**Slide Show Notes**

**Trade in Services**

Purchases of services from foreign sources has been growing in importance. Since services have such different characteristics from goods, government policy and international negotiations have taken a different shape from the goods negotiations and services have their own WTO agreement.

The goal of this module is help you understand how countries use the WTO system to promote competition in services.

Services are becoming more important parts of the economy. In addition to consuming services directly, consumers also receive services indirectly because goods embody increasing amounts of services.

This is due to goods' production becoming more sophisticated and services being outsourced to independent providers, instead of manufacturing ("secondary sector") or agricultural ("primary sector") firms providing services to themselves, internally.

The share of "agriculture" in U.S. employment decreased from 40% in 1900 to 2% in 2000 while total agricultural output increased, in part because so much of the work that went into agricultural output was being done off-farm, to manufacture farm equipment and chemicals, and to provide services, including marketing, research, and training.

Manufacturing employment has similarly not grown as fast as services employment partly because manufacturing too is benefiting from buying services like research, training, and finance from firms outside the manufacturing sector.

If farms and factories were conglomerates that did everything under one roof, the shares of sectoral output might be different. But thanks to specialization the increase in services is visible in the revenue of service industries.

Services employment has come under less downward pressure than employment in primary and secondary sectors because it has (so far) been easier to reduce technical labor requirements in agriculture and manufacturing than in some important services.

Cross-border purchase of services has traditionally been held back by several factors.

One factor is the obvious technical one: services that need to be provided face-to-face may be problematic to provide from other countries.

Also, some of the most important services like medical care have sometimes been considered "social" services that should be provided by the state. This has tended to take those services out of commercial circuits, including out of cross-border commerce.

However, both factors have decreased in importance, thanks in part to improved telecommunications technology.

* Services that formerly didn't travel now can be provided remotely, thanks to better telecoms (including the Internet).
* And the transformation of "plain-old telephone service" (that's what it's really called — POTS!) into cellphone and then smartphone service changed phone service from being an infrastructure-heavy public utility to being a less expensive service provided by private companies that compete, including potentially foreign companies.

A case of the change in telephone provision is Kinshasa. When I lived there, 1984 to 1988, practically no one had a telephone in their home. I heard years later, however, that seven private cellphone companies were operating in the city! That could never have happened when a telephone network required a network of lines and poles. But in the case of cellphones, even without a supportive government it was possible to serve a network of subscribers.

As governments around the world started taking advantage of the option of expanding telephony by contracting with global cellphone companies, it opened their thinking about how to provide services in general. Private firms could manage water works or mass transit (even if only as contractors).

Nonetheless, services still do travel less than goods. The percentage of services that cross borders is about one sixth the percentage of goods that cross borders.

One thing to note about statistics on trade in services, however, is that when a service firm that is an affiliate of a foreign company bills a local client, it's counted as "trade in services," even though the affiliate and the client are in the same country. This is because the foreign company's having "commercial presence" in the country via an affiliate is considered as merely a "mode" of cross-border service delivery. The local government's national accounts, however, will include the value of that service as part of the country's GDP, since physically the service was produced in the country.

The General Agreement on Trade in Services (GATS) was put in place at the same time as the WTO was created, in 1995, and was the result of a decade-long negotiation.

That negotiation was shaped by a couple factors that were different from the case of the earlier negotiations over trade in goods that had started in the 1940s.

* One factor is the legacy described above of local control over provision of important services, with substantial governmental participation and regulation.
* Another factor is the greater role of developing countries in the negotiations. Developing countries had become independent and joined the GATT in much greater numbers between the 1940s and the 1980s when the GATS started being negotiated. They saw the prospects for exporting services as being mainly on the side of service providers in the U.S. and other industrialized countries, so they were reserved about the developed countries' services proposals.

The GATS has to take account of the fact that services are provided differently from how goods are provided.

Traditionally, services that were "traded" were those that naturally crossed borders, like transportation services such as maritime shipping and passenger service.

That mode of service provision, which the GATS refers to as "Mode 1," is still very important.

But also, tourism and international studying are substantial (Mode 2).

Because services often are better provided in person, face-to-face, service industries have established affiliates in other countries to be close to clients, including clients from their home countries who are present in other countries because of FDI — Foreign Direct Investment. An example would be a bank branch that serves a client's affiliate in another country. As mentioned above, the GATS considers this as being a way of providing service across borders and includes it in "trade in services" under Mode 3.

Having an individual travel personally to provide services is Mode 4 and is a relatively small part of cross-border provision.

The trick about WTO members' commitments to allowing market access to service providers from other members is that you don't just make a commitment for service area X, you make four separate commitments — one commitment for each of the four modes of delivering X.

For FDI, Mode 3, the industrialized countries like the U.S. have been interested in negotiating more access.

For travel of "overseas workers" to provide services in foreign countries (Mode 4), developing countries like the Philippines are interested. (Mode 4 provision overlaps with "migration and labor mobility," which will be the subject of another module in this course.)

This slide shows the artificial example of a GATS commitment schedule that appears in the "Introduction to GATS" document, page 11.

The example covers just one of the 160 possible service areas, "Retail Services" (like grocery stores). The fictional country, Arcadia, signals commitments that apply to Retail Services in two lines:

* One across-the-board line for "All Sectors Included in This Schedule" (which includes Retail Services).
* And one line specific to Retail Services.

When Arcadia says, "All Sectors Included in This Schedule," that may mean many sectors or only a few, depending on how many sectors Arcadia chooses to list. It's up to each country whether to make any commitments in each of the various service areas.

Confusingly, the system is that the country doesn't phrase its commitments in terms of "Yes, foreign firms or affiliates can provide this service," but rather about which limitations Arcadia may apply to market access: "Yes, Arcadia may limit foreign firms' rights to provide this service." In other words, as far as the foreign firms are concerned, yes means no.

This is signaled by the word "Limitations" at the top of the second and third columns in the schedule of commitments.

For example, in this system a commitment described by the word "Unbound" doesn't mean that foreign service providers are unbound — it means that Arcadia doesn't bind itself as regards what limitations it may pose.

Of course, just because Arcadia is unbound and can cut off access doesn't mean that it will. It's a bit like goods under the GATT: a "bound" tariff rate is a maximum rate that the WTO member commits not to exceed, but the "applied" rate may be quite a bit below the bound rate, or even zero.

Similarly, just because Arcadia is unbound as regards limitations it may impose on foreign-owned grocery stores, it doesn't mean that it will impose any. But the foreign owner knows that Arcadia might adopt a limitation, as Arcadia didn't promise in the GATS not to.

The other confusing word is "None." It doesn't mean that there is no market access. It means the opposite, that Arcadia commits that no limitations will be imposed on market access.

(It gets worse when reading languages that are foreign to you. "Unbound" in Senegal's documents becomes "Non consolidé" — in other words, not made solid, still fluid.)

So, with that usage of terms in mind, what is Arcadia committing to? Let's look at FDI (Mode 3): can foreign grocery chains build stores in Arcadia?

* It appears that they can, so long as the foreign chain can get authorization to buy land (see the "All Sectors" line) and so long as it owns no more than 51% of the local affiliates' shares (equity).
* On the other hand, the foreign chain should be aware that its local competition may get "investment grants" that it, as a foreign affiliate, won't be eligible for. So, maybe the competitive environment may be stacked against FDI, depending on what investment grants Arcadia's government actually makes.
* Also, it appears that the local affiliate may have to use local managers, because under the "Presence of Natural Persons" limitation on essential senior executives, specialists, and representatives (Mode 4, All Sectors) Arcadia only commits to "temporary presence" or "90 days ... to negotiate sales of services." Arcadia may decide not to allow foreign employees to be present for any longer than those minimum amounts of time. (Or it may allow them to stay longer. It just doesn't commit to doing that.)

On the other hand, what about Retail Services where goods are shipped by mail order, Mode 1? For mail order, foreign companies are good to go: Arcadia commits to not imposing any limitations and to not granting any anti-competitive benefits to local providers ("national treatment").

The WTO's basic principles aren't applied exactly as they are for goods.

* MFN does rule: if firms from one WTO member get market access, then there's access for firms from all WTO members.
* Also, the system should be transparent.
* But on the other hand, members do not have to commit themselves to National Treatment. They can give privileges to local service providers unless they explicitly bind themselves not to. That's why there's a column in the schedule of commitments for "Limitations on national treatment."

In short, there's ample opportunity for WTO members to restrict foreign service providers' access. And they do restrict access.

Relative to Mode 4, in particular, countries tend to provide access to individual foreign persons to provide services through bilateral labor agreements or through migration policies, rather than through GATS commitments.

Indeed, services are generally believed to be more heavily protected than goods, although regulations (non-tariff barriers) are hard to compare with tariffs. An economic statistician would have to estimate by how much the price of a service is higher due to a barrier to foreigners' market access: you could consider that hypothetical price increase as if it were the effect of a tariff.

National regulations of service sectors commonly pose barriers to importing services from foreign providers.

Particularly in telecommunications (but also in some other services), governments that used to operate a state-owned monopoly have increasingly allowed private firms, including perhaps foreign firms, to provide the service.

Privatization changes how the sector is regulated. Regulation that used to be applied by simply instructing the government entity must, after privatization, be codified into official regulations, or in license agreements, or in contracts. If the government wants to change something, firms that have invested money and are performing in good faith will have some legal rights, enforceable in court. That wasn't the case when the government was simply setting policy for its own firm.

Not surprisingly, governments have been cautious about committing to opening their markets. The WTO's presumption at the time the GATS was adopted was that a great deal of negotiation and time would be needed. And, indeed, results of negotiations have been thin.

Nonetheless, the WTO has provided facilities to support negotiation efforts. The "Built-In Agenda" tried to create a presumption that agreements in certain areas could be reached. A "Working Party on Domestic Regulation" was established to harmonize thinking about how best to regulate service sectors — but the Working Party has not been very active, for lack of interest.

The dispute over foreign provision of Internet gambling services in the U.S. illustrates several points.

* Services are confusing and can lead to errors.
* The DSS has been even-handed between big and small countries.
* A respondent who loses in a WTO dispute has options. In a case where the respondent really is committed to a policy different than what was promised in the WTO, the respondent can keep the policy and offer compensation instead.
* There can be disputes even about the amount and type of compensation for being harmed by the removal of a concession.