Negotiating about Trade and Investment in Services

Rodney de C. Grey

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NEGOTIATING ABOUT TRADE AND INVESTMENT IN SERVICES

Rodney de C. Grey

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

THE THIRD ANNUAL WORKSHOP ON U.S.-CANADIAN RELATIONS

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Institute for Research on Public Policy, Ottawa

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1. It was proposed that this paper should "seek to clarify the major barriers (to trade and investment in services) by type, sector, and country, review the status and treatment of service issues in the major industrialized countries and in the GATT, OECD and UNCTAD, and offer a framework for bilateral and multilateral negotiations concerning services." Anyone who has, even casually, considered any of this range of issues will realise that such an assignment is ludicrously ambitious. Moreover, it is, in part, quite unnecessary, because the US GATT Study on services sets out the factual background, at least from a US viewpoint, well enough. Nor do I propose to offer "a framework for negotiations." Rather, I would like to set out a series of propositions about the proposal of the US Government that there be negotiations under the aegis of the GATT to develop some general rules about trade and investment in services. This series of propositions is designed to raise some questions and to express some concerns.

2. We should begin by defining the "Services Proposal". There are various versions; as I read the various statements, the proposal is that the major advanced market economies and at least the key developing countries should negotiate some set of comprehensive international rules covering trade in services, whether delivered directly (as in data services) or by
establishments. This proposal reflects the growing realisation that there are significant and costly restrictions on such trade and that services exporters and services corporations could improve their prospects by removing some of these restrictions. However, the services proposal, at least as expressed by representatives of major services corporations, involves the assertion that such restrictions could most effectively be removed, or brought within some framework of rules—involving rights and obligations, dispute and settlement procedures and sanctions for non-compliance—by the negotiation of rules of an across-the-board character, rather than by negotiating sector-by-sector. It seems to me that such a proposal must have very little appeal to developing countries— or, indeed, to most smaller countries. Many of them will prefer, as an important issue of policy, to develop some of the services industries with the minimum of restricting obligations, and, to that end, to control access to their national markets for particular services by foreign firms or for foreign-produced services. They will resent being pressed by the powerful services-oriented economies (the US, the UK) to take part in a general negotiation in which they may find it difficult to establish just what are the implications of particular proposed general rules for their plans to develop domestic capabilities in particular services sectors. Nor will they wish to enter into a negotiation in which their existing rights of access to the markets of the industrialized economies for their manufactured exports or potential exports are at risk if they do not concede guarantees of access to their domestic markets
for US and UK services companies. As they will see it, the fully industrialized and services economies of the North are trying to re-work the GATT bargain, so as to either secure new scope for restricting imports of goods, or for securing new rights in the markets of the South.

3. It is important, it seems to me, to make an effort to appreciate how the "Services Proposal" will look to others. However, the fact that developing countries, understandably, will wish to stand aside, should not stop us from addressing the issue in a fairly systematic way. As the various services industries develop, there will be problems of access, in regard to traded services, and problems regarding the establishment and treatment of foreign-controlled corporations in the services sector. It is interesting, in this context, that three at least of the recent issues between Canada and the United States have arisen in regard to services. There was the "Border Broadcasting" issue, a nagging and totally unnecessary dispute which is more about advertising than "informatics". Another was the set of issues thought to be raised by Canadian trucking firms operating in the United States; this was more about the gap between two regulatory regimes than about trucking. A third is the provision in the Canadian Bank Act imposing a requirement on foreign-controlled banks (and on Canadian banks too, for that matter) that they maintain certain minimum records in Canada rather than solely on data storage facilities outside Canada. This provision seems to have irritated a lot of Americans, although, to banks with de-centralized, distributed data bases, it imposes no great
burden. American commentators appear to assume that because the enactment of the provisions was welcomed by protectionists in the Canadian computer services industry, it had only to do with their interest, and little to do with the more legitimate consideration of bank regulation. Perhaps some of the recent problems of some American banks will make Americans more comprehending about other countries' regulations. It is important that these three examples all relate to regulated industries. Many services industries are regulated industries; of course, regulation can easily be an excuse or a screen for protection against foreign competition. US enthusiasm for de-regulation does not take much account for the fact that other countries acquired much of their enthusiasm, and much of their techniques for regulation, from US models and from US exposition. It may take some time, perhaps for ever, for the de-regulatory case to be learned in other countries.

4. My first proposition in trying to come to grips with the services proposal is that trade and investment in services should not be thought of as taking place in a kind of vacuum, as taking place in an absence of rules. There are some regimes providing some rules for some sectors. There are important bilateral and multilateral understandings, which are the result of detailed and prolonged negotiations, covering some aspects of particular services activities, eg, air transport, telecommunications, banking. Given the existence of these relatively elaborate and long-established arrangements, the advocates for the holding of some sort of general multilateral multisectoral negotiation
must accept the onus of showing why what they say they want cannot be secured by the revision of existing sectoral agreements. Moreover, not only are there instrumentalities such as the ITC, IATA, and so forth, there is the whole body of national legislation on the various services sector. National legislation, in all major countries, has been developed in the knowledge that the activities which the legislation seeks to control must be carried out in economies which are open to outside influences, which are not hermetically sealed. Economic agents engaged in services activities do so with knowledge of the legislation in their own country and in other countries; there are bodies of national legislation which work and which provide a set of rules. Further, there is the body of acceptable commercial practice and private international law which bears on services activities as on other international transactions. We must not address the issues as though in regard to goods there was a functionally effective set of multi-sectoral rules of general application and in regard to services no rules.

5. My second proposition is one of very general application across the whole field of foreign relations, although it is more a method or approach, rather than a proposition. As I see it, there is utility in thinking of a nation's negotiating skills, its negotiating credit, being limited at any given time; it follows that one should examine any proposal to launch negotiations from the point of view of whether the stated objective can be achieved more economically,
in the sense of not using so much negotiating credit. As
Ambassador Robert Strauss so often said to the rest of us
in Geneva: "I have only so many chips." It follows that we
should try to get clear just what particular groups in the
community think their interests will be served by a proposal
to enter into negotiations, we should try to formulate
these interests clearly, and then consider how they can
be most economically secured, if we agree that the interests
of the particular groups concerned is also the national
interest. In the present case, we should ask: what do services
corporations in the US (and in the UK) really seek to secure
when they ask their governments to launch a comprehensive
negotiation about services? Is what they seek to secure
in the interests of the US (and the UK) as national entities?
If so, how can it be achieved with the least expenditure
of national bargaining power? Put more precisely, what is it
that American financial services companies, American insurance
companies, American air transport companies, think they want?
Should the US be making a major diplomatic effort to serve
their interest - rather than addressing the question of how
to sort out the mess in the trade in textiles and
textile products, in steel, in autos, and in agricultural
trade, and in trying to improve the trade prospects of the
Third World? There is no evidence that the US negotiations
have the diplomatic skills or credits to address all these
issues effectively at the same time; their assertions that
attention to services issues will not draw effort away from
other issues is just that: an assertion. My proposition
could be stated - "proceed, if you must, but with the
minimum possible expenditure".
6. My third proposition is that the GATT, as a system, cannot be an analogue for a set of rules on services. One important reason is that the GATT is manifestly not working; the GATT, as a system, regardless of the intellectual rigour and skillful drafting of the specific provisions, is in considerable disarray. It is not working effectively for traded goods; surely, it is not necessary here to argue this point in detail. If the GATT is not working, is it wise to assume that it could be the basis or the model for a system of general rules for traded services?

7. We shall consider below the extent to which some key GATT provisions are being ignored, flouted, or rendered ineffective. But looking at the GATT as a system, it is important to realize that some of its central provisions evolved as detailed rules to limit the use of restrictive mechanisms which were already established in domestic legislation (and, often, the subject of provisions in bilateral agreements). I have in mind Article VI (anti-dumping and countervail), XII (balance of payments restrictions) and XIX (emergency action to limit imports). If we have to write similar rules for traded services, such new rules would sanction restrictive action of types not now common in regard to traded services. Do we really want anti-dumping duties for traded services, countervailing duties on allegedly subsidized exports of services, systematic restriction on transactions in the services sector justified by balance of payments considerations, "escape clause" action in services to protect particular
domestic producers against imports thought to be causing a threatening "services injury"? One can make a tidy abstract case for saying yes; the trade bar and the Commerce and ITC bureaucracy might think that that case was interesting. However, as a practical matter, this would be a retrograde development. Of course, that that is so does not mean that it is not part of the agenda of a services negotiation, even though, as usual in trade negotiations, the real agenda is rather obscure.

8. That the GATT is now not an effective set of rules for goods, and therefore should not be assumed to be a suitable analogue for a set of rules for traded services, is really my key proposition. That being so, we should look at the GATT system more closely.

9. The key concept of the GATT is not "free trade" but non-discrimination. This concept is addressed in Article I, which is a most-favoured-nation clause cast in the unconditional form. Such a clause requires that concessions negotiated with one signatory must be extended unconditionally - that is, without other specific payment - to all other partners with treaty rights. One could argue that the central issue in trade policy, as it evolved in relation to trade in goods and shipping was not "free trade" or protection, but the conflict between the concept of bilateral reciprocity (and the closely related concept of conditional most-favoured-nation treatment) and the concept of non-discrimination, given expression in the most-favoured-nation clause in the unconditional form. "Bilateral
Reciprocity was exhaustively argued about some decades ago in relation to traded goods. By the mid 1920s it became abundantly clear that whatever could be said for the notion of reciprocity cast in broad, general terms, that is, as invoked by Cordell Hull in his Reciprocal Trade Agreements Program, precise or mirror reciprocity in product terms, in relation to traded goods, is unworkable. However, the concept of reciprocity, when applied to certain services, particularly those services provided by extensively regulated industries, and those services industries involving the delivery of services by establishments, may prove workable and useful. The model for services agreements may not be Article I of the GATT, but the conditional m.f.n. approach (or reciprocity criterion) followed by the US in regard to the Tokyo Round Subsidies/Countervailing Duties Code, and the Tokyo Round Procurement Code. Put another way: the reciprocity criterion is designed, first, to deal with the "free rider" problem, and second, it is really the most equitable way to approach establishment considerations. One country may, as a matter of domestic policy, accept foreign-controlled establishments in various sectors regardless of reciprocity, but it is quite another matter to accept an obligation to ignore reciprocity.

10. A second principal or concept of the GATT was that there were to be no new preferences. Such margins of tariff preferences as remained after the first Geneva negotiations were not required to be abolished; the absolute margins could be maintained, but could not be increased. Moreover it was
assumed that all tariff preference-giving countries would be prepared to negotiate for reductions in preferences. Is it necessary to do more than merely state that these provisions are widely ignored? Preferences and discrimination, in one form or another, is what modern trade policy is largely about. It is therefore very likely that, if we develop general rules on traded services on the GATT model there will develop preferential arrangements for services in and around the EEC, and for developing countries. This will not be in the interest of the US (or of Canada); like many existing preferences on goods, they will be preferences against North America. Of course, to the extent that the European Common Market becomes a real common market, that is, that it is a common market for services, there will inevitably be European preferences against North American services competing in Europe. This suggests that it would be perhaps more advantageous to try to improve the OECD code on invisibles—to build in sanctions and provide some sort of dispute settlement procedure, and bring in some key developing countries—than to look to Geneva for the model set of rules.

11. Another key concept of the GATT, one of obvious relevance for services, is national treatment. This concept, long established in the pre-war "system of treaties", is also addressed by the OECD. There it is national treatment for establishments. The GATT concept is, in fact, rather narrowly drawn. It deals, like the rest of the GATT, with the treatment of goods; it provides that, once the
border barrier has been surmounted (the conditions of an import quota fulfilled, or the frontier tax or customs tariff paid) the goods entering the national market are to be treated on the same basis as comparable domestic product. This is important with respect to commodity taxes, for example. (In Canada, our provincial authorities have been tempted from time-to-time, to fiddle with sales taxes, in order to improve the competitive position of local producers. Invoking, Article III, which sets out rights to which US producers attach importance, has been sufficient to bring these authorities back on the straight and narrow.)

12. The one important exception to Article III is government procurement. This exception, like the rest of the Article, is carefully drafted; it excepts from the national treatment obligation only the purchase of goods for use by the government concerned. This does not cover the purchase of goods for resale (that, in theory, should be caught up; of course, in the obligations regarding state-trading entities, in Article XVII); nor does it cover the purchase of capital equipment for the production of goods for resale; on this basis the domestic product preferences practised by many state-owned utilities are probably in breach of the GATT.

13. It is a nice question, therefore, whether in the re-negotiation or re-working of the GATT procurement code now starting in Geneva (draft request lists have been exchanged) it would be better to try to make the code effective over a significant range of transactions in goods (by revising the list of entities) or whether effort should be
diverted to trying to cover services contracts. I would guess that there will be some real difficulties in the latter course. For example, in Canada, under the previous administration, there was an attempt being made to divert government controlled (or influenced) contracts for consulting engineering from the Canadian subsidiary of a foreign corporation to Canadian-controlled firms. If that has been the thrust of policy, then it seems a long step to agreeing that a foreign firm, operating and established outside Canada, can compete in Canada for government contracts on the same basis as Canadian firms. (One should note that, in regard to this sector, a preference for a domestic product functions like an import tariff; if there were tariffs on services there could be national treatment, even for procurement).

14. It should be evident from these comments that, in regard to its key concepts, the GATT is no longer effective, if it ever was. That means that the GATT no longer serves adequately the interests of small countries, such as Canada, nor of the developing countries. My key proposition is, therefore, that if we have a system which, by and large, is not working—or, if it is working, works primarily to protect or advance the interests of the larger entities, then we might at least be cautious about trying to extend it to cover transactions in other sectors. I doubt that the interests of Canada, and even of the US will be served by trying to extend the GATT to another area of trade.

15. As I see it, the principal task of trade policy makers in the near and medium-term must surely be to consider what
sort of trade relations system can be reconstructed, to
put in place a functionally more effective set of rules
regarding traded goods. Only then should we worry about
the scope for some such system of general rules in regard to
traded services. This perspective does not mean that there
are not some elements or concepts of the GATT, and perhaps
some notions, or at least phrases, derived from pre-war
bilateral treaties, notably "national treatment", which
could have application in regard to certain traded services,
if carefully delimited as to what measures or devices the
obligation is to apply.

16. The difficulty with building a consensus on services
around the concept of national treatment is that the United
States approach is contradictory and inconsistent, and
therefore unconvincing. On the one hand, in the OECD (and
in bilateral arrangements) the US argues that the foreign
subsidiaries of US corporations are to be treated on the same
basis as domestically controlled corporations; however, when
in areas like anti-trust, securities regulation, banking,
to balance of payments considerations, to strategic controls
on exports involving high technology, the US treats the
subsidiaries of US controlled firms in other jurisdictions
as though they are subject in some measure to US jurisdiction,
and are, in some measure, legitimate conduits for US policy.
One should not be too high-minded or naive about this; there
is some extra-territoriality involved in the jurisdiction
asserted by many countries. And of course, a vigorous assertion
of sovereignty and a vigorous rejection of US assertions
of jurisdiction may sometimes be a cover for protectionism and cartelism. But the US surely has to sort out just what it really wants for US-controlled corporations established in other countries; at present, US assertions of extraterritorial jurisdiction have driven some sort of large conveyance right through the case for "national treatment". That is, if you like, another "proposition".

17. In my view, the detailed elaboration on a sector basis of "national treatment" provisions, applying to traded services, roughly, as Article III of the GATT (that is, recognizing the legitimacy of a bound charge or restriction at the frontier) and applying to establishment roughly on the OECD model, and applying as between OECD member countries, and not thrust on developing countries, may be a useful way to come to grips with restrictions on traded services and the delivery of services by establishments. Concepts of reciprocity, articulated bilaterally, and/or conditional, must-favoured-nation treatment, could be integrated into such an approach. My proposition is, therefore, that if one insists on negotiating about services, that is the way to go. Clearly, it involves a lot of discussion, a lot of hard analysis, nationally and then internationally, before getting into anything resembling negotiations.

18. If we do rush into a services negotiation, on the basis of the analysis contained, one assumes, in the various national studies, such negotiation might either never reach any useful conclusion, or that if it did, it might be achieved only
through the US and EEC, which have an interest as services exporters, imposing their will on others. That was what became necessary in the Tokyo Round — as Ambassador Strauss realized — if that project was ever to be concluded. Such a process is bound to yield very unsatisfactory results for many other countries, such as Canada. As a technique of conducting relations between states it is a threat to the development of any rational international order.

19. It is useful to note that, when general rules were being negotiated, as on subsidies and countervail, the Tokyo Round produced, not only an inadequate result, but a perverse and damaging result. By contrast, it was when sector arrangements were being negotiated, as in the aircraft sector, that the most useful results in the Tokyo Round were achieved. Multi-sector negotiations can provide opportunities for striking imaginative bargains, if the will is there, if the mutual interest exists, and if an adequate intellectual basis has been established. Multilateral negotiations addressed to general rules can also provide great scope for blocking tactics, if the will and interest is there, and for working to a hidden agenda.

20. Another proposition which I find compelling is that, while it may well be that there are costly restrictions on services, there are other restrictions on trade, and other trade policy issues, which are perhaps of even greater importance, even to the US. Focussing on traded services, important as this may be to US service companies, is diverting
attention from those other difficult trade issues which threaten to destroy what little is left of the post-war trade relations system. None of the literature on services makes an effective case for giving an overwhelming priority to the "services proposal"; the priority being accorded in Washington is simply a reflection of the lobbying skill of particular interests and individuals. The priorities for governments must surely be international monetary management, the achievement of more stable growth in the OECD area, and the bringing of some sort of order and some systems of rules to those sectors of traded goods where there is now autarchy and anarchy - eg, to the trade in steel, textiles, garments, agriculture, autos - and to doing something about the access to industrial markets of the manufactured exports of developing countries, not so much for the improvements in trade balances, but to encourage investment in manufacturing for export.

214H: Having said all that, we would agree that in the longer term it may be possible to devise some set of rules that could improve, at least marginally, on the complex international order covering trade and investment in services. It would therefore be useful to have a multilateral examination, a systematic study, of the broad range of commercial policy arrangements - GATT, OECD (particularly the codes on invisibles and on capital movements), UNCTAD (shipping and restrictive practices), FCN treaties, arrangements regarding particular services sectors, such as the Chicago convention establishing ICAO and its subordinate arrangements - to
see if some mix of model provisions can be devised which might be useful for particular sectors or in particular contexts. As I have already stated, I see a detailed "national treatment" provision as central to such an effort. But it seems beyond argument that the GATT, given its history and given its demonstrated lack of effectiveness, is not where we should start. It might be that the result of such an examination would be the conclusion that particular treaty provisions or commercial policy concepts could be most effectively made use of in bilateral arrangements, rather than being deployed in what might become, at a multi-lateral level, no more than vague codes of conduct on the UNCTAD model - arrangements without binding force, and not carrying the promise of an exchange of rights and obligations on a contractual basis. Whether such a modest but realistic and workmanlike approach would be acceptable to US services companies is not clear. The US appears to be approaching the services issues in an unduly adversarial fashion. US representatives give the impression that they are quite determined to open the markets of other countries to US services companies, and that, to that end, a great deal of negotiating leverage will be used (eg, the GPS). It seems not to be understood in the US that many other countries have objectives - such as "development" and "sovereignty" - which are as important to them as the gains from trade are to the US. I would not deny that there are gains from trade in the services sector, but how important they are in comparison with other gains may be difficult to determine for many countries. It is for that reason that there is so little real support for the US "services proposal".
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