francisco and construction supervisors in Saudi Arabia. The Chicago Mercantile Exchange and the Singapore exchange have linked up to provide continuous trading. Utilization of major computer centers now shift to different parts of the world with the rising and setting of the sun.

Second, the increasing economic integration of the world and the growth of multinational enterprises has created a demand for services on a global scale. The multinationals want to be provided services of a known quality and a uniform standard around the world. As service companies have responded to supply the demand for such global services, they have created global service networks that now serve as efficient channels of trade for such services. Specialized communication channels serve as channels for the exchange and transmission of services, which can now be traded faster, cheaper and more efficiently than goods.

Third, service inputs into manufacturing output has steadily grown in importance relative to physical labor or material inputs. In many manufacturing companies white collar labor now exceeds blue collar labor. With this trend has come a growing specialization in service activities within manufacturing enterprises, and the establishment of separate profit centers for such activities as computer processing, software design, engineering, and research.

Once you had separate profit centers, profit center managers soon found it profitable to sell their services outside the firm. Boeing and MacDonald Douglass, for example, have become two of the larger sellers of data processing services. On the other hand, unprofitable profit centers tend to get eliminated, and the services are purchased from outside suppliers. Business services have thus become the fastest growing sector of our economy.

Fourth, goods and services increasingly come bundled together in a single package. A computer or a robot is useless without expensive software and maintenance services. Trade in many goods and services can no longer be separated in economically meaningful terms.

Economic thinking and popular perceptions have been slow to respond to the new economic realities. These new economic realities, however, do explain why the business community in the United States, and increasingly in other countries, has been pushing for increased consideration of trade in services. This brings me to the topic at hand, negotiating strategies with respect to trade in services.

Trade in services was injected into the trade policy and trade negotiating arena when a small, hardy band of service industry representatives led by Ron Shelp and Hank Greenberg of AIG, persuaded the U.S. Congress in 1973 to add a negotiating mandate on services to the Trade Act of 1974. After a considerable negotiating effort, the United States succeeded in getting the word "services" into the Government Procurement Code and the Standards Code during the Tokyo Round of Multilateral Trade Negotiations. As a further concession to the United States the developed countries agreed in 1980 to undertake a study of trade in services in the OECD Trade Committee.

It was clear from the beginning that this was a systemic issue, and the principal advocates in the business community for trade negotiations in services have consistently taken the same view. For the past 35 years or so, the GATT has provided a framework of contractual rights and obligations, and a set of procedures for discussing debating and negotiating trade issues with respect to goods. With all its warts and shortcomings, the GATT system has provided an organized basis for addressing the commercial concerns of business enterprises engaged in trade, and for removing barriers to the expansion of such trade. What our businessmen wanted was both very simple and very difficult; they wanted the same kind of system for services.

A patchwork of agreements has provided an international framework for some services. There are no agreements at all in other areas of services, particularly in the most rapidly growing information-based services. The agreements that do exist, serve primarily a regulatory function, and as such they do not provide a hospitable environment for the resolution of commercial issues or the liberalization of barriers to trade. Indeed, regulators tend to be more interested in increasing government intervention in pursuit of regulatory goals, rather than reducing it, and they tend to be more interested in assuring that regulatory goals are achieved than in assuring that a businessman engaged in trade can make a buck.

The task, therefore, in the views of U.S. service industry interests, was to develop a general framework for trade in services. Pursuing this goal in the OECD and the GATT has been an exercise in avoiding a series of traps, each of which could have bogged the effort down in a hopeless swamp of theoretical argumentations leading nowhere.

Our first task in the OECD was to define what we were going to study about services. There were those who proposed we should first define services, and we could have had wonderful semantic and philosophical arguments on the subject. There were others who argued we should collect statistics, and since governments collect little data on trade in services this could have led to a prolonged debate with statistical experts. Others proposed that we examine the regulatory structure for services, and we could easily have immersed ourselves in regulatory minutae. The US proposed that we look at trade problems involving services, and ultimately our proposal was accepted as the approach that would most readily shed light on the key issues, namely whether there were any trade problems in services that were not being addressed adequately.

The second issue which needed to be resolved was how we would go about studying trade problems. There were those who argued for sectoral studies. Those who argued for this approach tended to do so because they felt that it would be more manageable, and because it would emphasize the differences among sectors, and therefore make the case for a sector by sector approach to negotiations, rather than a general or horizontal approach to such negotiations. The United States argued for a general inventory approach, with a cross-cutting analysis of the types of barriers found in service sectors across the board. We took this approach because it would lead us to an overall conclusion more quickly, and because we wanted to emphasize the possiblity and utility of a more general approach to negotiations on trade in services. In order to disprove the argument that it couldn't be done, we produced a general inventory of trade barriers based on complaints by U.S. service industries in less than six months. The Solomonic decision of the Trade Committee was to pursue the study of trade problems in services through both a sectoral and a general horizontal approach in tandem. A great deal of work has been done on this basis over the past two years.

The next major decision facing the OECD Trade Committee will be on the recommended approach to future negotiations on services. I am confident the Committee will decide to recommend both a general and a sectoral approach to negotiations. It will need to contain some general elements, because it will need a common economic and political focus, and a framework for setting out the issues from a trade point of view. Without it, it could easily lose its focus on trade liberalization. Moreover, a common framework can save time in getting more efficiently to certain principles and concepts which can serve as a common base. To a large extent, these common principles and concepts set out principles of good government, an orderly process for approaching negotiations and a coherent notion of what one is getting from any negotiated commitments. It has less to do with liberalization per se. A general approach, moreover, can assure that sectors which do not pose special issues are included in the process of liberalization rather than being excluded because they do not warrant separate sectoral negotiations.

A sectoral focus will be needed because a number of the key service sectors do have special characteristics, and a regulatory and international negotiating history of their own. A sectoral or an item-by-item approach to negotiations is more likely to lead to hard, concrete commitments where there are extensive barriers to trade or heavy regulation of activity.

To date we have given considerable thought in the United States to the general principles that could provide the basis for a general code or framework for trade in services. The first principle is transparency. It would require governments to identify barriers to trade in services explicitly and to notify other countries of any changes in laws and regulations affecting trade.

The second principle is national treatment. It would require governments to administer all domestic laws and regulations that are not identified as trade barriers on a non-discriminatory basis, treating domestic and foreign suppliers equivalently. In other words, governments would clearly have to separate the protection of domestic services industries from the regulation of services.

The third principle is that public monopolies should maintain an arms length relationship between their public monopoly and their involvement in competitive markets. This means that a public monopoly should not use its monopoly position to disadvantage a foreign competitor in the international arena, or in domestic commercial activities outside of the monopoly mandate. For example, a foreign PTT monopoly should not be able to use its control over telephone lines to disadvantage a foreign data base company if the law allows the PTT and foreign companies to supply such services on a competitive basis.

The fourth principle is reciprocity. It basically says that if any country violates a previously negotiated deal, other countries affected by that action can withdraw some of their own commitments to restore the balance.

The fifth principle involves the orderly settlement of disputes. Countries agree to consult with each other when there is a problem, and seek to resolve it on a bilateral basis. If this process doesn't work, there is an impartial mechanism in the GATT for sorting out the facts in the case and for weighing the respective arguments.

A framework as outlined above would make possible a wide variety of negotiating approaches. It could provide the basis for either sectoral or item-by-item negotiations. It could also provide the basis for an overall standstill commitment, i.e., a commitment not to establish new barriers to trade in services except in specified circumstances.

U.S. ideas on a possible negotiating approach was first laid out under Bill Brock's name in an article published in November 1982 in the World Economy, the periodical of the Trade Policy Research Center in London. They were also set out in a more indirect way in the U.S. National Study on Trade in Services submitted to the GATT in January 1984. More recently, these ideas have formed the basis for the negotiation of the US/Israeli Declaration on Trade in Services, which will form part of the upcoming agreement on the US/Israeli Free Trade Area.

In developing our ideas, we also had to make some decisions on what should be included in our definition of trade in services. We decided, for instance, that the movement of people and questions of immigration policy should not be covered within any agreed negotiating framework. We also decided, for example, that we would not include investment in services establishments within the negotiating framework. This was not a popular decision with our business community, but we felt that investment restrictions would be far more difficult to tackle than trade restrictions, and that we should, therefore, restrict ourselves to services supplied across national borders.

This distinction between trade and investment is probably one of the most difficult conceptual issues we have had to address. People are not used to thinking of the distribution system for services as separate from the traded service, even though no one has a difficulty in separating the activities of an automobile dealership from trade in automobiles. Along the same lines, it should be possible to separate the activities of local insurance brokers from insurance provided by a company located abroad.

I would now like to turn from some of the conceptual issues, to some of the more practical aspects of reinforcing the preparation of negotiations and to some of the questions of negotiating strategy which we must confront in the months ahead.

Early in the process of building consensus on trade in services, it became clear that we would have to tackle a number of systemic problems that went considerably beyond the absence of a GATT-like structure for trade in services.

The absence of theoretical underpinnings for trade in services, for example, needed to be corrected. We took a number of steps to encourage academic work, including sponsorship of seminars and helping to raise funds for academic research in services. These and other efforts have paid off, and the gap is being filled by conferences such as this.

Another systemic problem is that governments have not collected much detailed data on trade in services, beyond the minimum needed for balance of payments accounts. Moreover, the balance of payments data itself is deficient, since large areas such as data processing, tuition payments, and professional services have escaped measurement. We have taken a number of steps to help correct this deficiency, including the sponsorship of two research contracts on data needs and availabilities, the formation of an interagency committee to overhaul U.S. government services data, and the formation of a working party in the OECD on trade in services data.

A third systemic problem has been the absence of any centralized responsibility for trade in services in foreign governments, or put in another way, the absence of either expertise or a mandate for services in foreign trade ministries. One of the most important aspects of the discussions in both the OECD and the GATT has been to develop expertise and lines of responsibility for trade in services in foreign government structures. We also decided to systematically raise individual trade issues with trade officials in other governments, to force them to develop both expertise and a level of responsibility for trade issues in services. Moreover, our vigorous pursuit of specific services issues in bilateral consultations and negotiations has helped reinforce the view that there are trade problems in services that need to be solved. By resolving a number of concrete issues of concern to our service industries, we were also able to expand and reinforce the private sector constituency for future trade negotiations in services.

Another systemic problem was that many U.S. laws did not lend themselves to a commercially oriented approach to trade issues. Also, the various committees of the Congress with substantive jurisdiction in individual service sectors had never really focused on the trade dimension. To begin the process of overcoming these problems, we worked with the private sector and Congressional staff in organizing Congressional hearings and drafting new legislation.

The Omnibus trade bill which passed the Congress last week included major provisions on trade in services, which had been debated and discussed in a number of different Congressional Committees.

Another problem we addressed was the public perception of trade in services. For a number of years we produced our own newsletter on what was happening in the area of trade in services, and we worked with the press in disseminating news about issues and negotiations. This has inevitably led to increased requests for information and for speaking engagements.

There remains a general uncertainty on what new agreements on trade in services would do, and how they would meld with existing regulations and institutions. To help answer these questions, we have begun to take advantage of targets of opportunity for negotiating bilateral agreements. The US/Israeli Agreement was one such opportunity. The US/Canadian discussions of a possible sectoral agreement on informatics has also been an opportunity for applying trade concepts to agreements in services. Another opportunity arose the other day when representatives of the National

Association of Architectural Accreditation Boards came to see me. It turns out they have been negotiating bilateral agreements with the relevant authorities in other countries, and we have decided to coordinate our efforts in the future. These and other bilateral initiatives are giving us an opportunity to set useful precedents, and to reduce uncertainty and fears about trade agreements in services.

The Israeli agreement should prove particularly helpful to us. It is a comprehensive agreement covering all services sectors. It establishes the key principles which we believe should be part of any general agreement, but puts them on a best efforts basis at this stage. At the same time, the agreement calls for a sector by sector review of the implementation of the agreement, with the objective of establishing a legally binding agreement at the end of the process. This procedure will enable us to go to federal and state regulatory agencies with a concrete set of commitments, and work out any sectoral understandings which are required. It will, in effect, be a learning experience for both the United States and Israel. In the end, we should have an operational agreement as well as a much better understanding of the issues that will need to be addressed in multilateral negotiations.

Another problem which will have to be dealt with is the relationships between any trade agreements in services to various existing international sectoral agreements and sectoral organizations such as the ITU, IATA and the CSG. Over the past few years we have begun a dialogue with responsible officials in these organizations, pointing to the relationship that now exists between the

Standards Code in the GATT and the International Standards Organization or between the Customs Valuation Code in the GATT and the Customs Cooperation Council in Brussels. As a result of these discussions and an active correspondence, we have been successful in the case of IATA in developing a mutually acceptable approach to a possible division of responsibilities in the aviation area.

This brings me to the bottom line. How are we going to get multilateral negotiations on in trade in services?

I should begin by noting that trade in services has risen in the hierarchy of U.S. trade policy objectives over the past few years, and it is now one of the top objectives. Services have become fully embedded in the U.S. trade policy process. The question for the United States is not whether new negotiations will be held but whether they will be carried out bilaterally, plurilaterally among a group of interested countries or among GATT member countries as a whole.

At the moment most developed countries are committed to a process leading to negotiations. A number of developing countries like Korea, Jamaica, Chile, the Philippines, and Singapore are favorable to the idea. A large number of developing countries, in particular India and Brazil are adamantly opposed. At the same time, both India and Brazil have indicated that if negotiations go forward despite their opposition, they will feel compelled to join the negotiations in order to protect their interests. In my mind, the issue therefore comes down to whether a number of key countries is prepared to move ahead now, even though we may not have universal consensus.

My prediction is that the major developed countries will decide within the next year or two to move to negotiations. At the same time I expect that a number of developing countries will decide to participate, some as observers, others more actively. The process will take a considerable amount of time, though I expect some concrete results by 1990. Whether this will be in the GATT or outside the GATT remains to be seen. Where it will take place is likely to have major implications for the GATT, since trade in goods and trade in services have become highly integrated in the U.S. trade policy process, and the U.S. will insist on linkage between the two in any future negotiations, wherever they are conducted.

The reason for this policy by the United States has both a strong economic as well as a strong political rationale. In economic terms, trade in services has become a major source of new jobs for the United States, and there is little sense in negotiating concessions in basic industries like steel or textiles where we are going to lose jobs, without foreign concessions in areas like services where we are going to gain jobs. Politically, we no longer have a strong enough political coalition to support free trade among goods industries alone. We need the support of the services industries to preserve an open trade policy. Service industries were an important factor in helping to pass the recent omnibus trade bill.

Before closing my remarks, let me make a few final comments on US/Canadian trade in services. I have already mentioned the discussions we have initiated in the informatics sector, after a very helpful paper written by Rod Grey and a proposal made by Mr. Frazee, the Chairman of the Royal Bank of Canada. Our initial discussions have been very productive, and I expect we could work out an agreement in twelve months if the political decision is made to push ahead.

We have given some thought to other initiatives we could pursue in the context of these sectoral discussions. We will certainly be interested in pursuing the discussion already underway between our Association of State Architectural Accreditation Boards and the responsible provincial authorities in Canada. We would also be interested in exploring possibilities in other service sectors. One idea might be to look at short-haul cross border commuter flights, and to take another look at trucking. We may also want to take a look at the US/Israeli Agreement and examine whether it might provide a useful model for US/Canadian trade in services.

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