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Stefan Voigt*

Traded Services in the GATT – What's all the Fuss About?

International trade in services has not been governed by the GATT in the past. Opinion is divided over whether there is a real need for any separate agreement on services. The following article asks to what extent flows of goods and services can be properly separated in the first place, and whether it makes sense to attempt such separation.

For many years now, services have been regarded as the true motor of economic growth. In the developed countries, almost two-thirds of the gross national product is now attributed to the services sector.¹ Cross-border trade in services accounted for 30% of world trade as a whole in 1987, and was valued at US\$ 960 billion. Trade in services rose by 240% between 1979 and 1987, trade in goods by 150%.² In order to ensure that this engine of growth was better integrated into the division of labour on a worldwide basis, it seemed only right to seek within existing agreements rules and principles by which cross-border trade in services could be governed. However, because many developing countries' governments are fearful that their positions would become weaker still if services were to be brought under the GATT umbrella, a diplomatic device was agreed upon at the beginning of the last round of trade-negotiations in Uruguay in 1986 which would allow all concerned to keep face. The forum of the GATT round would also be used for negotiations on services. These negotiations would not, however, take place between the contracting parties to the GATT, but between ministers of countries which also happen to be GATT members. This "two-track" approach meant that, in strictly formal terms, the negotiations were conducted outside GATT.

The Uruguay Round negotiating positions of individual governments will not be set out here, but will begin by asking to what extent cross-border trade in services has attracted academic interest to date. The central hypothesis put forward in this article is that there is little point in separating trade flows into the categories of goods on the one hand and services on the other. The conclusion to be drawn from such a hypothesis is clear: if there is no

substantial difference between goods and services trade, any attempt to pass a new framework agreement dealing exclusively with the regulation of services trade is superfluous.

The General Exchange Model

It is repeatedly emphasized by economists and jurists alike that the welfare effects associated with trade in services cannot be explained by using the tools of classical foreign trade theory.³ It is indeed the case that one central premise of the classical model is frequently not fulfilled by trade in services: before services can be tradeable in the first place, it is often necessary for a factor to be present at the location where the service is provided. The circumstances may therefore be such that services are only tradeable if factor mobility exists, yet the Ricardian model assumes that not to be the case.

These differences between goods and services are then often taken to infer that it would not be advisable to extend the rules of the GATT to trade in services. What is needed, the argument goes on, is a separate set of regulations for services. Indeed, demands are often put

¹ The 1987 trade statistics under the heading of "Developed Countries" show that an average of 63% of GNP was generated in the services sector. Among the countries with above-average values were the USA with 68% and Belgium/Luxembourg with 67%; see GATT International Trade, 1988-89, Vol. 1, p. 28.

² According to IMF data, quoted from GATT Activities 1988, p. 56.

³ Cf. e.g. M. A. Kakabadse: International Trade in Services: Prospects for Liberalisation in the 1990s, Atlantic Paper No. 64, The Atlantic Institute for International Affairs, London et al. 1987. He states on p. 54: "However, economic theory is still underdeveloped with regard to services and the literature has not yet fully addressed the question as to whether, and to what extent, the principle of comparative advantage applies to international trade in services." A similar line is taken by T. P. Hill: On Goods and Services, in: The Review of Income and Wealth, Vol. 23 (1977), p. 315: "Indeed, large parts of economic theory may be irrelevant to the analysis of services anyway, precisely because they are not goods which can be exchanged among economic units."

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forward for two regulatory levels to apply to services, with an "umbrella agreement" containing general rules on one level followed by specific regulatory mechanisms for individual service industries on another.⁴

However, neither the fundamental argument nor the demands derived from it for a special regulatory mechanism for trade in services are especially convincing. The fact that a central premise of the Ricardian model is frequently breached by trade in services is not at all in itself a denial that such trade also results in greater welfare: it is simply a further piece of evidence that the comparative-advantage model is based on assumptions which are far too restrictive. It would therefore seem appropriate to leave the close confines of the Ricardian approach and turn instead to the general trade model: this states that trade will take place whenever all the parties involved expect the transaction to improve their own situation. The information an observer gains from the fact that economic units from different countries engage in trade with one another is that they expect this to provide the best possible improvement of their positions, that is that they judge it to be possibly less advantageous to trade with economic units from their own country.

Attempts at Definitions

Setting out from the hypothesis that "services are not goods and their characteristics differ fundamentally from goods",⁵ T.P. Hill attempted to establish a definition of services in 1977. According to Hill, they represent "... a change in the condition of a person, or of a good belonging to some economic unit, which is brought about as the result of the activity of some other economic unit, with the prior agreement of the former person or economic unit ... Services cannot be put into stock because a stock of changes is a contradiction in terms."⁶ The definition subsequently distinguishes between "services affecting goods" on the one hand and "services affecting persons" on the other.⁷ The argument continues that, if any dichotomy is desirable at all, then that between goods and services should be abandoned and a distinction should be

made instead between goods and services concerned with goods on the one hand and services concerned with people on the other.⁸ That article also initiated a discussion on cross-border trade in services. Other attempts to classify trade in services include that made by Bhagwati, who focused on whether it is necessary to be physically present at the same location as the customer to provide a service. If the latter is the case, he goes on to distinguish between situations in which

- ☐ the supplier of the service is mobile, but the customer immobile,
- ☐ the supplier is immobile, but the customer is mobile, and
- ☐ both supplier and customer are mobile.⁹

A similar attempt at classification was also undertaken by Sampson and Snape.¹⁰ As the discussion on trade in services has continued, two of Hill's arguments, in particular, have cropped up again and again, namely that services cannot be put into stock and that an interaction has to occur between the service's supplier and its consumer, which often necessitates a factor movement.

All the attempted definitions so far mentioned have sought to suggest that it is indeed possible to make an unequivocal distinction between goods and services, and also that the distinction would be more than a mere academic definition since different rules would have to apply to cross-border trade in services than to similar trade in goods. This author proposes the contrary hypothesis that any such distinction will always be arbitrary and, as far as economic criteria are concerned, should be of no consequence for foreign trade policy.

Any exchange of goods always includes a certain proportion of services. For example, prospective customers in an electronics store will be given advice by sales staff, which should obviously count as a service. Even supermarkets provide a service by performing such tasks as labelling their products with their selling prices. On the other hand, restaurants not only sell a service, but

⁴ Cf. e.g. R. R. Rivers, V. A. Slater, A. A. Paolini: Putting Services on the Table: The New GATT Round, in: Stanford Journal of International Law, Vol. 23 (1987), No. 13, p. 23: "The GATT principles currently used for goods may be usefully applied to services trade to create a regulatory umbrella, with industry-specific sectoral regulation following to address special issues pertaining to each services industry." See also J. H. Jackson: Constructing a Constitution for Trade in Services, in: The World Economy, Vol. 11 (1988), p. 191: "The top layer, often referred to as an 'umbrella agreement', would be complemented by a series of industry-specific agreements—for example on banking and on insurance."

⁵ T. P. Hill, op. cit., p. 315.

⁶ Ibid., pp. 318 f.

⁷ Ibid.

⁸ Ibid., p. 328; an earlier attempt at classification can be found in M. A. Katouzian: The Development of the Service Sector: A New Approach, in: Oxford Economic Papers, Vol. 22 (1970), pp. 365 ff. This paper distinguishes between "new" services which are in increasing demand as people receive higher personal disposable incomes and have more leisure time, complementary services for which the demand always arises in combination with the supply of goods, and "old" services which originated in pre-industrial times and have continually been declining in significance.

⁹ J. N. Bhagwati: Trade in Services and the Multilateral Trade Negotiations, in: The World Bank Economic Review, Vol. 1 (1987), No. 4, p. 552.

¹⁰ G. P. Sampson, R. N. Snape: Identifying the Issues in Trade in Services, in: The World Economy, Vol. 18 (1985), p. 172.

also perfectly tangible goods in the shape of meals on plates.¹¹ Just how closely intertwined goods and services can be becomes especially evident in the capital goods sphere: from the planning and construction of an item of plant through to its maintenance, various services regularly need to be supplied. There are many such cases in which the separation between goods and services will inevitably be arbitrary.

Another factor speaking against any artificial separation of goods and services is technical progress: Bhagwati cites the example of Luciano Pavarotti, whose singing performances would only have been marketable as services before the invention of the gramophone, but in reality are tradeable today as gramophone records, cassettes and compact discs, i.e. in the form of physical goods.¹² If two different sets of rules were indeed to be applied to cross-border trade, a number of consequences would result: first of all, the object being exchanged would have to be properly classified as either a good or a service. Then, objects would have to be reclassified continually, due to technological progress. Conflicts over the right classification for objects being exchanged would appear inevitable, and the level of certainty regarding the future in international trade, which after all is a primary objective of international agreements, would be diminished.¹³

The Factor Mobility Requirement

The argument most frequently put forward in favour of giving separate treatment to trade in services is that factor mobility is frequently required. However, that is not an argument which is wholly convincing. Even the advocates of a separate agreement to cover services are aware of the fact that there are now a number of services which are tradeable without any need for mobility on the part either of the supplier or the customer.¹⁴ Thus the argument only applies to a certain proportion of tradeable services. The central objection to the mobility argument, however, is a different one, namely that any advocate of individual

freedom as a fundamental value ought to accept that a policy designed to prevent the cross-border mobility of factors is incompatible with that basic value, and that he/she can only consistently uphold the basic principle if he/she also argues for freedom of movement for labour across national boundaries.¹⁵

Nevertheless, the argument does remain relevant from the political point of view, as governments generally have to try to resolve conflicting objectives. Safeguarding employment can then be used as a reason for restricting factor mobility, while other arguments include fears of too much foreign influence, preservation of the national character, etc. Even for services which, for the time being at least, still require the mobility of labour, it is conceivable that a solution such as limited-period work permits might be used as a means of allowing the two conflicting policy goals to be met, i.e. the maintenance of certain safeguards while allowing economic units to benefit from engaging in cross-border services trade.¹⁶ The stay of personnel needed to provide such services might either be limited by issuing work permits for a limited number of months, or else by requiring them to leave the country again once the service has been completed. In the long term, though, the scope for using immigration or emigration rules as an instrument of trade policy will be still further reduced by technological progress: once a service becomes tradeable without requiring the physical presence of employees, protection can no longer be given to members of the domestic labour force by means of immigration regulations.¹⁷

Lack of Transparency

Another argument often used against giving equal treatment to trade in goods and services is that even simply obtaining statistical data on trade in services is far more difficult than it is for trade in goods, and that it is virtually impossible to impose tariffs upon a number of services.¹⁸ However, from a freedom-oriented perspective

¹¹ A similar example is cited in R. A. Cass, E. Noam: *The Economics and Politics of Trade in Services: A United States Perspective*, in: D. Friedmann, E.J. Mestmäcker (eds.): *Rules for International Trade in Services*, Baden-Baden 1990, p. 47: If a confectioner, who certainly produces tangible goods, is employed in a baker's shop, his/her activity is counted as contributing to the production of goods, whereas if the same person is employed to make exactly the same cakes in a restaurant, that activity is counted under services.

¹² J.N. Bhagwati: *Splintering and Disembodiment of Services and Developing Nations*, in: *The World Economy*, Vol. 7 (1984), pp. 137 f.

¹³ This classification problem is quite comparable with the need to define a relevant market in competition policy. Those who follow discussions on competition policy will be aware that it is impossible to define such markets according to "objective" criteria, leaving the subjective views of the person or body charged with establishing a definition as the determining factor. Discretionary decisions made on a case-by-case basis are noted for their inability to foresee future changes, and that inevitably entails diminished security of expectations.

¹⁴ See the classifications mentioned above which have been attempted by Bhagwati and by Sampson and Snape.

¹⁵ This was clearly recognized in the Single European Act, on the basis of which the European Community is carrying out its single internal market project, for the Act specifically refers to fundamental freedom of movement for goods, services, capital and people.

¹⁶ Bhagwati calls this concept "temporary-factor-relocation-requiring"; cf. J.N. Bhagwati: *Trade in Services* ..., op. cit., p. 554.

¹⁷ J.N. Bhagwati: *Splintering and Disembodiment* ..., op. cit., p. 141.

¹⁸ On this, see e.g. R. M. Stern, B. M. Hoekmann: *Issues and Data Needs for GATT Negotiations on Services*, in: *The World Economy*, Vol. 10 (1987), pp. 39-60. Cf. also G.P. Sampson, R.H. Snape, op. cit., p. 180, who write, "... many of the issues, in principle, resemble those relating to goods. In practice, however, there are many important differences. Unlike goods many internationally traded (separated) services, do not pass through customs houses. Taxing the transferral of electronically-transmitted data must be difficult."

these are not convincing arguments either. However much problems in recording the volume of transactions may be a source of consternation to specialists in national accounting or to politicians with a mercantilist desire to ensure that total service exports should be higher than total service imports, if we allow ourselves to regain sight of the trade paradigm, in which economic units only enter into agreements if they expect to benefit from them, we will realize that statistical difficulties are not a sufficient reason to curtail individual rights to freedom and/or to regulate trade in services any differently from that in goods.

Similarly, from a free-trader's point of view, the difficulty in charging tariffs on services cannot be an argument for giving this area special treatment. On the contrary, as long as imported services remain free of import duties there will be real competition between domestic and foreign suppliers of the services, without domestic producers' being accorded a price advantage via customs duties. However, the difficulty in charging tariffs in this field does unfortunately mean there is a danger that trade in services will be subject to non-tariff barriers instead. Yet even that danger cannot be used as an argument for separate

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treatment, as non-tariff barriers to trade are already prohibited under the terms of the GATT. The fact that they have increasingly been used in practice during recent years is rather an indication that GATT has not had enough teeth in any sanctioning mechanisms.

Reciprocity

In reality, the diplomacy of international trade is based on a mercantilist approach. The line of thinking normally followed in trade negotiations starts out from the position that cross-border trade has been restricted in the past because of tariff/non-tariff barriers. In order to improve export opportunities for their "own" producers, the diplomats will try to obtain reductions in the tariffs or other restrictions imposed by the trading partner, but they know that they will only achieve that by granting "concessions" which will also allow exporters in other countries to improve their positions. Reciprocity is commonly understood to entail exchanging concessions such that the additional exports the country can hope to gain are at least as high as the additional imports which can also be expected to be generated.¹⁹ This is a mercantilist policy line in the sense that it assumes that as large a trade surplus as possible is desirable in "the national interest". Apart from the fact that this ignores the monetary effect of a balance-of-payments surplus (exchange rate movements), it also ceases to consider the interests of individual persons or economic units. The use of the word "concession" implies that one trade diplomat really is granting such a thing to another. In reality, what they are doing is improving the possibilities of intensifying the international division of labour, which is bound to be of benefit to consumers. As such, it would also make economic sense to grant such "concessions" unilaterally.

The argument which is now used with regard to cross-border trade in services is that it is very difficult to achieve what is termed "equivalent reciprocity", "because that would require knowledge of what would happen to a market once foreign suppliers are permitted to engage in particular activities."²⁰ It is in their very nature that the concrete outcomes of market or competitive processes cannot be precisely predicted, since they are open-ended processes. The comparative advantages in one particular country may thus just as easily change as a result of product or process innovation as they may change in another due to the discovery of new raw material deposits.

¹⁹ On the reciprocity yardsticks which may be applied, see the remarks made by one of the US delegation members during the Kennedy Round, Ernest H. Pre eg : Traders and Diplomats, Washington D.C. 1970, pp. 132 f.; cf. also J. W. Evans : The Kennedy Round in American Trade Policy, Cambridge, Mass. 1971, p. 21: "Usually, ..., the aim of the negotiator was even more precise: to see that the expected increase in his country's exports should at least equal any likely increment in its imports."

Each of these changes may give rise to a new trade pattern. The non-predictability of trade patterns is thus inherent in trade itself, and is not a phenomenon which is primarily or exclusively associated with trade in services. Non-predictability is not therefore an argument which can be used in favour of separate rules for trade in services. What the argument can do, though, is clearly bring out the dubious value of mercantilist-oriented foreign trade policy.

Non-Discrimination and Anti-Dumping

According to the principle of domestic treatment, there should be no discrimination between domestic and foreign economic units. The argument used against applying that principle to trade in services is as follows: "However, to maintain service quality it may be necessary to make a distinction between domestic and foreign providers. This distinction is justified only to the extent that foreign providers operate from a regulatory system whose required quality standards are lower than those of the domestic system."²¹ Yet that is not in truth an argument for giving special treatment to trade in services, but simply a very unorthodox interpretation of the principle of non-discrimination. As "domestic treatment" itself directly implies, economic units from other legal jurisdictions should be treated exactly equally to those from within the territory concerned: that is, they are required to meet precisely the same legal standards as those which are imposed on domestic suppliers. If the product standards desired in a country's domestic market (for political reasons) are to be maintained, then it is not necessary to discriminate against foreign providers, but simply to treat them in the same way as domestic ones.

Advocates of separate treatment for goods and services continue by arguing that cross-border trade in services allows a variety of restrictive business practices. One such practice is price differentiation which service providers are said to frequently resort to, while a further problem is that a large portion of internationally traded services represent intra-company trade, in which prices can easily be manipulated.²² They also plead that the concepts of dumping and of countervailing duties are not well defined for companies which have established subsidiaries in a recipient country.²³

There are a number of premises involved in these

²⁰ P. Nicolaides : Economic Aspects of Services: Implications for a GATT Agreement, in: Journal of World Trade Law, Vol. 23 (1989), No. 4, p. 129.

²¹ Ibid., p. 131.

²² D. Nayyar : Some Reflections on the Uruguay Round and Trade in Services, in: Journal of World Trade Law, Vol. 22 (1988), No. 5, p. 44.

²³ P. Nicolaides, op. cit., p. 132.

arguments. For one thing, price differentiation is evidently regarded as a restrictive practice per se. Yet that does not seem a useful approach: if a company wishes to introduce one of its products to a foreign market where it has not previously operated, one strategy it might follow is "penetration pricing", in which it will endeavour to find potential users by offering them a price discount at least on their first purchase. Once the phase of market introduction is over, the price is generally raised. The legitimacy of such methods is by now recognized in foreign trade policy, and where doubt remains is rather on what level of price difference between different markets should be regarded as acceptable, or for what period of time such price differentiation should be regarded as an offensive marketing strategy but not as a restrictive practice. This remains a doubtful approach, as it centres around a conception that there is such a thing as a "right" price. Article VI of the GATT, which deals with anti-dumping measures and countervailing duties, attempts to define what dumping is, but the definition offered is far from clear. Terms such as the "comparable price of a comparable good" or "reasonable addition for selling costs and profit" show that this is a problem. In particular, these terms are normative in that they evidently believe it is possible to tell a company what it ought to be asking for as a "reasonable profit margin". Moreover, the definition is based on the myth that costs can always be established in full. It overlooks the fact that underbidding other suppliers' prices is a classic element of the competitive process. For that reason, costs cannot be fully estimated *ex ante*. If there is such a thing as falling average costs, the demand that price ought to be a function of costs cannot be maintained, since the price asked for in the market will be among the determinants of the quantity demanded, on which unit costs depend. In this case, costs are a function of price and not vice versa. The observation that the concepts of anti-dumping and countervailing duties are not very well defined for services is therefore correct, yet that does not apply to services alone but is equally true of goods. Consequently, this too cannot be used as an argument for treating goods and services separately, but at best as one for redefining the concept all round.

Sector-specific Agreements

The discussion on the inclusion of services within an international regulatory system not only involves arguments for the separate treatment of goods and services, but also for different systems of rules for different sectors. An example of how this call is justified reads: "The details of how best to design an international discipline for the banking industry, for instance, may differ substantially from that endeavour for the insurance or engineering

service industries. Different industries have different rates of technological advance and different degrees of importance to 'national security' or other sovereign goals and they rely on substantially different business structures."²⁴

Here again, the arguments are hardly convincing: it is just as banal to observe that different sectors progress at different growth rates as it is to say that they have different business structures. Yet it is completely implausible to conclude from this that they therefore need different regulatory systems. After all, different sectors grow at different rates in the goods sector without this resulting in a cry for different treatment.

On the face of it, the point about "national security" does appear compatible with the basic value of individual freedom which is used as a reference throughout these considerations, for individuals are only able to develop freely within a framework which is outwardly stable, i.e. one in which national security is safeguarded. Nevertheless, one is bound to ask if this is not an "argument of last resort". If foreign banks offer more favourable interest rates, or insurance companies better-value policies, or telecommunications suppliers can provide a more comprehensive service, the people or economic units in a country can improve their situation by availing themselves of these services. If governments then regard such activities as a threat to national security, one is bound to get the impression that they can think of no better reason why they should deprive foreign suppliers of access to their markets.²⁵

Sector-specific agreements are also called for by Nayyar,²⁶ though to some extent on the basis of different arguments: he points out that various sector-specific agreements are already in place such as the International Telecommunications Union, the International Government Bureau for Informatics or the United Nations Centre for Transnational Corporations, the infrastructure of which could be used for the purpose. Secondly, he argues that it would be possible to make quantifiable, meaningful mutual concessions within the terms of each such sectoral agreement. Yet the inclusion of services within the GATT regulatory system would equally appear

²⁴ J. H. Jackson, op. cit., p. 188.

²⁵ Military technology generally contains the most modern technology of all. It is not our purpose here to examine whether there can be much prospect of success in banning trade in goods which might also be used in military spheres. However, doubts on that score would appear to be justified in the light of experience with the COCOM list. The argument that by trading in services developing countries would give up one of the opportunities they might have to pursue their own development strategy autonomously, is examined later in the article.

²⁶ D. Nayyar, op. cit., pp. 41 f.

quite compatible with making use of the organizations mentioned. Their knowledge would still be of benefit for the integration of services trade into the GATT. The second argument is not even convincing if, in spite of the counter-arguments discussed above, one accepts the trade diplomats' concept of exchanging concessions, for if – as one would expect – the economic units in different countries have comparative advantages in different sectors, an exchange of concessions could also only be expected to occur *between* sectors. If Nayyar's suggestion were to be taken seriously, it would be tantamount to an attempt to achieve sector-specific balance-of-payments equilibria by means of bilateral negotiation. That in turn would mean no less than the systematic renouncement of comparative advantages, and the international division of labour would be artificially constrained.

Raising the Stability of Expectations

The view of this author, however, is that any sector-specific agreement only serves to increase uncertainty in international trade as a whole, and is therefore of dubious value. The reason why uncertainty would increase is that the parties involved in any case of conflict could not be sure as to which arbitration procedure they could refer their case to. This reduced stability of expectations can be illustrated empirically by the experience in operating with the individual agreements born out of the Tokyo Round. Since 1979, whenever governments have had trade disputes between one another they have first had to agree on which specific agreement and associated arbitration procedure they should use as the basis for settling the dispute.²⁷ Thus, in as far as raising the stability of expectations is said to be one of the aims of new international agreements between trading nations, sector-specific agreements would not meet that objective. It was pointed out earlier that the classification of traded items either as goods or as services cannot be empirically derived, but will always be influenced by the subjective ideas of the person or body doing the classifying. Sector-specific agreements would simply add another dimension to this problem area of classification, for having once decided whether or not a traded item is a service, one would then have to decide which sector it should be attributed to. A look at the trend towards "financial supermarkets" is enough to show that unequivocal

classification will not always be possible: financial institutions now provide much more than banking services alone, and may also offer insurance, accounting and auditing, merger advice, management consulting, and so on. The first thing which would therefore have to be sorted out in the event of a conflict would be whether the service being traded was actually a banking service or whether it ought not to be considered under the terms of a completely different agreement.

Not only a general system of regulations could increase the stability of expectations, but also a general arbitration procedure, a point which is certainly also recognized by Jackson.²⁸ It would of course then be much more consistent not to introduce new dispute-settlement procedures to deal with conflicts concerning services trade, but to expand the jurisdiction of the arbitration mechanism which already exists to also cover the new area. In the event of there being dissatisfaction with that existing mechanism, this should hardly be used as a justification for introducing new procedures to cover only a portion of international trade flows, but should be an argument for improving the mechanism across the board.

Special Treatment for Developing Countries

Trade diplomats from a number of developing countries as well as a number of academics in the field have repeatedly pleaded for special treatment for those countries in any agreement on services. The countries' position is put forward thus: "They believe that negotiating access to communications, transportation, or financial sectors is tantamount to bargaining away a country's ability to manage its developmental strategy and protect its national security."²⁹ The argument is evidently based on the idea that strategic sectors still exist today over which developing countries' governments ought to be able to retain control within their own territories. This, the thinking goes, is the only way they can be in a position to pursue their own development strategy. Yet that is an argument which overlooks the most fundamental insights of the comparative advantage approach, for it concedes that the price of integration into the worldwide division of labour is indeed a greater interdependence, yet the reward is overlooked in this case, namely that economic welfare will be increased overall. How questionable the protective approach is can be clarified by looking at one or two of the arguments used. It is said, for example, that the import of services into developing countries may lead to a "lower level of domestic innovative activity".³⁰ That amounts to a

²⁷ As a result of the Tokyo Round, several specific agreements with their own dispute-settlement procedures were established (on technical barriers, rules for government procurement, countervailing duties, bovine meat, dairy produce, customs valuation, import licensing procedures, civil aviation and anti-dumping measures).

²⁸ J. H. Jackson, *op. cit.*, p. 194: "A single overall procedure offers the best chance for the prestige of a dispute-settlement to develop, which is the real basis in international relations of the potential effectiveness of a treaty or an agreement."

²⁹ M. Gibbs, M. Mashayeki: Services: Cooperation for Development, in: *Journal of World Trade Law*, Vol. 22 (1988), No. 2, p. 92.

³⁰ *Ibid.*, p. 96.

plea for engineers in developing countries to be left on their own to "re-invent" the innovations which have already been introduced in industrial countries; though such a proposal may sound rather incomprehensible, it is indeed a path which was experimented with for many years in many countries, as they pursued their strategies of import substitution.

Another argument is that because the share of services in the value of goods produced is steadily rising and because a product's success on the world market also depends on the efficiency and quality of those incorporated services, the developing countries are in danger of having to export more and more goods in order to be able to retain the same absolute share of revenue for themselves.³¹ The authors recognize the implication of their statement, that developing countries generally tend to be at a comparative disadvantage in the provision of services. What they fail to see, however, is that even when exporting goods they have no other choice but to buy in the cheapest services which later become part of those goods from elsewhere, for that is the only way the finished products will be able to assert their position on the world market. Thus even if the increasing proportion of value-added which is attributable to service inputs is taken into account, that cannot be a reason for allowing separate treatment for developing countries.

Another point made is that jobs in service industries with internationally tradeable products generally require a high level of qualification. If countries were to become dependent on foreign providers of such services, that would mean that only the less demanding service jobs would remain for their own nationals.³² However, this is an argument which does not hold much water provided that the services concerned require the physical presence of personnel where the service is provided: if services are performed in developing countries, then expertise will be in demand in those self-same countries.

A number of other, similar arguments is given by Gibbs and Mashayeki. What they would evidently like to see is that the old "import substitution vs. export diversification" debate should be rekindled in the services arena. Yet that debate was concluded against the advocates of import

substitution, in both theoretical and empirical terms.³³ Given the parallels between goods and services trade already discussed above, there is no reason to suppose that the new debate would come to any different conclusions than the old one.

Implementation Problems

The infant-industry argument originally put forward by Friedrich List is also often presented in favour of special treatment for developing countries.³⁴ It maintains that when new goods are produced, positive externalities are generated which the producers themselves are not able to internalize. However, the case continues, because the externalities are desirable for the broader economy, a short-term protective tariff may be justified in order to give producers a chance of competing with foreign suppliers, at least in the domestic market. However, those concerned have yet to manage adequately to implement this theoretical consideration in practice. As far as cross-border trade in services is concerned, then, some proof would need to be provided that the implementation problems generally associated with the infant-industry argument could be satisfactorily solved in this instance. Yet the entire line of argument presented in this article so far makes it unlikely that any such supposition could be fulfilled: if services can only be separated from goods on an arbitrary basis, and both are traded according to the same principles, there is nothing to suggest *prima facie* that the implementation problems could be soluble. In reality, two problems are paramount:

□ A problem of knowledge, for the level of the protective tariff ought to be derived from production cost patterns and from the positive externalities to be expected from the operations concerned, expressed as a monetary value. Yet such costs and benefits cannot be reliably established. The problem applies to goods and services alike.

□ A politico-economic problem, in that the theoretical idea only endeavours to justify a tariff for the *short term*. It has been shown again and again in practice in the political world that once privileges have been granted it is very difficult to remove them again. Once more, the problem applies equally to goods and services.

In the event that a comprehensive set of rules for trade in services really is established, the governments of developing countries will have to do their best to prevent sector-specific agreements being made. With such agreements, they would run the risk that the workforce, and firms, in their countries might not be able to fully develop their comparative advantages. It is in the nature of things that such advantages would normally lie in service industries which employ a relatively large number of

³¹ Ibid.

³² Ibid, p. 97.

³³ The two alternative strategies are evaluated in L. Hoffmann: Binnenmarktorientierung vs. Weltmarktorientierung – Entwicklungsstrategien im Spannungsfeld zwischen Ökonomie und Politik, in: M. E. Streit (ed.): Wirtschaftspolitik zwischen ökonomischer und politischer Realität, Wiesbaden 1988, pp. 45-59.

³⁴ E.g. by D. Nayar: The political economy of international trade in services, in: Cambridge Journal of Economics, Vol. 12 (1988), p. 294.

people with relatively low qualification levels. Yet the developed countries would be likely to try and establish sector-specific agreements in those areas where they suspect that they have comparative advantages of their own. Nanyar provides a vivid description of the type of unequal treatment that might occur between one service and another: "It is curious that when the North wants to send workers abroad, it is accepted as trade in services, but when the South wants to do so it is described as immigration."³⁵

If trade in services were written into the GATT, governments in developing countries would in any case be able to invoke Art. XXXVI:8, which states that the developed member countries shall not expect any reciprocity on the part of less developed countries for any obligations that the former enter into. Nevertheless, there are now many developing countries which are beginning to realize that the exceptional concessions given to them are of little effective value. If it is advantageous to economic units in the industrial countries to agree upon general rules, there is then no reason why the same should not be equally true for economic units in the developing countries. In fact, because they have the freedom to deviate unilaterally from internationally agreed rules, governments of developing countries are then deprived of a good domestic argument which they would otherwise be able to use to refuse to pander to particularized interests at home: that is, they cannot refuse the protective measures demanded by certain special-interest groups by referring to obligations under international agreements.³⁶ Given that "preferential" treatment of developing countries can often be withdrawn unilaterally and at short notice, such arrangements tend to make them vulnerable to blackmail attempts by the industrial countries. In that sense it is quite a rational development that increasing numbers of developing countries are now renouncing the preference of their own accord which they had had to fight for years to obtain.

Thus, if a "General Agreement on Trade in Services" does come about, it will be in the developing countries' interests

- ☐ not to strive for special treatment and
- ☐ to endeavour to secure a general agreement which does not lay down agreements applying to specific sectors.

³⁵ D. Nanyar: Some Reflections ..., op. cit., p. 40.

³⁶ Whalley has stated that such domestic considerations played a part in Mexico's decision to accede to the GATT: cf. J. Whalley: Recent Trade Liberalisation in the Developing World: What is behind it, and where is it headed?, in: NBER Working Paper No. 3057, Cambridge, Mass. 1989, p. 37.

The argument so far has largely been based on the principle of individual freedom. In reality, though, politicians also relate their actions to other objectives such as the protection of national security, the preservation of citizens' health and so on. If the pursuit of ends such as these is in conflict with the principle of individual freedom, they always need to weigh the possibilities against each other. Two frequently named political objectives will be examined below with regard to their relevance for an agreement on international trade in services.

National Security

There is not actually a *prima facie* conflict between the principle of individual freedom and the goal of protecting national security. Indeed, it is only possible to benefit from one's individual freedom in the context of a generally stable order, which means that the two aims even complement each other. Nevertheless, in political discussions the national security argument is often used to justify impediments to trade virtually arbitrarily. Even a national shoe-making industry may then come to be regarded as involved with national security: after all, in the event of hostilities the country's soldiers would all need boots!

It is an unconvincing demand that trade in services ought to be regulated separately because national security interests are often involved. The industries regarded as crucial to such interests are generally also those in which the most modern technologies are used. Because service industries frequently make use of modern computer systems, politicians tend to conclude that these must be sensitive industries from the security point of view, and that any cross-border trade in which they engage ought to be subject to special rules. Yet this is an obvious misconception: if producers of modern technology are seen as crucial with regard to national security, the reaction ought not to be one of protecting those industries in which the technology is used, but those in which it is actually produced, which in this case would be the computer or robot manufacturing industry. I shall leave aside here the issue that even barriers to trade in these goods are difficult to justify on security grounds.³⁷

Regulation as Protection

In many countries, precisely those branches of business which are usually classified as belonging to the service sector are subject to particularly wide-ranging regulation. It is enough to cite telecommunications, insurance and banking as examples of this. Evidently, most citizens welcome strict requirements in a number of these areas. Anyone handing over money in the present in

order to help protect him/herself from future adversity naturally has an interest in the insurance company's remaining solvent until that unknown future date. The protective goal underlying the regulatory measures is generally justified in terms of an asymmetry of information between the suppliers and the users of the service concerned.

Yet even the pursuit of these objectives does not in itself have to stand in the way of including services within the general regulatory system for cross-border trade. The domestic treatment principle requires only that domestic and foreign providers of a product must be subject to the same rules and regulations. It goes without saying that the same principle should be demanded for situations in which the "product" is a service. One objection made to that is that it is often not possible to apply the principle to the provision of services, for while goods can be regulated by examining the actual products for compliance with certain quality standards, if users of services are to be protected that requires checks to be made on the providers themselves. If such a provider is registered in a different country where the requirements are less strict, it is not therefore allowed to export the service into the country with the stricter regulations.³⁷ Although one way round the problem would be to establish a subsidiary in the country with the stricter controls, that would no longer constitute international trade in services, but would be direct foreign investment. Taking into account the divergences among national regulatory systems, specific service agreements could under some circumstances facilitate a larger volume of cross-border services trade. That would be so on the premise that national regulatory systems present providers of a service with certain conditions, the fulfilment of which cannot be verified from abroad. The way out of this difficulty would be to establish an agreement that companies finding themselves in this situation would only be required to make up the difference between the easier rules at home and the stricter ones in the country into

which they are exporting. For example, if banks in Germany have stricter rules on the level of shareholders' equity than their US counterparts, the latter would be permitted to begin operations in Germany once they had made up the difference in their equity base.

Conclusion

It has been demonstrated above that the delineation between goods and services is an arbitrary one. Because technological progress will inevitably also continue to modify the potential for supplying services, any demarcation line set out at a time t would be susceptible to continual shifts in the subsequent periods $t + n$. Because cross-border trade with any objects of exchange can only be subsumed under the general exchange paradigm, this article has advocated uniform treatment for goods and services within one single, general agreement. On the strength of that argument, one really is entitled to look at the question of traded services in GATT and ask: "What's all the fuss about?"

International trade in services has not previously been covered by the GATT. Yet there is good reason to suppose that this interpretation in practice was not the original intention of the General Agreement's authors, at least as far as the most-favoured-nation principle is concerned. Whereas the drafts for the International Trade Organization and for the Havana Charter both spoke explicitly of "goods", the GATT treaty applies the most-favoured-nation clause to "products". From this one can conclude that it was intended to apply to as wide a field as possible, which ought not necessarily have been confined to cross-border trade in physical merchandise.³⁸ However, what that original intention may have been is no longer a major factor in formulating present-day policy.

This article has also argued that a specific agreement on services, possibly also supplemented by subsidiary agreements applying to specific sectors, is not in keeping with the objective of further intensifying the international division of labour. A more promising road would appear to be that of endeavouring to increase the GATT's scope and binding power. A number of suggestions have been put forward as to how that could be achieved. When it comes to ensuring that economic principles are upheld in the overall framework, priority needs to be given to reforming those GATT rules which at present facilitate arbitrary political decisions, which consequently also reduce certainty on the part of private individuals or economic units, and are thus alien to overall objectives. This particularly applies to the articles governing anti-dumping measures and countervailing duties (Art. VI), the safeguard clause (Art. XIX), and finally Art. XXXVI:8 which provides for developing countries to be given special treatment.

³⁷ On this, cf. R. B. Reich: *The Work of Nations*, New York 1991, pp. 154 ff. Reich criticizes a decision reached in Washington to prohibit the takeover of the Californian semiconductor manufacturer Fairchild by Fujitsu, the Japanese electronics corporation, on the grounds that the transaction would grant Japanese companies access to technology which was sensitive from the security point of view. Reich argues to the contrary, that the takeover would have been beneficial to US security interests since it would have made available on American soil some of the skills in producing microchips which Japanese industry already possessed.

³⁸ J. N. Bhagwati: *Trade in Services ...*, op. cit., p. 556; cf. E. J. Mestmäcker: *Free Trade in Services: Regional and Global Perspectives*, in: D. Friedmann, E. J. Mestmäcker (eds.), op. cit., p. 22. Mestmäcker concludes, because of the difficulty in making a clean distinction between national regulations and the trade barriers which result from them, that a sector-specific approach is "inevitable".

³⁹ R. Senti: *GATT – System der Welthandelsordnung*, Zurich 1986, p. 110.