TASK FORCE
ON
TRADE IN SERVICES

BACKGROUND REPORT

QUEEN
HD
9985
.C22
T3
1982
c.2

OTTAWA

OCTOBER 1982

HD
9985
C32
T37
1982

TASK FORCE ON TRADE IN SERVICES

BACKGROUND REPORT

COMMUNICATIONS CANADA
MAR 29 1984
LIBRARY — BIBLIOTHÈQUE

Ottawa

October, 1982

HD
9985
C32
T37
1982

DD 3481568
DL 4454415

Task Force on Trade in Services

BACKGROUND REPORT

Table of Contents

List of Tables and Charts Accompanying Text

A. BACKGROUND

1. Origins of the Task Force

The Task Force on Trade in Services was set up in the fall of 1981 and asked to report by early summer 1982 on Canada's interests in regard to prospective multilateral negotiations on trade in services.

This development was the direct or indirect result of several currents. Internationally, there was growing discussion - in both the Organization for Economic Cooperation and Development (OECD) and the General Agreement on Tariffs and Trade (GATT) - of bringing trade in services under some kind of effective multilateral discipline. The United States in particular was urging its trading partners to tackle "impediments" to the circulation of services and this policy thrust was intensified under the Reagan administration which came to office in early 1981. Within Canada there had been, as elsewhere, relatively little work done on services as a whole, although interest was increasing as services' share of the economy swelled to some 65% by 1980. Several provinces had indicated to federal officials their interest in seeing the subject explored. The government recognized that the gaps in our knowledge were so great as to render policy-making difficult and hazardous. They therefore moved to set up under the wing of the International Trade Component of the then Department of Industry, Trade and Commerce, a small interdepartmental task force of federal officials to study and report at an early date.

2. Organization of Work of the Task Force

(i) Study Topics

The principal focus of the Task Force was on international trade in services. The topics for study were selected accordingly. Given the paucity of Canadian work to date, the selection was made rather arbitrarily, albeit in the light of studies underway in the OECD, lists of topics prepared by the United States and a stab at likely items of interest or concern to Canada. The initial list was amended and amplified but remained open-ended till the report was finalised. The main "vertical" items were engineering/ construction and related consulting services; telecommunications and computer services; transport; banking and other financial services, including insurance; and cultural services. "Horizontally", particular attention was paid to investment issues, government procurement, export assistance, as well as taxation and immigration.

Papers were commissioned specially on a services overview, on statistical availability and comparability, on the GATT in relation to services, and on the economic effects of a suppositious rapid and sustained growth in services exports. Several provinces submitted written material. The substance of these contributions is incorporated into the body of the report.

(ii) Contacts

The Task Force attached particular importance to obtaining the views of business but faced evident difficulties in making the necessary contacts, given the limitations of resources and time available to the Task Force on the one hand and the wide range of potential business addressees on the other.

Initial inquiries and subsequent contacts were carried out with the Canadian Export Association, the Canadian Manufacturers Association, the Canadian Business and Industry International Advisory Committee, the Business Council on National Issues and the Canadian Importers Association. CBIIAC and CMA established a joint subcommittee to assist the work of the Task Force. Both the CMA and the CEA kindly sent out questionnaires to selected members and the Canadian Importers Association took a similar course through its newsletter.

The Task Force also was able to meet with the Export Trade Development Board ("Hatch Committee"), having first provided the Board with material and questions on the work of the Task Force.

The Task Force was in touch with many sectoral business organizations, including the Association of Consulting Engineers of Canada, The Canadian Construction Association, the Canadian Bankers Association, several insurance associations, a half dozen maritime transport associations, the Investment Dealers Association and many more. In addition, the Task Force met individually with many firms across Canada.

Within the country, contact was made with the Canadian Labour Congress and with a number of academics. Relations developed with the Institute for Research on Public Policy (which has been interested in services for some time and has commissioned several studies on the subject).

Outside the country, the Task Force had early contacts with the OECD and GATT secretariats and subsequently with U.S. officials along with officials from the European Community and Japan. It has of course also utilized the good offices of the extensive network of Canadian posts to obtain background on services activities and thinking abroad.

(iii) Assessment of Organization and Contacts

The Task Force has tried to cast its net as widely as feasible given the time and resources available. Indeed, the position of the Task Force throughout its operation was that it was seeking the views of all who wished to provide comments. No group or firm or individual

...../3

was excluded. But the Task Force itself was not in a position to contact all groups, firms or individuals and hence recognizes that some sources and ideas were undoubtedly missed. Groups contacted may not have been able to make known their views to the Task Force in time to have them taken into account in this report. Moreover, even those groups which did make an input, may not have had enough time or data to offer definitive views. The Task Force takes comfort from the fact that this report is not - indeed could not be - the last word on this subject. It should be underlined, as it was in all contacts made by the Task Force, that this report is not the end of the road, and indeed is really little more than a beginning. Views from business and others will be needed and welcomed for many years to come on the whole complex of services issues. It is quite clear that the full range and depth of Canadian interests have yet to be defined.

As for relations with business, this is clearly a key to proper understanding of Canadian economic interests in trade in services. For a number of reasons, however, the response from business has been uneven. Business representatives almost invariably welcomed the existence of the Task Force and its invitation to provide comments. Many did so. But some understandably were puzzled by the lack of specificity to date on the issues to be negotiated. As Canadian business has more time to reflect on the subject of international trade in services and as that subject is pursued more actively among governments, the need for a more structured dialogue between government and business will have to be addressed, recognizing that the task of each association or firm is to speak as effectively as possible for those it represents.

3. Outline of the Report

In light of the foregoing, the Task Force has prepared a Report in the seven chapters outlined below. Chapter B, on The Services Economy, by way of definition looks at some characteristics of services. It then discusses the difference between trade in services (where the service is transferred from the home country) and "trade" by way of investment or establishment in a host country. The former is what the Task Force was set up to study, but the latter also emerged as a matter of considerable importance and is considered in the Report. The relationship of goods and services is then examined and four categories of relationships are posited. There are major problems in regard to the data on services trade and the next part of Chapter B looks at some of these. The last part of this chapter makes a number of observations on services in the economy, including such elements as proportion of GNP, employment, productivity and other factors.

Chapter C examines Canada's Trade In Services. Canada's international services account includes a number of items other than "tradeable" services - notably income from investment. There are also other difficulties with the current account figures of the balance of

...../4

balance of payments. The first part of this chapter looks at these issues and Part 2 examines the components of Canada's trade in "tradeable" services. These are travel; freight and shipping; and "other services". Whereas quite a lot is known about the first two components, very little is available on the third - which is nevertheless the most interesting of the three from the point of view of this Report. Part 3 examines service sector trade orientation and brings out that whereas trade propensity of goods has increased significantly in recent decades, that of services has remained constant. The result is that services have declined somewhat as a proportion of Canadian external trade. The fourth part of this chapter examines what would happen if the constant deficit on tradeable services were reduced and, not surprisingly, suggests that there could be some interesting economic effects.

Chapter D outlines Sector Profiles of the major sectors examined by the Task Force. These were chosen either because they were known to be of interest to Canada, or because they were being discussed already internationally in one way or another.

Horizontal Issues are dealt with in Chapter E. Government procurement is an issue which is bound to come to the fore within the next 18 months, because of the provisions of the existing international agreement in this area. One question to be considered is whether services should be included. The second part of this chapter looks at the issues of investment and "right" of establishment which have emerged as major subjects in connection with the issue of negotiating on services internationally. Canada will need to consider carefully how it is to play these issues - whether they emerge in the investment or in the services contexts. Parts 3, 4, and 5 of this chapter look at assistance to service exports, taxation questions and immigration issues. Part 6 is a brief review of the Canadian import regime as it touches on services, including the provision in the import policy white paper for an examination of problem imports. Part 7 of this chapter describes several studies commissioned by the Task Force to deal with statistical issues, in particular the classification of services and the availability of data. Part 8 reports the feeling among certain business groups - and some provinces - that more of a concerted effort might usefully be made to improve domestic policy and programs on services within Canada.

The next chapter (F) refers to International aspects of the services question. Part 1 reviews, first, the situation in the United States, which has been the most important catalytic factor in getting consideration of services off the ground and where developments could impinge significantly on Canadian interests. Secondly, other developed countries have been less interested but are gradually swinging to a recognition that they will need to do their homework in this area. Thirdly, the developing countries are important as markets and, in the case of the NICs (Newly Industrializing Countries), increasingly as competitors in some sectors; hence it is desirable to have them involved. They have, however, been so far withholding acquiescence. The next part outlines how existing agreements touch on trade in services. Parts 3 and 4 review developments in the OECD and the GATT. The OECD is already looking at services in a variety of ways and a number of instruments of the OECD touch on services. Work is expected to intensify in the OECD in coming months. As for the GATT, a number of its principles might be made to apply to trade in services, even though the GATT itself was written basically for goods. The U.S. has proposed inclusion of trade in services on the GATT work program. The next part of the paper summarizes the international situation. These include impediments to trade in services, a general framework for handling services internationally and the issue of national treatment. This part of the paper is posited on the assumption that one moves at some stage to a negotiating situation - an assumption yet to be confirmed.

Chapter G sets out the conclusions of the Task Force.

B. THE SERVICES ECONOMY

A persistent current in economic thought for many years has distinguished between goods and services on the basis that activities resulting in the first are "productive" whereas the latter are "unproductive" - and inferior. Adam Smith wrote:

> "The labour of a menial servant... adds to the value of nothing... The labour of some of the most respectable orders in society is like that of menial servants, unproductive of any value, and does not fix or realise itself in any permanent subject or vendible commodity which endures after that labour is past... In the same class must be ranked... churchmen, lawyers, players, buffoons, musicians, opera singers, etc."

As a general proposition, the Task Force does not subscribe to this view.

1. Some Characteristics of Services

Services are difficult to define. A little simplistically, they can be described as intangible economic commodities produced for sale or distribution through the market mechanism or through established programmes or institutions. In most cases tangible goods can be distinguished from intangible services without difficulty but borderline cases and transactions involving a mix of services and goods are by no means uncommon.

* Counselling Services ?

Goods are transferable, whereas only when a service is embodied in a good can its ownership be exchanged.* Services, being intangible, cannot be transported or stored as such, but must be provided to the user as they are being produced, (e.g. as a theatrical performance, rental service, surgical operation, or equipment repair) or provided over a period, (e.g. storage service, education, consulting service). Thus, services are end products or the products of intermediaries and the sector presents a disparate array of service industries each of which has its own type of measurement unit -students educated, goods sold, tonnage moved, visitors accommodated, advice given, conversations transmitted, etc. These ultimately get translated into values, and general ideas about the service sector can be obtained. While the costs of providing the service are usually definable, and collectable as statistics, the benefits are often indefinable in monetary terms and are only partly collectable, and collected, statistically.

2. Services Trade and Establishment

Given the nature of services, the question arises of how they can be traded across borders - the subject of this study. Transfer of a service relies heavily upon direct contact between producer and "consumer"; in many cases one or the other must travel (e.g. producer/-consultant, consumer/tourist). In other cases services can be embodied in goods and transported across frontiers (e.g. books, tapes, blueprints), although some sort of service is then still usually required to "unlock" the tape or blueprints. And some services can only be transferred via elaborate and costly physical mechanisms e.g. the telecommunications and transportation networks, health and education plant, and others.

Such techniques of transferring services permit international trade in services to take place from the home country. For one reason or another, however, (e.g. local requirements, size and efficiency of operation, etc.) many service firms may establish affiliates abroad in order to carry out business (e.g. banks, insurance companies). The resulting transfers are not international trade as usually understood, although the transactions to which they give rise are important and can lead to significant flows of funds across borders. This type of service transfer can be called "establishment" transactions.

The Task Force was directed to study trade in services and, to this end, has focussed on "tradeable" or "traded" services. However, given the importance of establishment transactions, as of the issues they raise, they receive some prominence at various points in this Report.

3. Relationship of Goods and Services

As in the domestic economy, so in international transactions - goods and services are often closely connected. Certain goods are required for the production of most services, and vice versa. The relationships can be categorized as follows (based on a GATT Secretariat study and comments from a Task Force consultant).

Category One: Services embodied in goods (e.g. motion picture films, sound recordings, books and computer tapes).

Category Two: Services complementary to trade in goods (e.g. shipping, including port services, handling and storage; other transportation (air, rail, road, inland waterways) including handling, warehousing and storage at loading and delivery stations; insurance and reinsurance of cargo for fire, theft and similar risks; banking related to trade in goods such as the financing of imports and exports; brokerage, such as transport and insurance brokers; and advertising for products traded internationally).

Category Three: Services that substitute for trade in goods - (e.g. franchising, chartering, leasing, and repairs and maintenance).

Category Four: Services that are traded without a relationship with goods (e.g. banking, other than that related to trade in goods, life and other types of insurance not related to trade in goods; professional services such as accounting, architectural, engineering, legal and medical; real estate; telecommunications, data processing and information services; and travel).

Accordingly, difficulties for goods trade can either help or hinder trade in certain services - and vice versa. These linkages are growing not weakening. It accordingly behooves exporters and negotiators of both goods and services to keep a close eye on these relationships as they evolve, as both opportunities and threats can materialize rapidly.

4. Data Problems

Statistical coverage of the services component of Canadian international trade is very poor by comparison with the detail available for the merchandise component. Totals are given in the current account of the Balance of Payments (see Table Seven). But these are:

(a) highly aggregated - the nearly twelve billion dollars' worth of exports in 1981 is distributed among six categories and three trading areas only, although the "freight and shipping" element can be broken down in somewhat greater detail;

(b) misleading in international comparisons - Canada enters the inland freight charges on exported goods as service exports, whereas many countries value goods at the border and so include those charges in the merchandise total; and

(c) conceptually imprecise - the four categories "travel", "freight and shipping", "business services and other transactions" and "government transactions" (the latter two of which are often lumped together as "other tradeable services"), all include some goods as well as services.

Additional detail is collected on various service activities in tax returns and occasional surveys; the most useful of the latter is the Quadrennial Survey of Business Services Receipts and Expenditures (BP21S). In summary, gaps in statistical coverage of trade in services include a lack of annual detail by service activity and a lack of detail as to trading partner; and although the surveys fill some of the holes, they are at present too infrequent and insufficiently detailed to meet the demands of trade analysts and negotiators. It should be noted, however, that Canadian statistics on international trade in services appear to be generally as good as those of the U.S.A. and the U.K.

Another problem is that the data in the important "other tradeable services" category are particularly weak and elusive. A commercial arms length transaction is counted in one place in the BOPs figures - as a traded service; the same service performed in-house but across borders may be counted in a different category, depending on the quality of the reporting data.

The activities of multinational enterprises (MNEs) epitomise the problems referred to in this Chapter. In the first place, they serve as a prime example of carrying out a services transaction through establishment abroad rather than through trade from the home country. Secondly, the statistics available on the internal activities of multinational firms may be incomplete or not in the same form as those for arms length trade or investment transactions. Thirdly, a multinational enterprise is in a position to allocate its expenditures to its operations in one country or another (depending on what it may decide is in its best financial and economic interest) - which may or may not correspond to the location of the economic activity itself. Fourthly, a multinational enterprise may provide many services from head office to an affiliate in the field, or purchase services for the affiliate from other firms with which it is familiar in the home country, thus in some sense "distorting" the picture. It is quite clear that one of the major areas of uncertainty and lack of knowledge relates to multinational enterprises where much more intensive analysis will be required.

The Task Force took three approaches to the statistical problems. The sector studies used figures obtained on a pragmatic basis from experts and industry groups, and Statistics Canada (see Chapter D). A review of the services component of Canada's current account can be found in Chapter C, based on Statistics Canada BOPs figures. And Chapter E reports on two studies commissioned by the Task Force, on Classification and Data Availability.

It should be emphasized that none of the data problems encountered by the Task Force could in any way be ascribed to lack of professionalism or cooperation on the part of Statistics Canada, which at all levels demonstrated great expertise, took considerable interest in this work and went out of their way to be helpful.

5. Services in the Economy - Some Observations

The Task Force was directed to focus on international trade in services, not primarily on services as such or the internal Canadian situation. Nevertheless, the following observations on some significant aspects of the services economy should help set the stage for the subsequent discussion. Unless otherwise specified, the comments apply quite generally to most developed, OECD countries.

(i) Overall Place of Services

Services appear to have been growing as a proportion of the overall economy of the developed countries, despite changes which have seen some service sectors grow dramatically and others decline. Table One is intended to illustrate these trends in Summit countries (different statistical bases render inter country comparisons problematical).

TABLE ONE
Services in Summit Countries
(GNP and Employment)

Country:	Canada		FRG		France		Italy		Japan		U.K.		U.S.A.	
Year:	'60	'78	'60	'78	'60	'78	'60	'78	'60	'78	'60	'78	'60	'78
Services' Proportion of GNP:	60%	65%	41%	49%	52%	58%	46%	51%	42%	55%	53%	62%	58%	63%
Services' Employment Share:	52%	64%	38%	48%	39%	51%	29%	39%	37%	48%	48%	55%	57%	65%

Source: World Development Report 1980

However, a recent study* entitled "The Growth of the Service Sector in the Canadian Economy", for the Ministry of State for Science and Technology, suggests that, at least in the case of Canada, when price changes are taken into account the relative position of services in the overall economy has been more stable, changing noticeably only in the 1970s. This report, if confirmed, would appear to imply that the importance of services in the economy has been underplayed for even longer than previously thought. *who could believe the accuracy of prices of services ?!*

TABLE TWO

Services as a Proportion of Canadian GDP

	1950	1960	1970	1979
Nominal	48.3	57.2	62.1	62.5
Real	61.6	62.2	62.7	65.0

Source: Internal MSST Study - based on Statistics Canada data.

In the service sector, the measures of real output are considered to be of good quality for only about 25% of the output of the sector. If proper output measures were available, the service sector's share of the total output of the economy could well increase. Thus, figures found in the Task Force report may be conservative. *or decrease*

---

* The Task Force acknowledges with gratitude the contribution of this independent, March 1982 study by Mr. U.K. Ranga Chand of the Policy Research Group of the Ministry of State for Science and Technology. The discussion of Employment and Productivity below owes much to Mr. Chand's work.

There is considerable sectoral variation in where the service economy has grown. Increasingly important is transportation and communication services. Less of a growth area is public administration. Domestic services are in decline. Trade (wholesale and retail), finance, insurance, and community, business and personal services have grown similarly to the service economy overall.

It is worth underlining the critical role that communications and information services play in the modern economy. For many other services, as also for many goods industries, the degree to which rapidly changing information technology is assimilated will be a key to the success or failure of those sectors.

More generally, services play a similar role of lubrication in the economy as a whole. They are the oil which keeps the economy functioning. In many cases they serve as a catalyst for goods sales. Services are ubiquitous, and overlooked.

(ii) Employment

As shown in Table One above, employment in services has been growing proportionately by leaps and bounds.

Total employment in the Canadian economy doubled from 5 million in 1950 to 10.4 million in 1979. Service sector employment more than tripled, from 2.2 million in 1950 to nearly 7 million by 1979. Of the 2.7 million new jobs created in Canada over the past decade, some 2.2 million - over 80% - originated in the service sector. However, CEIC does not expect such a high growth rate of services-related employment to be maintained in the 1980s. (See "Labour Market Development in the 1980's", CEIC Task Force Report of July 1981).

Again there are marked differences among service sector components. Transportation, storage and communications in fact did not increase their relative position in total Canadian employment (1946 = 8.9%, 1979 = 8.7%). The trade component increased 3 or 4 percentage points to 17.4% in 1979. Finance, insurance and real estate doubled in proportion (1946 = 2.7%, 1979 = 5.3%) and the catchall groups - community recreation, business and personal services, and public administration - more than doubled (1946 = 16.7%, 1979 = 35.1%). Goods producing industries (including agriculture) fell from 58.9% of total jobs in 1946 to 33.4% in 1979.

(iii) Productivity

Any analysis of productivity is extremely tenuous because of the conceptual and data difficulties involved.

It appears that the substantial increase in employment that took place over the 1950-79 period in the service sector relative to goods actually enhanced the average level of productivity in the economy. This is in contrast to the popular view that the growth of the service sector in fact reduced the overall level of productivity. According to the Chand paper, this did not happen because in 1950 the level of productivity in the service sector was 50 percent higher than the national average, while in the goods sector it was 25 percent less than

...../12

the national average. Productivity in each continued to grow but productivity in the goods sector was growing faster than that in services. By 1979, the gap was closed and the productivity levels of the services sector and the goods sector were both, coincidentally, the same as the national average. Thus, when account is taken of both the level and growth of productivity in goods and services, the impact on overall productivity of employment shifts from goods to services between 1950 and 1979 turns out to be negligible.

Interestingly, if productivity in the goods sector continues to grow at a higher rate relative to the service sector in the future, as a general proposition further shifts in employment towards the service sector would reduce the overall level of productivity in the economy compared to what it would have been in the absence of such shifts. This would occur simply because the level of productivity between these two sectors is currently the same and the trend lines are converging. Of course, the past may not be a guide to the future: productivity in certain services may well grow significantly e.g. information services.

As the rate of increase in productivity has been higher in the industry and agriculture sectors compared to that in the overall service sector, if judged on output per person-hour (which is not necessarily the proper basis for judgement), this factor plus increased demand for many services and the creation of new service functions, together seem to explain the high growth in services employment in recent decades.

Several reasons have been advanced for the comparatively slower rate of growth in overall services productivity. Foremost are the statistical problems associated with measurement of output; others are the overall slower rates of increase in amounts of capital employed per person, a slower increase in the quality of labour employed, a slower rate of technological innovation and a general inability to capture economies of scale as a result of the preponderance of small-sized enterprises. Moreover, the public sector portion of the services economy is technically allocated by economists a zero growth in productivity, which would have a technically depressing effect on figures for services productivity.

On productivity also there are important sectoral differences. Capital utilization is extremely high in transportation services, consulting is among the highest range of education levels, technological innovation is very rapid in telecommunications and computer services and some of the largest Canadian companies are entirely in the service sector. In other words, there are a large number of "winners" by both subsector and corporate structure in the service economy.

The level of productivity, consequently, varied substantially among the different sectors of the service economy. Output per manhour in the transportation, communication and other utilities sector increased by 280% between 1950 and 1979. It increased only 27% in the commercial, business and personal services sector over the same period. The finance, insurance and real estate grouping had already established itself as the highest individual one in terms of productivity by 1950;

...../13

thereafter increases were only a paltry 17%. But new technologies currently being introduced might again give this area substantial productivity growth rates.

Given the technical problems associated with measuring productivity in the service sector, the link to international competitiveness has not been studied in detail. It should be noted, however, that domestic productivity is of limited relevance here to those areas which are more or less closed to international competition, whether by regulation or by their intrinsic qualities (e.g. personal services).

(iv) Regulation

Related to the question of productivity and efficiency is that of competition policy and regulation. Quite apart from the large public and para-public services domain, many service sectors are highly regulated, either by the Government (banking, insurance, etc.) or by the industry on behalf of government (e.g. the professions). These regulations have been put in place in whole or in part for sound and continuing reasons of public order. Some have a protectionist effect either incidentally or, it appears in some countries, by design. Regulations written for goods industries can affect services and *vice versa*.

A number of service sectors generally have been affected by the American movement to deregulation e.g. aviation. There is some suggestion that this influence may be having a wider effect on U.S. government and others' thinking on services. This remains to be confirmed.

The Canadian approach to regulation has a different philosophical basis from that in the United States, grounded in a different Canadian approach to intervention in the economy. There have been various Canadian reports and recommendations in recent years concerning the process and substance of necessary regulatory reform in Canada. This includes the Economic Council of Canada studies of 1979 and 1981 on "Reforming Regulation". It is clear that as the process of examination of services unfolds internationally, a close eye will need to be kept on the question of regulation and deregulation, and on the relationship with competition policy.

(v) Services Internationally

Interestingly, the overall share of services in international trade appears to have remained more or less constant over the past fifteen years, at about one-third of merchandise trade, although the structure of international services trade has changed. Indeed, for countries such as the United States and Canada, services have declined as a proportion of total exports (for Canada, see Chapter C4 below).

However, if one takes account of the internal activities of multinational enterprises (MNEs) including Head Office activities on behalf of branches and subsidiaries, as well as a tendency to "export" services by way of establishing abroad, it can be speculated that international services transactions as a whole, including services trade, may in fact have grown at a rate not far off the expansion of comparable services in domestic economies. For the U.S., as outlined below, the combined surpluses on tradeable services, and on investment income, more than cover the goods deficit. The OECD Secretary-General and the GATT Secretariat argue that services trade would have grown at a rate closer to its growth in the overall economy were it not for the existence of barriers and impediments to such trade. These factors fuel the push for negotiations on trade in services.

C. CANADA'S TRADE IN SERVICES

As indicated in the previous section, Canada has become a service economy - at home. Despite the domestic importance of the service sector, however, Canada's trade orientation is concentrated in goods. In 1981 Canada exported $84.1 billion worth of goods but only $14.9 billion worth of services ($11.7 billion of "tradeable" services). In the same year imports amounted to $77.5 billion worth of goods and $29.7 billion on services account ($14.8 billion "tradeable" services).

Canada's export orientation in goods production in 1977 (the latest year for which such data are available for all sectors of the economy), was 28 percent, almost four times greater than our export orientation in services (7.5%). Import penetration of Canada's market for goods was more than 29 percent in 1979, more than four times greater than the import penetration of our market for services (6.8%).

1. Canada's International Services Account*

As noted above, Canada's service account receipts in 1981 amounted to $14.9 billion while our payments in this category totalled $29.7 billion, resulting in an overall deficit position of $14.8 billion on service account. A deficit in the service account is not new to Canada; this account has been in deficit every year since 1950. Over the last ten years, however, with service payments growing at a faster pace than service receipts, the deficit has been growing as a share of GNP. For example, in 1971 the overall service deficit accounted for 2.5 percent of GNP; in 1981 it accounted for 4.5 percent.

This deterioration in the net position of the service account can be traced almost entirely to Canada's growing deficit in terms of interest, dividend and miscellaneous investment income payments. Between 1971 and 1981 the deficit in this sector grew from $1.6 billion (1.7 percent of GNP) to $9.7 billion (2.9 percent of GNP). On the other hand, the deficit in the remaining components of Canada's service account, i.e. the "tradeable" services - travel, freight and shipping, government transactions, business and personal services and other service transactions - while also increasing in absolute terms over this same period (from $0.8 billion to $3.1 billion), held about steady as a share of GNP at close to 1 percent.

---

* The Task Force wishes to acknowledge the substantial help of the Policy Branch of the Department of Industry, Trade and Commerce, from whose contribution the first three parts of this chapter is largely drawn.

Canada's overall balance on interest, dividend and miscellaneous investment account is a reflection of the degree to which Canada has borrowed abroad. The degree to which service payments in this category have grown recently reflects a number of factors, including the relatively high level of interest rates throughout the world during this period, the depreciation of the Canadian dollar after 1976, the shift toward debt and away from equity capital and the increasing size of the outstanding debt itself.

As explained earlier, Canada's interest, dividends and miscellaneous investment income, therefore, comes from what we are describing as "non-tradeable" services. For this reason Table 3 breaks the service account of the balance of payments into "tradeable" and "non-tradeable" components. A very general rule of thumb is that tradeable transactions usually are conducted at arms-length. The reader will appreciate however that even this attempt at greater precision is not fully successful. For one thing, as discussed already, the current account of the balance of payments mixes goods, investment and "tradeable" services revenue. The miscellaneous income subcategory in particular is comprised of a large number of categories, some of which are tradeable. In addition, of course, an unknown but significant portion of the investment income will be derived from services transactions which are not transactions across frontiers (i.e. trade) but within a country (i.e. establishment). Moreover, the "tradeable" services line in Table 3 does include government services; if this item were omitted, the "tradeable" services deficit in 1981 would be almost half a billion dollars less.

TABLE 3

CANADIAN BALANCE OF INTERNATIONAL PAYMENTS CURRENT ACCOUNT
(millions of dollars)
1981

Item	Receipts	Payments	Balance
Merchandise	84,140	77,504	6,636
Services	14,859	29,673	- 14,814
"Tradeable" Services	(11,700)	(14,800)	- (3,100)
"Non-Tradeable" Services	(3,100)	(14,800)	- (11,700)
Transfer	3,058	1,456	1,602
Total	102,057	108,633	- 6,576

It will be evident from Table 3 that Canada's merchandise trade pays for our services and investment income deficits (The U.S. is in the reverse position).

The remainder of this section will discuss those services which we are considering as "tradeable", i.e. excluding returns on investment. Government transactions were included in the work done for the Task

Force and, unless otherwise indicated, are included in the figures below. On reflection, however, the Task Force is inclined to the view that government transactions should not be counted as "tradeable services", since they are not commercial.

2. Canada's Trade in "Tradeable" Services

In 1981 Canadian service receipts from travel, freight and shipping, government transactions, business and personal services and other service transactions amounted to $11.7 billion, or about 3.6 percent of total GNP. In the same year, however, Canadian service payments in this category amounted to $14.8 billion, or about 4.5 percent of GNP. Thus Canada's "tradeable" services account was in a deficit position in 1981 by some $3.1 billion, or by an amount equal to 0.9 percent of total GNP ($328.5 billion in 1981) - less, if government services are excluded.

Ten years earlier the situation was not much different. Receipts amounted to 3.5 percent of GNP, payments to 4.4 percent of GNP and the deficit to 0.9 percent of GNP. In the intervening years this deficit at times was as much as 1.4 percent of GNP. But this deterioration - like that in the merchandise trade balance during the same years - apparently reflected the fact that Canada for a short while was operating "out-of-phase" with respect to our major trading partners in terms of the business cycle and cost competitiveness. In the past two or three years, again as in the case of the merchandise account, the deficit in "tradeable" services has gone back to its historical position. (This mid-1970s deterioration shows up just that much more dramatically if constant dollar data are used; on this basis the deficit as a share of GNP reached 1.9 percent in 1976; by 1980 it was back to 0.9 percent, however, as it had been in 1971).

It has been put to the Task Force that the Canadian deficit in "tradeable" services is not necessarily undesirable nor symptomatic of an underlying structural weakness. (For example, the two most successful trading countries in the world - the FRG and Japan - have tended to run larger "tradeable" services deficits as a percentage of GNP than Canada, while countries such as Spain and Italy have tended to run surpluses). This view seems fairly generally shared among Ottawa government economists.

The story with respect to the individual components of Canada's "tradeable" services will be discussed in turn.

(i) Travel

Canadian travel receipts from foreigners reached $3.7 billion in 1981, thus accounting for 31.5 percent of Canada's total "tradeable" services receipts. Travel payments abroad by Canadians amounted to $4.9 billion in the same year, however, thus accounting for 33.1 percent of Canada's total "tradeable" services payments. Thus Canada's travel account was in a deficit position amounting to $1.2 billion in 1981; this deficit accounted for 38.7 percent of the total "tradeable" services deficit.

Canada's travel account in the early 1970s was not nearly so significantly in deficit. In 1971, for example, the deficit in this account was $0.2 billion and accounted for 24.8 percent of the deficit in "tradeable" services. By the mid-1970s, however, the travel deficit had widened substantially until it reached a peak at $1.7 billion in 1978, accounting for 56.0 percent of the "tradeable" services deficit that year. Several factors were involved in this deterioration including the "out-of-phase" cyclical nature of the Canadian economy and a relatively high value for the Canadian dollar during this period. During the last several years, however, the travel deficit has improved substantially and has been hovering close to the $1 billion mark.

More detailed data are available. They indicate that 80 percent of Canada's travel receipts in 1980 represented spending by non-residents (other than transport crews) on items other than carrier fares with most of the rest due to carrier fares. The same proportions held in terms of Canadian travel payments abroad. The carrier fare proportions vis-à-vis the U.S. in both directions were obviously smaller than vis-à-vis other countries. Travel between Canada and U.S. explained 65 percent of the overall travel deficit even though only 58 percent of Canada's travel receipts came from U.S. residents. It is interesting to note that in 1980, Canada for the first time ran a surplus vis-à-vis countries other than the U.S. in terms of carrier fares.

(ii) Freight and Shipping

Canadian freight and shipping receipts reached $4.2 billion in 1981, thus accounting for 35.8 percent of Canada's total "tradeable" services receipts; such payments amounted to $4.0 billion that year, or 27.0 percent of Canada's total "tradeable" services payments. Thus Canada's freight and shipping account was in a surplus position in 1981, amounting to $0.2 billion.

In the early 1970's this account was in a slight deficit position; by the mid-1970s it was $0.4 billion in deficit (again largely the result of relative cyclical activity). Since 1978 it has been in a surplus position, however, and had been improving annually until 1981. There is felt to be a tendency for trade in this sector to follow the movements of goods trade overall.

More detailed information on this sector is available. For example, the data can be broken down by the form of transportation (air, water, rail, truck, bus, etc.); data are also available regarding pipeline transportation and regarding payments for port services here and abroad.

(iii) Other Services

This account, which includes business and personal services and government transactions, accounts for the remainder of service transactions. In 1981 this category generated receipts of $3.8 billion, or 32.4 percent of all "tradeable" service receipts. In terms of payments it was by far the largest category at $5.9 billion, or 39.9 percent of total "tradeable" services payments. This account was in deficit by $2.1 billion in 1981 and therefore accounted for 67.7 percent of the "tradeable" services deficit. Excluding government transactions, the 1981 deficit was however $1.6 billion.

The other services account has been in a deficit position in every year of the past 30 or so years. This deficit has been growing in absolute terms. Excluding government transactions, however, it has held fairly constant over the last ten years as a share of GNP at about 0.5 percent (both in current and constant dollar terms).

Detailed information regarding this account is sketchy. Special Statistics Canada surveys for the year 1973 and 1977 (The 1981 survey data were not yet available) revealed that some of the more significant sources of receipts, in order of importance, were consulting and other professional services, management and administrative services, payments for research and product development, royalties, copyrights, trademarks and film rentals, and advertising and sales promotion. The main payment categories in order of significance were royalties, copyrights, trademarks and film rentals, management and administrative services, special tooling and automotive charges, and research and product development. Table 4 (on page 23 at the end of this section) summarizes the results of the 1977 special survey.

3. Service Sector Trade Orientation

The trade orientation of the total service sector in 1977 was about one quarter as high as in the goods sector. This represents a significant change from 1961, over a decade and a half earlier, when the trade orientation of the service sector was roughly one half as high as in the goods sector. This change occurred because the trade orientation of services remained fairly constant over the 1961-1977 period while that of goods increased significantly.

The import penetration of the goods sector increased from 20.9 percent in 1961 to 29.1 percent in 1977 while the corresponding figures for services are 6.1 percent and 6.8 percent. Similarly, the export orientation of the goods sector increased from 17.5 percent in 1961 to 27.3 percent in 1977 (a significant factor in the increased degree of goods trade orientation during this period was the Canada-U.S. auto pact). The export orientation of services, however, was 7.5 percent in both years, though the export orientation of the service sector went as high as 9.3 percent in the late 1960s.

...../20

Import penetration of services is by far the highest in business services, at 15.9 percent in 1977; this was the case over the full 1961-77 period. At the other extreme, personal and other miscellaneous services is shown to be virtually unaffected by import penetration. This, however, may be somewhat misleading: expenditures by Canadians travelling abroad on this type of service, which includes such items as accommodation and food services, are not treated as an import of this category. Rather such expenditures are counted as imports under the travel account (unallocated imports and exports in the Input/Output accounts). Nevertheless, when Canadians choose to buy foreign services rather than domestic alternatives, domestic activity in this category is affected.

Communication services is the only category to show increasing import penetration, moving from 0.5 percent in 1961 to 1.6 percent in 1977. On the other hand, both transportation and storage, and other finance, insurance and real estate indicated quite stable import shares of the domestic market over the 1961-77 period, with both at 2.7 percent in 1977.

Transportation and storage has the highest export orientation, though it has been declining over time, moving from 10.2 percent in 1961 to 8.3 percent in 1977. Even so, export orientation remains substantially higher than import penetration in this category. In contrast, the personal and other miscellaneous services category shows the lowest export orientation. However, as already noted, these numbers are somewhat biased due to the exclusion of exports related to expenditure by foreigners travelling in Canada, similar to the problem discussed above on the import side.

The export orientation of business services has varied over time, ranging between 4.7 percent (in 1961 and 1973) and 7.2 percent (in 1965). Over the most recent period for which data are available, 1973-1977, the export orientation of this sector increased from 4.7 percent to 6.2 percent. However, the export orientation of this sector remains well below its corresponding import penetration figures.

Communication services is the only sector to show a significant upward trend in export orientation, moving from 0.9 percent in 1962 to 1.2 percent in 1977, thus paralleling in direction but not fully matching the upward trend in import penetration in this sector. As the sectoral analysis (Chapter D.5) brings out, there could be a widening disparity between exports and imports in this sector, which will bear watching. The other finance, insurance and real estate grouping's export orientation remained fairly stable over this period, at less than one percent.

This brief look at the degree of trade orientation of the broad service sectors raises a number of interesting questions. For example, why does the trade orientation of service sectors not increase over time as is the case with goods? Why is the import penetration of business services so much higher than its export orientation? Why has the export orientation of transportation and storage been declining over time? What are the implications of the diverging trends in communications exports and imports? These questions do not necessarily indicate problem areas but rather indicate the need for a more detailed assessment based on a much finer breakdown of the data than is possible here.

4. Some possible effects of a reduction in the services deficit

As already indicated, the deficit of some $3.1 billion on "tradeable" services account is not regarded as being of undue concern by the economic community in Ottawa. The Task Force was nevertheless curious to learn what the results might be if the deficit were reduced through an increase in exports of services by Canada. It accordingly commissioned INFORMETRICA of Canada to do an econometric study of three scenarios. The idea was to try to see how the economy would be affected generally and which sectors of the economy in particular might benefit or be damaged by such a turn-around. The three scenarios envisaged, through an autonomous "shock", first, the elimination of the deficit by 1990, the second the elimination by 1985 and the third assumed a reduction of the deficit by half by 1990.

The Task Force appreciates that this kind of study sometimes raises more questions than it answers. And it recognizes, as does INFORMETRICA, the uncertainties in such forecasting and the weaknesses of the data base available.

This being said, there are a number of indications given of possible effects on the economy of such a turn-around in the deficit. Real gross national product exceeds the base case levels in all years. Moreover the impact on real GNP is greater than the "shock" (i.e. the economic impact required to bring about the increase in exports) and the difference between the shock and the impact continues to grow in the long run. The increase in final demand is translated into an increase in employment. In all cases the unemployment rate is lower and total employment is greater than the base case; indeed in some cases the labour markets become tight by the end of the study period. Some inflationary pressures due to tightness in the labour market, particularly in manufacturing wages, are offset at least in part by a decline in import prices, and the CPI and implicit GNE deflator are kept below the base case levels.

Per dollar of shock the overall impact is greatest in the case with the smallest rise in exports. This occurs because in the other cases the upward pressure on the value of the Canadian dollar caused by the better trade performance of services, tends to retard the growth of industries which compete on international markets. The study however also suggests other policy options to absorb the large increases in demand.

The study suggests that in the long run it is the service sectors which gain most (especially business and personal services; transportation, storage and communications; and wholesale-retail trade) and that the mining and manufacturing sectors, faced with an appreciating dollar toward the end of the study period, do less well than under the base case (although even under the base case the dollar appreciates anyway e.g. due to energy developments). This however is not for some years and might be mitigated by other policies in the meantime if governments preferred to resist such trends.

The Task Force would not wish to attempt any very specific conclusions from such a preliminary and partial examination of a very complex set of issues. Clearly, in any allocation of resources and efforts there are choices to be made as to both sectors and means. The Task Force is encouraged however by the signs that even some of the more modest policy and programme suggestions made by its interlocutors to help service sectors, if implemented, could be expected to produce some interesting direct and indirect effects, extending over time.

...../23

TABLE 4

CANADA'S TRADE IN BUSINESS AND PERSONAL SERVICES AND IN GOVERNMENT TRANSACTIONS - 1977

(millions of dollars)

Survey Results:	Receipts	Payments	Balance
Consulting and Other Professional Services	186	130	56
Management and Administrative Services	80	376	-296
Commissions	60	99	-39
Insurance Premiums & Other Insurance Transactions	59	158	-99
Scientific Research & Product Development	31	190	-159
Royalties, Copyrights, Trademarks, Film Rentals	31	460	-429
Advertising and Sales Promotion	28	37	-9
Equipment Rentals	17	25	-8
Franchises and Similar Rights	-	11	-11
Other Services	342	484	-142
(a) Total Survey Results	834	1,970	-1,136
Other Items Not Covered By Survey:			
Commission Agents	272	157	115
Expenditures of Railways and Airlines	322	328	-6
Commuters	59	-	59
Other Insurance Business	110	96	14
Miscellaneous Services Items	316	395	-79
(b) Total Non-Survey Results	1,079	976	103
Total Business Services & Other Transactions (a+b)	1,913	2,946	-1,033
(c) Government Transactions	371	594	-223
TOTAL (a+b+c)	2,284	3,540	-1,256

Source: Statistics Canada

...../24

D. SECTOR PROFILES

1. Consulting and Other Business Services

The transfer of knowledge and skills has shown itself to be one of the principal characteristics of tradeable services. In some sectors this transfer is minimal (e.g. transportation or tourism), while in others such transfer is the main value of the service.

The Task Force identified a number of sectors in which consulting as a tradeable item was important. Foremost are those described in Part 2 below on engineering/construction and related design consultancies. At present almost 80% of these Canadian export receipts are obtained from the developing world, with the rest from the United States. Such consultancy is also an important aspect of education and health services sold abroad (especially to third world countries). Major consultancy contracts have been obtained abroad in the telecommunications area and for many countries, including Canada, computing services are a growing source of export receipts. Oil and gas services are in the same category, though Canada is a net importer.

Although the developing countries are obvious target markets for consulting services, there is a substantial amount of trade between developed countries as various skills are developed within countries and then sold abroad. Such skills ultimately get transferred and "known", and unless there is constant improvement in knowledge and a continuous creation of new specialised niches, trade will decrease. That this has not happened in value of Canadian export business obtained is an indication of the rapidity with which new technologies are indeed being developed and demand created between developed countries.

Canada, as a developed country, is obtaining markets where development is occurring and where new technologies enhance an existing capacity. It is not surprising that all developed countries are in this market in a considerable way and that many governments have identified this sector as being a major actual or potential export earner. It is equally unsurprising that newly industrializing countries (NICs) are becoming equally aggressive in obtaining offshore markets in this sector.

Many other services categories have a consultancy component to them but they are much less involved in international trade. Other Canadian professions such as lawyers, accountants or management consultants, would have amongst their group individuals who are heavily involved in offshore practice but the magnitude of this trade is relatively small and is hard to determine.

The sale of knowledge now extends into areas traditionally not thought of as consulting. There has developed a wide array of business skills which are sellable and which have no formal professional base to them. Equally important are those services for which someone (or some country) has developed a specialized market (an example being protection skills which are sold internationally in a big way). The array of

...../25

such services is ultimately unlimited, ranging from individuals with an esoteric specialty to the development of whole industries (e.g. fashion). Balance of payments figures show a total of $3.4 billion for Canadian receipts for "business services and other transactions" but detail by sector and service function is to date provided only in the quadremnial surveys.

The Task Force has focussed its work on the sectors which follow. The next five Parts of this chapter consider various types of services which have generally a large consulting element, with the remaining five Parts in this chapter devoted to other types of service.

2. Engineering/Construction and Related Consulting Services

(i) Structure

The industry had $1.7 billion in fees in 1980, employed approximately 42,000 people of mainly professional qualifications, and has approximately 1,700 firms oriented to the consulting engineering business. The design functions of construction firms are included in these figures, but not the finished product of construction (this being estimated at $64 billion in 1982). Architectural firms number 1,500 - 1,700 and employ 9,500 people. Firms range from the heavy engineering companies concentrated in Ontario, Quebec, British Columbia and Alberta through to local engineering firms which are ubiquitous in their regional dispersion.

The industry is primarily Canadian owned with three firms - Lavalin, Monenco and SNC - being amongst the largest consulting engineering firms in the world. There is increased formation of joint ventures and activity in mergers both between domestic firms and with foreign firms, and a steady rhythm of firms establishing subsidiaries across the Canadian/U.S. border in both directions. Such activity is seen by Canadian firms as the way to establish in the U.S. market and to obtain the technologies necessary for development, particularly in the oil and gas area. Unlike European or Japanese firms, Canadian firms do not have vertical ownership links with either construction or manufacturing firms,although there are strong traditional links between engineering and construction firms. The latter are also involved internationally, and have successfully bid on a number of contracts in the U.S. often in association with Canadian developers.

The industry is highly cyclical and closely tied to overall economic performance. Dependent upon the obvious connection between megaproject commencement and engineering demand, real domestic growth could reach 4% to 5% per year.

(ii) Trade

The sector has fluctuated between positive and negative balance of payments amounts involving arms-length transactions. Figures reported as pertaining to this sector show export fees of roughly $340 million and imports of $170 million in 1980. However, if one includes imports of MNE affiliates, according to the Canadian industry association the picture changes to one of consistent trade deficits (their latest estimate of such imports is in the order of $500 million).

Exports are equally divided between the U.S., Latin America, the Middle East, Far East and Africa. A few turnkey contracts have been signed with Eastern European countries. Eighty percent of reported imports come from the U.S. Imports have traditionally been in the industrial sector and related primarily to oil and gas projects. Import substitution is occurring with many of the MNEs increasing their Canadian content on projects and Canadian owned firms acquiring access to the latest technologies by establishing joint venture companies with foreign based companies. It is estimated that Canadian companies should increasingly be able to manage many of the megaprojects which may be developed. For general and trade contractors in Canada, it has seldom been necessary to import such services.

Exports have become an increasingly important source of revenue for some companies. This market is growing twice as fast as the domestic market and has become an important profit centre for many companies. At the present time, industry spokesmen have targetted 20% as an acceptable level for an industry wide proportion of fees earned from exports. Committed companies will maintain an active export interest if only to compensate for cyclical downturns. Canadian firms are clearly leading centers of technology in some fields and have consistently obtained a significant proportion of their billings from abroad. Many companies, large and small, rely heavily on aid contracts (both CIDA and International Financial Institutions) to maintain their export billings. Construction companies are estimated to have $700 million in foreign work in 1982, but with almost all of the labour and material being bought on site.

(iii) Legislation, Policies & Regulations of Governments in Canada

There are a number of policies established in legislation or as practice which direct national or provincial objectives in this sector. FIRA is a factor for right of establishment and other investment issues. The Industrial and Regional Benefits Objectives and Guidelines attempt to ensure that Canadian companies have the opportunity to participate in megaproject developments. Other requirements relate to immigration, customs, and the professional licensing regulations established by provinces. In practice, some provincial and municipal governments tend to maximize local development through government procurement. However, in comparison with most developed countries, Canada appears to have a regime with relatively few impediments to trade.

(iv) Impediments to Canadian Exports

The OECD is investigating this sector for trade impediments and Canadian companies were asked for their input. The OECD area itself generates very little trade. Some countries say this is because local industry is well developed (true) and there is little incentive to call on outside competition; others maintain that there are substantial trade barriers and a strong protectionist attitude on the part of OECD governments. The latter viewpoint would mean that the OECD area as a whole was one with major problems suitable for international negotiation.

Between Canada and the U.S., there has been a history of the professional associations in each country discussing trade impediments, with the blessing of their respective authorities. Partly as a result practices of licensing, customs, government procurement, visa restrictions, etc. tend to be at roughly the same level. It was put to the Task Force that this has, in essence, led to a market of ten provinces and fifty states which is more or less compatible, although there are a few problems (e.g. licensing, immigration). us

In other countries, the major distortions to foreign trade revolve around aspects of subsidization. Some problems and situations are similar to those found for goods trade, others are specific to consulting engineers. Subsidies relate to (i) state participation, (ii) domestic subsidies, (iii) exports, (iv) discriminatory practices in granting of aid, (v) competitive practices of firms and (vi) other distortions of a more general nature.

These subsidies tend to close off markets in the OECD area and in third country markets in which Canada is competing. Subsidies in many cases are offered to advance goods sales; a consulting contract is offered at below real market cost so that the follow up contract will be placed in the subsidizing country. Not only are several OECD countries subsidizing service contracts but several Newly Industrializing Countries are doing so as well. The problem is particularly difficult for Canadian companies as they do not have the vertical integration links to manufacturing or construction and thus cannot recapture profits on following sales (which are often several orders of magnitude larger).

Other impediments distort the market, but Canadian companies generally would see these more as irritants. As most non-U.S. developed country markets are regarded as essentially not available, for whatever reason, these irritants are usually an issue in the developing world where they are often used to protect infant industries or to obtain a desired level of technological or financial transfer. These impediments can run the full gamut - problems of access, visa provisions, licensing restrictions, customs regulations, standards, requirements in other service areas e.g. banking or insurance, profit remittals and tax impositions. The cumulative effects of these generally make life abroad difficult but not impossible.

The Canadian industry has the competitive ability to win markets abroad and compete at an increasing level of sophistication in Canada. The sector is a significant contributor to Canada's trade position, with the industry confident that there is a rapidly growing market associated with the developing world which is obtainable. The major item of concern is the subsidization of contracts by some developed countries and some NICs in both their own markets and in third country markets.

3. Education

(i) Structure

Education in Canada is, for the most part, in the public domain. Overall educational policies are set by provincial governments, costs are highly structured in Federal/Provincial agreements, and individual institutions at all levels are directed by local boards. The principal orientations of the educational systems are to transfer knowledge to the Canadian public and advance the state of knowledge. A significant portion however, is operated by private enterprise, which fills a wide variety of educational needs.

Throughout most of the 1970s there was a rapidly growing level of public expenditure to develop the educational system. With a changing economic environment and a demographic structure which is putting less demand on the system, it is generally conceded that there is capacity in the educational system available for export.

(ii) Trade

Trade in educational services is made up of the education of foreign students in the public system, private enterprise transfer of skills and material and a general flow of knowledge into the foreign environment through a wide assortment of mechanisms ranging from consulting and conferences, to programs transferring both people and material. There is a large demand for education which can only be handled through aid programs, but this paper deals with the commercial aspects of the international educational scene.

The largest component of exports is the education provided to foreign students. A total of 66,399 foreign students held educational visas in Canada during 1981/82 at all levels of the education system; roughly 5% of the total university enrolment is foreign. The majority of these students come from high income countries, with another 36% coming from middle income countries. Only 3% come from the poorest countries - often funded through official or volunteer aid programs. The 1981/82 figures show 73.8% of total funding is generated from outside Canada, with each student contributing a prorated average of $10,000 per year to the Canadian economy. A very rough estimate would have this sector earning approximately $400 million in receipts, with this figure being reported in the travel account.

Most of the students coming to Canada come as individuals, but increasingly foreign governments want to place blocks of students in Canada and will contract for total educational costs. The question as to what it really costs to educate them is currently being discussed by provincial governments so they can establish some common ground rules for accounting purposes. The institutional framework to sell educational services is being put in place. Agreement is understood to be close at the Federal/Provincial level on a mechanism which would allow the Government of Canada to enter into such agreements. In addition to this, there has been a growing number of contractual arrangements between individual institutions and foreign bodies to educate students on a cost recoverable basis.

Imports equate to Canadians who study abroad. There are approximately 30,000 and the expenditure pattern is roughly the same as foreigners in Canada (i.e. per capita expenditure is estimated at $10,000 annually). Thus the exchange of students is a positive contributor to the Balance of Payments, and trends indicate an increasingly favorable situation if Canada takes advantage of the rapidly growing demand for education in developing countries such as Saudi Arabia, Nigeria and Malaysia.

Private education at the moment relies on training foreign students. The private educational system has identified the export of educational skills and materials as a virtually unlimited market. The potential is found in developing countries amongst individuals who want a vocation or enhanced career or amongst governments which have identified a skill shortage which is impeding development. There is also growing interest among firms in establishing abroad and selling a wide range of educational services.

Canadians, either as individuals or as part of an institutional package, often work abroad in an educational or expert capacity. Universities, technical institutions, and government training agencies, all have growing involvement in exporting their experts for consulting purposes. The construction of educational infrastructures and the selling of educational systems have been identified as particularly lucrative markets.

The potential for benefit from exports by this sector is often captured in other sectors. Future trade opportunities lie in contacts which Canada has established with future decision makers at all levels of a country's development. This gets translated into subsequent sales from Canadian suppliers and consulting and other service contracts. Transfer of knowledge, either in Canada to foreign students or in the

...../30

host country by providing training packages or people can also be judged on humanistic as well as economic grounds.

(iii) Legislation, Policies & Regulations of Governments in Canada

Most of the education system in Canada is in the public domain and therefore not susceptible to trade negotiations. In the private sector, legislation is applicable to business in general but not to education specifically. For example, while one needs a license from provinces to open a training or educational institution, no quality assessment is made.

(iv) Impediments to Canadian Exports

The "western" developed world has established almost complete freedom for the interchange of personnel and educational material. Some developing countries (LDCs) place currency restrictions or exit requirements which make it more difficult for their citizens to obtain an education abroad but these are generally minimal. In most cases, it is the LDC governments who contract for educational exports and thus they have an interest in seeing that barriers are removed.

The degree of competition from developed countries for third world markets is increasing in most areas but the demand is very large. Much of this demand will continue to be satisfied through aid channels, but both private and public educational systems can probably generate larger export earnings than they do at present, given the proper encouragement.

4. Health

(i) Structure

In 1979, the Canadian health care industry accounted for 7.2% of GNP, or $18.9 billion. This amount is split between public expenditures of $14 billion and the private sector for $5 billion. The locus of services is determined by demographic needs. The public institutional services sector is regulated to a high degree, notably by provincial governments i.e. public license, standards, budget control, etc. The private sector is mostly Canadian owned and also heavily regulated by provincial governments or professional organizations. There are indications that some of the people involved in the health area would be accessible resources for export as demand seems to have levelled off in Canada.

(ii) Trade

The largely public nature of the sector has generally precluded trade. The complete health care packages available from companies in the U.S., Europe or Japan would not find a market in Canada unless there was a major change in policy to privatize the system. Some imports are found in research and development (R&D) services, health requirements for Canadians abroad, and health consultancy companies.

Exports are also limited at the present time but there is a rapidly growing market for health care systems in the third world, to the extent that developed countries could find readily available markets. Health consultancy has generated a considerable amount of work for both public institutions and private enterprise firms. At present, many of these contracts flow through international aid agencies or are direct government to government contracts. Services tied to goods sales are also a growth area, although at present Canada still probably has a negative trade balance in both.

As with education, the benefits can be exogenous to the sector. The results of R&D in the health area potentially benefit everyone and all countries. The contacts made in selling a health care system or winning a contract to build a hospital often lead to long term goods/service sales. Canada, by participating in world health organizations, establishes that it possesses the degree of professionalism required to win contracts in the third world.

(iii) <u>Legislation, Policies and Regulations of Governments in Canada</u>

There is a tightly woven policy blanket established in this sector, by both provincial and federal levels of government, applicable to the delivery of health care (clinical). Regulation is much less apparent in the development of health care packages. It is the latter which is particularly tradeable. The public component at least does not appear susceptible to trade negotiations. In the private sector, major regulations revolve around licensing and professional standards, but these are non-discriminatory in that they apply equally to all to ensure quality control. In any case, the cost/benefit structure of the Canadian health care system is not necessarily judged on economic terms as benefits derive from the quality and length of life.

(iv) <u>Impediments to Canadian exports</u>

For the private entrepreneur, large sections of the health services business are outside the commercial sector due to the public nature of the health care system in most countries. Much of the market is filled by governmental expertise or is supported by development assistance. Barriers to trade on overseas contracts for such things as hospital construction have been outlined in the consulting engineering paper.

With a rapidly growing demand from Third World countries, many developed countries are beginning to assess the health services sector in terms of export potential. The flow of health-related services and people will likely remain relatively free of trade impediments as the "commodity" is demanded by governments for the most part. Developed countries sometimes give export assistance to firms bidding on contracts; for such contracts in the third world this assistance could be recognized as part of an aid package. This support should be established at roughly the same level by all developed countries to avoid subsidized trade distortions. Additional resources to meet export demand could be deliberately created by government policy if the health services sector were to be identified as an area for trade development.

The health services market is probably larger than expected and impediments appear minimal due to the fact that governments are the prime demanders of the service. This sector has the potential to play a greater role in Canada's trade as it does have the professionalism and resources to capture overseas markets.

5. Telecommunications and Computer Services

Governments are uncertain about the trends, scope, and public policy implications of the dramatic technological developments and the rapid diffusion of the new technologies; there is a dearth of useful relevant statistical information on which to base policy decisions. Governments see a potential for major gains for economic development, but are also concerned about possible negative economic, social and political implications. This area is therefore characterized by great uncertainty, ad hoc measures to deal with perceived problems, a reluctance to change existing policies based on old technologies, and a lack of relevant precedents on which to rely. It is one of the subjects under consideration within the OECD.

It is becoming increasingly difficult to distinguish clearly between certain telecommunications services and computing services. Different governments, therefore, take different approaches as to which service should be offered competitively.

It is difficult to define clearly what is meant by "trade" in telecommunications transmission services. Some limited form of "organized trade" might be said to exist, but most countries would be opposed to competitive trade in what is usually a monopoly service, considered essential to the well-being of the state. On the other hand, consulting on the construction and implementation of telecommunications systems is very much a tradeable commodity.

In considering trade in computing services most of the functions are conducted by private enterprises at least in Canada, and exist in an environment much more shaped by technological advances than by government regulation. A clear distinction does need to be made between competitive trade in the commercial sense, and the provision of services by multi-national enterprises (MNEs) to foreign affiliates (intra-corporate "non-market" activities). This is an area complicated by the close linkage between trade and foreign investment. These services exhibit all of the transfer mechanisms which were discussed earlier - utilization of international infrastructures (i.e. minimal

...../33

terminal connections to a foreign computer centre), movement of people and goods, and establishment through such things as a "store front" operation.

Finally, telecommunications and computing services are essential to the operations of domestic industry, and to increasing international trade in all sectors. User industries in both goods producing and service sectors may derive major benefits from use of these technologies, examples being greater coordination of activities, more effective and efficient use of resources, timely information on foreign markets, smaller inventories of supplies and finished products, and faster order processing and delivery.

(i) Telecommunications

(a) Structure

The vast bulk of the telecommunications services in Canada (some 98%) is provided by fifteen telephone companies and Canadian National/ Canadian Pacific Telecommunications (CNCP). Total operating revenues for all carriers amounted to $6.25 billion in 1980. Teleglobe (responsible for overseas traffic) and Telesat (responsible for satellite traffic) have acted primarily as "carriers' carriers" rather than dealing directly with customers. The TransCanada Telephone System (TCTS) is a consortium of the largest telephone companies in each province (9 in total) and Telesat. TCTS and CNCP provide national data communications facilities and services in competition on a duopoly basis. They (and not Teleglobe) provide links to the U.S. carrier systems. Only B.C. Telephone and Québec Téléphone are partly foreign owned, by U.S. interests.

Use of private lines for the development of intracorporate networks is permitted but the resale of carriage services is not generally permitted. Major "value-added" services are provided by the carriers. Guidelines regarding the offering of other value added services by non-carriers, (such as the electronic mailbox offered by IP Sharp) are not yet finalized.

Canada is regarded as a leader in the provision of telecommunications facilities and services, as carriers have overcome our geographic liabilities and have become more responsive to increasingly sophisticated user demands. Operating revenues are increasing steadily even though rates of return are strictly regulated. New technologies are being introduced, and R&D for some participants in this sector (including equipment manufacturing) is an astonishing 10% of sales (compared with 1% for the economy as a whole).

(b) Trade

At present, all Canadian-U.S. telecommunication traffic is provided on terrestrial systems. In general, the connecting agreements reached by TCTS and CNCP with their U.S. counterparts divide border-crossing revenues on a 50-50 basis. In 1978, TCTS had a net settlement on U.S.-Canada flows of + $5.5 million. In response to increasing demands for transborder satellite communications, agreement was recently reached between Canadian and U.S. officials on approaches to dealing with revenue sharing requirements. Satellite communication between the two countries was previously governed by an exchange of letters between the two governments in 1972. Under these letters, domestic satellites could only be used to provide services between points in the other country in exceptional circumstances to relieve a temporary shortage of facilities in the other country. The letter specifically ruled out the use of domestic satellites for transborder traffic in the absence of agreement by both governments. Telesat is currently leasing spare facilities to U.S. carriers for internal U.S. traffic, and other contracts have been signed. These arrangements are temporary and should not be interpreted as reflecting future trends. Teleglobe handles all other foreign traffic on a bilateral revenue sharing agreement basis. In 1980/81 it had net inflows of $64 million and net outflows of $57 million.

Both the carriers and a number of other Canadian companies have developed a high calibre of expertise in modern telecommunications techniques. Canadians are increasingly involved in international consulting. Because of the high degree of expertise in Canada, few foreign consulting firms have won contracts here.

Telecommunications consulting services (often associated with the provision of equipment) is a growing area for international trade. Developing countries provide particularly important export markets for Canada although Canadian expertise has been sold to a variety of developed countries. A contract can include system design, modernization of existing plant, network development, staff training, and future plans.

The major value-added telecommunications services will likely continue to be provided in Canada in the short term by the established carriers.

(c) Legislation, Policies & Regulations of Governments in Canada

Canada presents a complex mixture of federal and provincial legislation, policies and regulation related to the provision of telecommunications services. A common goal is to maintain intra-Canada traffic firmly within Canadian borders. In general, then, provision of telecommunications services is not treated as trade in the traditional sense. This is particularly true for terrestrial systems where revenue sharing agreements have a long tradition. The use of satellite systems opens up new possibilities, but the Task Force was informed that Canadian policies are likely to continue to be based on the precedents set for terrestrial systems.

(d) Impediments to Canadian Exports

In general, countries prohibit foreign ownership of telecommunications facilities; most, in fact, provide services through a state-owned monopoly. It is unlikely that this situation will change dramatically in the foreseeable future. Some change is occurring, spurred by the progress of deregulation in the U.S. However, trade, in the traditional sense, of telecommunications services is not likely to become a major factor.

A major impediment to Canadian exports of consulting services is the heavy subsidization of the international consulting activities of domestic companies by other governments. This type of subsidy often leads to the offering of extremely attractive trade "packages" to the country purchasing the service. Complaints about these practices have been frequent, but these subsidies are very difficult to detect and, if detected, hard to prove.

Two impediments to exports of consulting services arise from domestic Canadian policies. The first is that it is becoming difficult to recruit expert Canadians for these projects; besides the shortage of skilled personnel the Canadian tax structure is not as favourable as that of other countries working on similar projects (see Chapter E.4 below). The second is the CRTC ruling to include income from such projects in the carrier rate base, which reduces somewhat the incentive for carriers to become involved.

Trade in telecommunications does not occur in the traditional sense. However the international telecommunications infrastructure and computer/communications technology has been and will continue to be a fundamental element in making world trade in services of all kinds possible. Canadian companies have a solid reputation in the consulting field.

Telecommunications value added services can either be offered by the regulated carrier or by unregulated firms; international discussions could explore the possible opening of this area to commercial practice, although Canadian policy has not been resolved on this issue.

(ii) Computer Services

(a) Structure

There is a lack of adequate statistics, in Canada and elsewhere, on trade in computer services, and on domestic computing service activities (in-house and commercial). The figures presented here are intended to give order-of-magnitude estimates only and should not be regarded as definitive.

...../36

Computing services may be provided "in-house" (i.e. by an internal computing centre), or may be purchased from computing service vendors. The value of in-house computing activities in Canada is estimated to have been about $4.6 billion in 1980, and is expected to increase to $12.4 billion by 1990. The revenues of Canadian computing service vendors were about $1.0 billion in 1980, and estimates show this rising to be approximately $4.2 billion by 1990. Computer services are defined here to include data processing, software development and information storage and retrieval services.

The in-house software activities (a component of the above) are estimated to increase from $1.9 billion in 1980 to $4.8 billion in 1990. Revenues for commercial sales of software in Canada were about $235 million in 1980 ($1.1 billion in 1990). The trend is expected to be towards a greater proportion of purchased packages, and a lower proportion of in-house and purchased custom software.

In considering the market for information storage and retrieval services a distinction can be made, in general, between information providers (data-base creators), information vendors, intermediate brokers, and end users, although in some cases, two or more of these activities may be integrated. User purchases of these services in Canada are estimated to be only about $30 million in 1980, but rising to about $350 million in 1990.

In spite of the rapid growth projections, it was put to the Task Force by one well-informed interlocutor that a shake-out might occur later in the decade within Canada in the number of companies selling these services. Prudent companies are positioning themselves in export markets in the same manner as engineering consultants. Another profit centre is established, and the vicissitudes of the Canadian marketplace can be stabilized if international reputations are established.

(b) Trade

It is estimated that imports and exports of commercially marketed computing services in 1980 were about $125 million and $60 million respectively. Imports are expected to increase to about $615 million in 1990, and exports to about $165 million*. Canadian-owned firms tend to dominate the industry. They account for more than 80% of the revenues earned by the top 35 service bureaus operating in 1980. Although Canadian firms tend to be somewhat less profitable overall than their U.S. counterparts, some of them are competing successfully abroad (mainly in the U.S.). Factors contributing to the lower profitability of Canadian firms are the higher cost of computing equipment in Canada vis-à-vis the U.S. (partially caused by Canadian tax and duty structures) and higher telecommunications costs.

---

* This scenario does not reflect certain recent trends in computer hardware and equipment cost reduction that could increase the demand for internal processing and reduce that for commercial services.

...../37

It is difficult to estimate the revenues associated with commercial imports and exports of software. Most of the purchased packages in Canada were developed in the U.S., and there is currently relatively little packaged software development in Canada. It is unlikely that there will be large scale exports from Canada unless there is a concerted effort to expand capacity. In general, custom software is not a major factor in international trade, but there have been some successes in this area, and its importance may increase.

Information storage and retrieval services are expected to increase in importance as a trade item. Reference, credit, and financial data-base services are characterized by a high degree of imports into Canada. However, information storage and retrieval services represent only a small proportion of total computer services. Data-base production generally requires considerable capital, and it is difficult for new entrants to break into areas already covered by existing data-bases. Data-bases containing only Canadian data are not hot items for export.

Laws and regulation pertaining to the protection of data bases and computer programs, including computer games, vary greatly from country to country. The World Intellectual Property Organization, an agency of the U.N., is involved in the preparation of an international treaty on the protection of computer programs. This involvement is still at a very early stage. These issues are also at an early stage of development within Canada and are being addressed by the Task Force on Trans-border Data Flows.

(c) Legislation, Policies & Regulations of Government in Canada

Computing services are provided on a competitive basis in Canada, and there are few restrictions on the vendors of such services. Carriers (at least those under federal jurisdiction) are expected to set up an arms-length subsidiary if they wish to offer computing services. As computing services begin to incorporate greater amounts of telecommunications, problems can arise from conflicts with the computer/communications services provided by the carriers on a monopoly basis. FIRA has turned down some applications from foreign firms wishing to establish subsidiaries in Canada. Even if they have been turned down by FIRA, foreign firms can still offer their services to Canadian users through telecommunications lines either directly or through another company already established in Canada.

The only legislation relating to in-house computing services is the Bank Act, which requires banks to process certain bank records in Canada in order that the Inspector General may carry out his statutory responsibilities effectively. The Act prohibits banks from offering computer services other than those related to banking.

(d) Impediments to Canadian Exports

Foreign impediments to Canadian exports arise from other governments' actions to stimulate (e.g. through subsidies, procurement, and support programs) or protect their own computing services industry (or capture the value of in-house activities for their nationals). Developing Countries and Newly Industrializing Countries are perceived as increasingly protectionist. A number of countries, particularly those maintaining a monopolistic approach to the provision of telecommunications services, have different policies regarding the leasing of private lines to vendors of computing services. Such problems include: limits on the types or numbers of terminals attached to the telecommunications networks; delays in providing facilities; tariff policies to promote use of public networks; and limits on the type of service that may be offered.

A number of developed countries, through their monopoly control on telecommunications carriers, inhibit private enterprise from developing where computer services rely on the provision of telecommunication lines to provide services. Thus, some computer service markets can become part of the monopoly and are "in-house", leaving the commercial sector relatively small.

(e) Summary

The computing services sector requires government attention to establish a sound policy for both domestic development and trade purposes. Because trade in services is vitally dependent on efficient international computer/communication links, any bilateral or multilateral agreements in regard to the development of the communications infrastructure and the conditions pertaining to the delivery of services are bound to greatly influence the way in which trade in services will develop in the years ahead. It is therefore imperative that Canada maintain its lead in communications technology development and continue to play an active role in international forums in order to participate fully in the decision making process.

Demand is growing fast, and is being buffeted by rapid changes in technology. All components of the industry and all government levels need to devote considerable effort to generate supplies of skilled personnel to overcome rapidly developing bottlenecks in the production and distribution process. Software could see a major trade deficit if measures were not taken to promote software development in Canada. However, this estimate does not fully take into account the recent boom in microcomputer use and the growth in demand for microcomputer software. If this software continues to be supplied from external sources, Canada could be facing substantially higher software imports.

In terms of future discussions:

a) in the developed countries, the split, or lack of same, between telecommunications carriers and computing service functions is an important one,

...../39

b) some developing countries have been actively restricting this market to their own domestic companies, constituting a source of concern for Canadian exporters,

c) software development and information retrieval will be growth areas and should be kept as free as possible; noted however, is the shortfall in our own resources to meet the requirements of the Canadian market.

6. Oilfield Services

(i) Introduction

The Canadian petroleum industry includes over 700 oil exploration and production companies, whose purpose is to drill the well, prepare it to produce, complete and maintain it. The oil companies function like general contractors, with the substantive work being sub-contracted to the so-called "service" companies. These services can be grouped into five major categories; pre-drilling, drilling, well completions, support services, and supply houses.

The companies are located mostly in Western Canada. The total net cash expenditure of the petroleum industry in 1980 was $14.3 billion. Gross sales for service companies for 1981, reported in a recent industry survey, amounted to approximately $1.3 billion. Most are Canadian owned and controlled. However, in the high technology (and high profit) segments such as well logging and stimulation, the dominant firms are subsidiaries of foreign companies.

(ii) Trade

Very few Canadian oilfield service companies have extended their operations abroad, with the exception of some drilling and consulting companies. Typically, key services carried on major well sites in most of the free world countries are performed by subsidiaries of large multinational enterprises. These firms have established international reputations and the oil companies tend to use them rather than assume the risks inherent in using unproven contractors. Moreover, the segmentation of world markets by MNEs will tend to preclude, in most instances, the Canadian subsidiaries bidding and competing worldwide against their affiliates. Based on a limited survey, services exported to the U.S. are quite modest, totalling less than $10 million in 1981. There has been some export of services to other countries, such as Australia, but in most cases the Canadian firms have set up subsidiaries.

Oilfield service imports are mostly concentrated in offshore and arctic operations taking the form of drilling platforms, dredge ships used in building artificial islands and some supply vessels. The estimated value of services imports in 1981 amounted to approximately $160 million.

(iii) Impediments

Impediments faced by Canadian companies abroad include the U.S. policy of "Buy America" and the 1920 Jones Act which restricts coastal and fresh water shipping, towage, freight and passenger services. The largest impediments to the export of services seem to be non-governmental, i.e. the relatively smaller size of the Canadian companies, due in certain sub-sectors to the dominant position in the Canadian market occupied by MNE companies, and the dominant position that the same MNE companies hold in foreign markets.

(iv) Canadian Legislation

Exploration, contracting and related services may be subject to review under the Foreign Investment Review Act, or to provisions of the Canada Oil and Gas Act, the latter inspired by objectives set out in the National Energy Program. Any acquisitions by foreign interests of service companies, or the establishment of new energy-related service companies by foreign interests are subject to review under terms of the Foreign Investiment Review Act. The compatibility of such proposals with national energy policies is included in one of the five factors considered by Government in determining whether or not the investment is of significant benefit to Canada. The National Energy Program (NEP) has the objective of increased Canadian participation in the oilfield service sector, so that regardless of which companies undertake the work, the benefits of the activity and know-how associated with such efforts accrue largely to Canadians. Under sections 10 and 76 of the Canada Oil and Gas Act, the Canada Oil and Gas Lands Administration is responsible for reviewing proposals by oil companies seeking exploration and production rights in Canada Lands. An applicant's contracting and procurement plans are scrutinized for industrial benefit contribution.

In addition to the specific legislation described above, Canada has blanket legislation that monitors and controls immigration and temporary work permits through the Canadian Immigration Act.

At least two provinces have enacted legislation regarding the oilfield service sector. Newfoundland's Petroleum and Natural Gas Act of 1977 spells out specific regulations concerning disclosures of well information, along with education, training, research and development provisions, preference in the hiring of local labour and the procurement of local goods and services. The Government of Nova Scotia has passed somewhat similar legislation in the form of its Petroleum Resources Act.

7. Financial Institutions

The environment, roles and relationships of the major Canadian financial institutions are briefly discussed below. More specific sections follow on banks, investment dealers (not including stock exchanges) and insurance companies. These three were selected for detailed examination due to their greater importance, national and international operations and the degree of current or anticipated foreign interest in operating in Canada in those areas.

The environment, both international and domestic, in which Canadian financial institutions operate is undergoing fundamental change. These changes are consequences, inter alia, of the increasing internationalisation of banking pursuant to the recycling of petro-dollars, the growth of MNEs and of world trade and investment, the keener competition in international and domestic financial markets, the level and volatility of interest rates, changes in information technology and changes in demands by both users and suppliers of funds. An important result is that the boundaries that have traditionally existed between various financial institutions are under pressure.

This is most clearly the case in the United States. U.S. developments bear careful watching; because of the importance of its market they are bound to have implications both internationally and on a country such as Canada, which like the U.S., also has a segmented financial market. The major change in the U.S. market is the entry of new competitors into traditionally protected commercial banking markets. A number of U.S. investment houses have introduced money market accounts with cheque writing and credit card privileges; those of Merrill Lynch alone now exceed $36 billion - $10 billion more than the domestic deposits of Citicorp. Non-financial institutions such as Sears Roebuck through acquisitions are attempting to become "financial supermarkets" by offering a range of services including many from which commercial banks are precluded. U.S. banks are not yet allowed similarly to expand the sphere of their domestic activities, although legislative changes are anticipated. There are indications that the U.S. administration supports permitting banks to engage in some broader activities.

The Canadian financial system has in the past been segmented with a variety of institutions each occupying a more or less defined area, but there has been a trend to greater homogeneity recently. The major institutions are the chartered banks, the "near-banks" and others, such as investment dealers and insurance companies. It is the banks, investment dealers and insurance companies that are most active abroad and consequently most exposed to the changes noted above in the international environment. These are likely to be the areas of greatest interest to foreign entrepreneurs, although because the whole market is linked together these pressures will also have consequences on other institutions such as the "near banks" which have a relatively insignificant international orientation.

The chartered banks play a major and central role in the operation of the financial system on a national basis. Banks are the major participants in the payments mechanism throughout the country and in international exchanges. They perform a major function in the process of intermediation between savers and investors on a national scale and in the provision of financial services on a common standard in all parts of the country and they are key in the implementation of national policies regarding the monetary and financial health of the system. A basic Canadian banking rule is that no shareholder or associated group of shareholders may own a controlling interest in a bank. This ensures that a chartered bank does not become captive to a person or associated persons who have business interests other than banking, thus avoiding a potential for significant conflicts of interest and possible risks to the bank's depositors.

The banks have rapidly expanded into foreign markets since the Second World War. They support the international operations of Canadian companies as well as competing with other world banks for profitable international business. One consequence of their operating in largely unregulated international markets is that they have been able to expand the scope of their activities beyond those permitted to them in Canada. This has led to competitive confrontations abroad between the chartered banks and investment dealers. For example, Orion Royal, a Royal Bank subsidiary in the U.K., and Wood Gundy compete in the international bond market.

The banks are also looking for additional ways to service their clients and to generate income independently of their intermediary function. Fees from services, such as brokerage, investment management and advisory services are one avenue. The emerging role internationally of bankers as paid financial and investment advisors is bound to increase. The Canadian banks are not participants in this sort of activity in Canada due to the prohibitions in the Bank Act.

Canada's policy on foreign banks is designed to achieve a balance between the objectives of maximizing competition and ensuring that the control of our financial system remains predominantly in Canadian hands. The Bank Act seeks to provide for more equitable and effective competition between Canadian banks and affiliates of foreign banks by requiring foreign bank affiliates to operate under Canadian banking legislation and providing economic and financial surveillance by Canadian authorities. It also provides a basis for treatment as favourable for Canadian financial institutions abroad, while insuring that Canada's banking system remains predominantly in Canadian hands.

A dramatic development in the financial system during the post war period has been the increase in the relative importance of the "near-banks". These financial institutions, not chartered under the Bank Act, include trust companies, credit unions, and caisses populaires. They are increasingly competing with the banks in the provision of broader ranges of services both to savers and to borrowers. Many are more local in the areas and markets they serve and more specialized in the services they provide. Many are provincially incorporated. As the "near-banks" broaden their range of activities, the degree of specialization diminishes and the basic differences tend to disappear.

Cooperative credit institutions (Credit unions and caisses populaires) are important in at least 6 provinces and indeed are major competitors of the banks in Quebec. While they were initially established to cater to the needs of their members by providing mortgages and personal loans some have recently begun to operate more as full service financial institutions by expanding their area of activity to include business lending in direct competition with banks. They have banking and trust company affiliations: Quebec caisses own shares in the National Bank; Cooperative Trust is a federally incorporated trust company owned entirely by credit unions and cooperatives.

Trust companies were originally formed to act as trustees, and the corporate fiduciary function is still unique to these institutions; however they have over time developed a banking function and currently play an important part in financial intermediation in Canada. This aspect involves receiving deposits from the public in the form of guaranteed investment certificates, time deposits, and savings deposits which are invested in mortgages, securities and other loans. They are major sources of mortgage finance in Canada with, in many cases, mortgage loan affiliates; many also provide property management services and act as real estate agents. Trust companies are also seeking more freedom to compete with other financial institutions. In particular, they want to be able to gain greater involvement in commercial lending, including possible syndications with foreign banks.

Other types of financial institutions include sales finance companies, investment dealers and insurance companies. The sales finance companies have diversified into various forms of corporate lending as a result of competition from the banks in the mortgage and consumer lending markets. The recent volatility and height of interest rates has had an impact on investment dealers and insurance companies. Investment dealers' major activities are underwriting the issue of corporate and government securities and trading stocks. There has been a decrease in revenue from both activities recently and the industry has had to rationalize its structure with several mergers. In the case of insurance companies it has made their traditional products unattractive. Insurance companies have recently expanded their role to take on the management of segregated funds, such as pension funds and are exploring the sale of equity - linked insurance products which offer greater risk and opportunity. In these areas they increasingly compete with trust companies, and investment firms. Like the banks, they operate on a national and international basis.

(i) Banking

(a) Introduction

Banks are the dominant financial intermediary in Canada with Canadian dollar assets, as of the end of December 1981, of about $202 billion or about 40 p.c. of total assets of all deposit taking institutions. The banks compete successfully internationally with about 40 p.c. of their earnings derived from operations with non-residents. Foreign banks have recently been permitted to establish subsidiaries in Canada and it is expected that charters will eventually be granted to about 60. Banking is one of the areas in which the OECD is undertaking a study of international impediments.

(b) Canadian Legislation

Banking is an area of federal jurisdiction. The legislation which governs the entry and operation of foreign banks is the Bank Act. The Bank Act as amended December 1980 permits the establishment of two types of banks, i.e. "Schedule A" and "Schedule B" banks. "Schedule A" banks are those that were chartered when the Act came into force and are all domestically owned, i.e. at least 75 percent of the voting shares are held by residents. Their shares are widely held, i.e. no single shareholder owns more than 10 percent of the shares in the bank. "Schedule B" banks are those whose shares are closely held in that one or more shareholder owns more than 10 percent of the shares. "Schedule B" banks include foreign bank subsidiaries, which by definition are closely held banks owned by non-residents. It is anticipated there will be some closely held Canadian-owned banks chartered under "Schedule B" in the future.

The government's intent is that foreign banks that carry on significant banking business in Canada establish subsidiaries under the Bank Act. Once established the major restriction on foreign banks is that, as a group, their total share of the domestic market may not exceed 8%. Foreign bank subsidiaries are also required to have a licence to commence and continue in operation and the licence has to be reviewed periodically. The licence can be made subject to such terms and conditions as the Minister of Finance may deem appropriate at that time. As "Schedule B" banks the prior approval of the Minister of Finance is required to open any branch, other than the initial branch, and they may not have a branch outside Canada or own a subsidiary that is incorporated outside Canada. In order to enable the Inspector General of Banks to be satisfied that banking records and data have been correctly processed, there is a requirement that affects foreign banks, although it applies to all banks, i.e. that data on banks'

...../45

operations may not be sent outside Canada for processing (although copies of the data may be sent outside Canada eg. to foreign bank head offices).

(c) Trade and Impediments

Canadian banks compete successfully internationally, with operations ranging from representative offices to full retail banking facilities in over 50 foreign countries. Their foreign activities include participation in domestic banking operations in various countries as well as "cross border" activities, generally subject to fewer restrictions, such as loans to governments. For many of these activities banks either prefer or are required to have a permanent establishment in the country in which they operate. They face a broad range of restrictions in their foreign operations, especially in their foreign indigenous operations. There are major Canadian banking operations in the United States, where Canadian banks are not limited by legislation in the share of the market they may gain. Due to state powers over banking, they are limited in their ability to establish full scale banking offices across the country and indeed are prohibited from a number of states. The United Kingdom is an important location for the foreign activities of Canadian banks, both of a retail nature as well as interbank or "wholesale" operations. They also operate in a number of other countries in Western Europe and have as well entered the Japanese market.

The banks face severe restrictions in developing countries both in terms of access as well as operation. Some countries have nationalized the banking system. Others, including some in the Caribbean and South and Central America, have imposed restrictions on foreign banks, such as majority local ownership requirements, or limit foreign banks' activities to dealing only with foreign subisidiary companies' operations.

Canadian banks have extensive and profitable operations in many areas of the world at present. While they do face significant impediments and there are areas where they might take advantage of liberalization, overall they feel that their foreign operations are satisfactory.

(ii) Investment Dealers

(a) Introduction

Canadian investment dealers are concentrated in a few large financial centres: Toronto, Vancouver, Montreal, Calgary and Winnipeg. The industry's main activities are trading securities and underwriting the issue of corporate and government securities. Capital employed by the industry in 1980 exceeded $530 million and dealers underwriting activities involved $27 billion.

(b) Canadian Legislation

Apart from the federal Foreign Investment Review Act of general application, provincial governments have jurisdiction over the securities industry in Canada. Each province has its own regulations and acts independently. There is no national securities body. To sell securities at the retail level across the country, it is necessary to register with the Securities Commission in each province separately.

The Canadian industry has little foreign participation. Foreign control of the industry was about 10% in 1978. Regulations in several provinces do not encourage further penetration. Unless they are "grandfathered" it has generally been the case that only Canadian dealers can register. Foreign dealers do have free access to the Canadian market for the sale of non-Canadian securities to institutional investors, and free access to governments and corporations to participate in the marketing of Canadian issues in other jurisdictions. As no Canadian borrower has ever chosen a foreign dealer for their Canadian operations, they have not been involved in underwriting securities in Canada except for the small number of companies such as Merrill Lynch who are "grandfathered" and do underwrite issues in Canada.

(c) Trade and Impediments

Canadian firms' activities in foreign markets are generally limited to an extension of their Canadian operations, i.e. services carried out with respect to foreign borrowing by Canadian borrowers. Fourteen of the Investment Dealers' Association's 74 members have offices abroad, a few of which have been active for several decades. The number of companies operating abroad and the number of countries in which they operate has been growing in recent years.

Overall, except in the U.S., Hong Kong and Singapore, Canadian securities dealers face significant restrictions on their operations, generally being prohibited from operating a branch business directly with the public. Eleven Canadian companies have offices in the U.S.A., chiefly New York, which has a relatively open door policy. Canadian dealers, if they conform to the rules of the U.S. National Association of Securities Dealers, may sell securities in all U.S. markets. There are an equal number of Canadian companies in the U.K. market although Canadian offices must, in effect, operate through London brokers, as seats on the Stock Exchange are for U.K. nationals. There are eight companies operating in Switzerland where Canadian companies must operate through banks, and three or fewer in each of Japan, France, West Germany, Hong Kong, the Bahamas, Jamaica, and Grand Cayman.

There is apparently some desire by foreign companies for access to the Canadian market. While the industry in the U.S. is likely to be preoccupied in the medium term with the restructuring underway in U.S. financial institutions, once this is accomplished there may well be more pressure to enter the Canadian market. The Canadian industry is understood to be prepared to see a limited degree of greater access for foreign companies, e.g. in the sale of foreign securities in Canada, but there seems to be some question about the degree of provincial interest.

(iii) Canadian Insurance Industry

(a) Introduction

Insurance companies are important financial institutions with assets of over $53 billion invested in Canada in 1980. The market is served by Canadian incorporated companies, either Canadian or foreign owned, and by non-resident companies that operate on a branch basis or from outside Canada. The industry can be broken into three segments; life, property and casualty, and marine. The international competitiveness of each varies sharply. The life insurance industry has a high degree of Canadian control and does more business abroad than is done in Canada by non-resident companies. Canadian controlled life insurance companies write approximately 80% of total Canadian premiums. Property and casualty companies are mainly controlled by non-residents and do almost no foreign business. Marine insurance is written to a large degree by institutions not registered in Canada. It would be difficult clearly to establish Canada's net return on trade in insurance services although it appears from the relative size and competitiveness of the three segments that Canada would on average have a deficit in this area.

The insurance industry is one of the areas in which the OECD is undertaking a study of impediments to trade.

(b) Canadian Legislation

Supervision of the insurance industry is shared by the federal and provincial governments although in practice it is largely undertaken by the federal government. The Foreign Investment Review Act affects foreign participation in the Canadian market. Any non-Canadian wishing to establish an insurance business in Canada who does not already have a related business here, must obtain clearance from the Foreign Investment Review Agency. Subsequently federal insurance legislation permits non-Canadians to establish new Canadian insurance companies subject to the same requirements that apply to Canadians. However, federal legislation prevents non-Canadians from acquiring control of a Canadian life insurance company that is already controlled by Canadians, although they are not prevented from acquiring any Canadian incorporated property and casualty insurance company, or a Canadian incorporated life insurance company that is currently controlled by non-residents. Requirements for registration by a non-resident company that wants to do business in Canada on a branch basis are no more stringent that the requirements for the registration of a Canadian incorporated insurance company. There is a 10% excise tax imposed on certain types of insurance when bought by Canadian residents from non-resident companies not authorized to do business in Canada, but there is nothing to prevent a Canadian from taking the initiative to purchase such a policy. There is non-discriminatory regulation of the industry to protect the consumer by requiring e.g. that a company has sufficient assets available in Canada to cover its liabilities and that these are invested in approved vehicles.

Reinsurance of large risks is an essential part of the property and casualty insurance business. Most is placed with companies registered in Canada, although the insurance statutes do not prohibit reinsurance with companies not registered in Canada. Legislation on this topic may be introduced shortly in view of the recent failure of a Canadian company due to problems with foreign re-insurers not registered in Canada.

Marine insurance is exempted from federal insurance legislation but provincial governments exercise some authority as well as exercising certain general responsibilities for all corporations, including insurance corporations. As a general rule marine insurance is not subject to provincial legislation except in Quebec and Alberta. In practice most provincial insurance departments encourage marine insurance corporations to comply with various non-statutory solvency requirements. General provincial insurance legislation has as its primary concern the rights of the policy holder, and relates to the licencing of agents, the contractual rights of beneficiaries and policy holders, claims procedures and related matters. Provincial legislation of this type applies to all corporations doing business in a province.

(c) Trade and Impediments

Canadian life insurance corporations have significant interests abroad. Virtually all foreign business is conducted on an establishment basis, using either a branch or subsidiary corporation. The foreign environment faced by Canadian companies varies substantially.

...../49

The vast majority of existing foreign business is in the U.S.A. and the U.K. 70% of Canadian life insurance business outside Canada is in the U.S. Canadian companies operate without serious problems in all U.S. states. The only difficulty they face is that they must deal with each of the states on an individual basis. The U.K. accounts for about 20% of the Canadian industry's foreign operations. Canadian companies are not active in the rest of Western Europe although there is some interest in expanding into those markets from existing subsidiaries in the U.K. There is also some interest in establishing in Japan in view of the possibility of Japanese companies entering the Canadian market.

Most of the remainder is in LDC markets, which, although relatively small, are growing quickly and offer long term promise. Canadian companies' experience in these markets varies considerably. While a few are quite open to foreign participation, e.g. Hong Kong, the Philippines, others are highly restrictive. Some developing countries have nationalized the industry and Canadian companies have been forced to withdraw from a number, particularly in Central America.

The property and casualty and marine insurance sectors have a high degree of foreign ownership and conduct virtually no business abroad. In the case of the property and casualty sector in 1980, although 67% of net premiums written in Canada were written by Canadian incorporated companies, only 25% were written by companies that can be considered to be Canadian controlled.

The major factors which account for the Canadian marine insurance industry's small share of the potential Canadian market are as much market considerations as government impediments. These factors include the international nature of marine insurance and its domination by a small number of large companies, traditional patterns of insuring Canadian trade overseas, MNEs' practice of often taking out "master contracts" which cover all their operations at home and abroad and developing countries' legislation requiring imports to be insured in their market.

8. TRANSPORT

The transportation system includes mainly the following components: air, water, rail and truck transport which all involve the carriage of passengers and freight; increasingly, these modes are combined by multi-modal operators - which also involves the participation of the freight forwarding industry, traditionally an intermediary.

From 1976 to 1980, the value of exports to the U.S. moving through the Canadian transportation system has almost doubled to $46.9 million.

...../50

This increase follows trends in the merchandise trade as well as inflation.

In recent years, Canada has had surpluses in the overall freight and shipping account of the balance of payments, the latest (1981) amounting to $243 million. Most of these surpluses are attributable to the inland freight component, although there have been small surpluses in shipping in the last two years. (See table below and Chapter C.2. (ii) above). Other countries do not include inland freight as part of their service exports.

Table Five

International Freight and Shipping Balance

(millions of dollars)

	1977	1978	1979	1980	1981
Shipping	(274)	(174)	(14)	71	47
Inland Freight	399	456	476	444	335
Intransit Revenues/Payments	(131)	(134)	(134)	(135)	(132)
Air Freight	(20)	(17)	(19)	(12)	(7)
Surplus (Deficit)	(26)	131	309	368	243

The Task Force examined maritime and air transport in detail, as well as other modes falling in a general cargo-trucking-multimodal designation. Summaries of these sub-sector profiles follow.

(i) Maritime Transport

(a) Introduction

Canada does not have a significant deep-sea fleet; however, maritime transport carries a very important part of Canada's trade. In the late 1940's, for a number of reasons, the Canadian government decided to liquidate its post-war deep-sea merchant fleet and to rely on foreign flag fleets to carry our deep-sea trade. It was put to the Task Force that this policy has so far worked in Canada's interest. As for the Great Lakes fleet, it has continued to develop and flourish, mostly because of government investment in the Seaway System.

This subject is under study in the OECD as part of its examination of impediments to trade in services.

...../51

(b) Canada's Maritime Trade

Movements to and from Canadian ports amounted to 239 million metric tonnes in 1978, including 44% in the deep-sea trade (valued at $29.8 billion), 31% in the transborder trade with the U.S., and some 25% in the coasting trade.

In the coastal trade, 95% of the tonnage was carried in Canadian flag vessels, while in the transborder trade, Canadian shipping carried about two-thirds of the tonnage.

The Canadian merchant fleet is composed of 118 vessels registered under various foreign flags and 261 vessels (95% of which are lakers) of over 1000 tons registered in Canada. In terms of tonnage, 7.3 million tons are Canadian owned but foreign registered, while 3.4 million tons are on the Canadian registry.

(c) Government Legislation, Regulations and Policies

Deep-sea shipping falls under federal jurisdiction, including matters related to registration of vessels (Part I of the Canada Shipping Act), shipping conferences (Shipping Conferences Exemption Act - 1979), coasting trade (currently under review) and the British Preferential Tariff (Customs Tariff Act) for goods originating from the U.K. under direct shipment requirements. Construction and operations are also under federal jurisdiction, as well as ports. The Darling Report (1974) outlined areas where policy stipulations were lacking and expressed concern that regulatory machinery for dealing with problems and trends in international shipping potentially harmful to Canadian shipping was either nonexistent or ineffective.

There is also some provincial legislation affecting shipping expecially in areas related to offshore oil-related activities. The Newfoundland and Labrador Petroleum Regulations of 1977 aim to ensure that preference is given to local labour on vessels engaged in offshore exploration or exploitation of natural resources off Newfoundland. Nova Scotia and Prince Edward Island are also developing similar measures.

(d) Impediments to Canadian Exports

Without a significant deep-sea fleet of its own, Canada must rely on the competitive forces of the marketplace to ensure that reliable economic shipping services are available to meet Canadian needs. Canada, therefore, has been monitoring the development of proposed protectionist legislation in other countries, particularly the United States, Canada's largest trading partner. Bill HR 3637, for example, if adopted, would provide for U.S. jurisdiction over common carriers by water engaged in foreign commerce to and from the U.S. and using ports in Canada and Mexico. U.S. coasting trade legislation (the Jones Act) also has some repercussions in Canada, since, quite apart from its general provisions on cabotage, some of its provisions prevent U.S. registered vessels involved in the coasting trade from being repaired and serviced in Canada.

Ships engaged in Canada's deep-sea trade are the subject of flag discrimination in several countries such as Algeria, Brazil, Chile, Ecuador, France, Peru, and South Korea. In most cases, cargo sharing is involved, some following the UNCTAD Code of Conduct for Liner Conferences cargo-sharing clause (where 40% of cargo is reserved for ships of the importing nation, 40% to ships of the exporting nation, and the remaining 20% to other ships), sometimes on a 50:50 basis (and even up to a 100% basis in the case of Brazil when carriage of government goods is involved). The trend is towards more cargo sharing, and government procurement guidelines in many countries clearly favour national lines.

In addition, Eastern Bloc fleets in the last two decades have grown to proportions where, quite apart from their military implications, they have been able to monopolize a large part of the shipping market. In this context, the time may come where, if those trends continue, Canada may not be able to rely on a free shipping market as it is doing now. Cargo sharing, especially in the bulk trades, could be detrimental to Canadian interest, since it would increase the costs of shipping.

However, it was suggested to the Task Force that, notwithstanding the elimination of impediments overseas, unless Canada introduced financial incentives for its shipping industry, the export of Canadian shipping services would not grow.

(ii) Air Transport

(a) Canada's Air Transport Trade

The Canadian air transport industry consists of national, regional and local air carriers employing 47,000 people and generating operating revenues of $4 billion in 1980. The two national carriers, Air Canada and C.P. Air, account for two thirds of revenues and employment and, along with the charter carrier Wardair, are the main Canadian operators on the international scene; the national carriers are involved in scheduled service as well as charter operations to foreign points.

Due to the large number of Canadians travelling abroad, Canada generally experiences deficits in its overall air transport account; balance of payments figures (which reflect only the difference between what Canadians spend with foreign carriers and what foreign nationals spend with Canadian carriers), indicate a deficit of $319 million covering both freight and passengers.

...../53

(c) Canadian Legislation, Regulations and Policies

The federal government exercises jurisdiction over aeronautics through two main statutes: the National Transportation Act (NTA) and the Aeronautics Act. The NTA established the Canadian Transportation Commission (CTC) as an independent regulatory body. Part I of the Aeronautics Act makes the Minister of Transport responsible for, inter alia, securing Canada's rights in international air traffic, while Part II gives the CTC extensive powers in regulating commercial aviation. Canadian policies reflect the government's goal of developing air transport services as an economic and social tool as well as a commercial activity. Internationally, government policies also used to take account of the air policy goals and tactical objectives of other countries.

In strictly bilateral services, with most of our aviation partners Canadian carriers enjoy a revenue advantage over their foreign competitors. However, with the U.S. our carriers generally suffer significant revenue deficits, due partly to the structure of airline networks and the high volume of traffic which travels to and from markets behind American gateways, more numerous and of a higher density than those behind Canadian gateways. On long-haul services, and especially those to leisure destinations, Canadian carriers tend to dominate, and the combined strength of Canadian scheduled and charter carriers has on occasion been competitively overwhelming for U.S. (and indeed other foreign) carriers.

(d) Structure of International Air Transport

The organization and operation of international civil aviation is at present regulated by multilateral treaties (Canada being party to all major treaties, including those on liability, hijacking, and terrorism), bilateral agreements, inter-airline agreements and arrangements (including IATA fare conferences) and national regulations and legislation. However, the most important role is played by bilateral agreements, Canada being a party to 34 such accords. The key multilateral treaty is the 1944 "Chicago Convention" which established the basic framework for the international exchange of air services along with norms relating to the treatment of foreign airlines, leaving the actual establishment of routes and rights to bilateral negotiations.

The principles of national treatment and non-discrimination are applied only to a limited degree in air transport through the Chicago Convention and bilateral agreements, where the basic approach has been bilateral reciprocity and the establishment of rights and obligations through multilateral rules. National treatment is however generally applied to provisions affecting tax and duty exemptions, as is the MFN principle, which is also applied to the rights to establish local offices with (or without) expatriate personnel, to remit revenues to the country of nationality, and to import technical and operational goods and materials. The MFN principle is sometimes applied in the bilateral agreements to the right to carry out in-house ground handling and servicing of aircraft and, in fewer cases still, to the right to contract with third country carriers on local handling and marketing operations.

(e) Impediments to Canadian Trade

A few specific issues stand out as problem areas for Canadian airlines abroad:

Taxation and User Charges: The 1966 ICAO resolutions on taxation adopted by the ICAO council have, to some extent, been accepted in principle by many ICAO contracting states, but these resolutions are not legally binding. Moreover, the Air Services Transit Agreement and the Chicago Convention recognize the right of individual states to levy "just and reasonable" charges for the use of airports and other facilities. Cost-related user charges are generally recognized as acceptable in both international undertakings and common practice. Australia, Italy, France, Mexico, Peru, Venezuela and Canada are among countries which have, from time to time, collected taxes or fees which have been considered by other countries as either unreasonable or discriminatory. In the Canadian context, the Transportation Fuel Recovery Charge was withdrawn in 1982 in the face of strong international challenge, and replaced by a mechanism analogous to an income tax; this is already the focus of fairly critical and intensive scrutiny. In the U.S. there has been a recent move to introduce a customs inspection charge.

Ground Handling: This includes passenger check-in counter (with or without expatriate staff), baggage handling, aircraft handling, cleaning and maintenance as well as provision of food services etc. Disagreements exist relating to lack of choice in ground-handling arrangements in many countries, and both national carriers have complained about this. Most labour disputes arise in areas related to ground handling, and CP Air has experienced difficulties in Mexico, the Netherlands, Portugal, Italy and Peru. However, ground handling matters are in many countries satisfactorily governed by inter-airline agreements based on an IATA Standard price.

It is generally recognized that, unless specifically addressed in bilateral agreements, non-scheduled or charter airline operations are governed by the national rules of host states. Due to the relatively few countries to which Canadian charter operations are conducted and the relatively less regular nature of such operations when compared to scheduled services, the impediments outlined above have not created major problems for Canadian charters.

(iii) Other Transport

(a) Description

This profile covers freight motor carriers and the traffic services industry, with passing references to railways. "Traffic services" include, among other things, storage, handling, forwarding, documentation, customs clearance and insurance, and this is offered by freight forwarders, cargo packagers, air cargo agents, shipping agents, customs brokers, stevedores, insurance brokers, terminal operators and parcel delivery/cartage firms. There is no clear distinction between the range of services each type of company offers, and there is sometimes considerable overlap. Indeed, larger companies may offer all of these services. Some of these firms, as well as unimodal carriers, offer door-to-door through service such that they can be considered Multimodal Transport Operators (MTO) according to the recent UNCTAD Convention on International Multimodal Transport of Goods. For this, they must consent to act as principals and not as intermediaries, and assume all responsibility for the performance of a total multimodal freight contract (i.e. the traffic services plus the transport by successive modes on a single MT contract, including a single through freight rate, and liability by one entity).

In 1979 there were about 3,900 motor carriers of freight in Canada with revenues of $4.7 billion, as well as 3000 or so companies involved in traffic services which have sales of about $2.5 billion. C.P. Rail had revenues of $2.5 billion in 1981, while the CNR posted revenues of $4.3 billion for the same year, although this covered its 54 or so subsidiaries, some of which are not involved in transportation. Both CP and CN are important MTOs.

These firms employ approximately 230,000 Canadians, the largest proportion being employed by railways (47%), followed by trucking (41%) and traffic services (12%).

(b) Trade

Work commissioned by the Task Force on the availability of statistics for services revealed only figures for 1977 regarding the breakdown of international payments by transport mode; it showed a surplus for non passenger rail services and truck transport. Recent figures indicated that in 1980, road and rail transport carried 43% and 28% respectively of Canada's exports to the U.S. in terms of value. This percentage reached as high as 47% for trucking in 1978; estimates place the total truck-supported trade with the U.S. at almost $50 billion for 1980. In 1979, 464 carriers operated between Canada and the U.S., generating revenues of $470 million.

The Canadian trucking industry is largely Canadian owned, although the few (1.5 or so percent) foreign controlled firms control as much as

...../56

15% of the industry's profits, according to a 1975 Transport Canada study. Foreign owned trucking firms are especially significant in important domestic and international traffic lanes, and some of these firms dwarf the largest Canadian companies.

In traffic services, the larger firms tend to be subsidiaries of U.S. and European companies. A government study noted that a few European companies accrued 90% of Canadian freight forwarding revenues. Large MNEs offer services based on well established international distribution systems.

Multimodal operations have had a phenomenal growth in recent years, and preliminary studies have indicated that in 1979, as much as 45% of all container traffic moved through MTOs. Furthermore, such operators are often able to control the market; they also have a strong negotiating power over national unimodal carriers, as well as exercising great power over the routing of cargo. In fact, at the present time, it was explained to the Task Force that U.S. MTOs are diverting sizeable portions of cargo traffic through the U.S., thus reducing the income of Canadian carriers.

In the parcel delivery and courrier field, in recent years, large American firms have entered the Canadian market with strong opposition from Canadian firms.

(c) Government Legislation, Regulations and Policies

The federal government has delegated its right to regulate extraprovincial motor carriage to the provinces, which all require permits or licences for extraprovincial and international carriage. Rates vary largely between provinces; intraprovincial rates are either closely regulated or set in the marketplace, and international rates are practically unregulated.

Any foreign trucking firm wishing to establish a new business or buy an existing concern in Canada must submit an application to FIRA.

The traffic services industry is largely unregulated, except for FIRA reviews, the licensing of customs brokers by Canada Customs, and provincial licensing of freight forwarder trucking operations. The Canadian policy on MTOs has not yet been thoroughly defined. However, preliminary work in the Canadian Transport Commission has indicated some need to regulate MTOs.

(d) Impediments to Canadian Exports

Although the deregulation of the motor carrier industry in the U.S. in 1980 benefited Canadian (and especially American) carriers, Canadian carriers increased their applications for operating authority in the U.S. Grants of authority to Canadians tripled over the number

...../57

of 1978 grants, while grants to U.S. companies increased 21 times. Despite this, there was objection by U.S. truckers and politicians to the growth of the number of grants to Canadian companies centered around an alleged lack of reciprocity on Canada's part. The Interstate Commerce Commission (ICC) has instituted an investigation of international trucking, and the Senate has passed the Bus Deregulation Bill which contains sections providing for a two-year moratorium on the granting of U.S. operating authorities to Canadian carriers. At the time of writing, the House of Representatives has not passed this measure, which also contains provisions that would allow the Administration to lift the ban if it was determined that U.S. truckers were not being treated "unfairly" in Canada. (This matter is currently under Canada/U.S. discussion).

Elsewhere, a Mexican decree on ownership of domestic carriers serves as a model for LDCs to implement the UNCTAD Convention on multimodal transport by requiring that MTOs operating in Mexico be 100% Mexican. It is included in the USTR list of impediments submitted to the OECD. Indonesia has more recently taken measures similar to those of Mexico. The impact of Mexican and Indonesian measures is under study by the Canadian government.

9. Cultural Services

(a) Introduction and Description

In the event of multilateral negotiations on services, there is a possibility that the cultural sector could be proposed for inclusion. In this regard, the United States has submitted to the OECD a list of impediments to world film trade. In fact, the OECD Code of Liberalisation of Current Invisible Operations, as well as Articles III(10) and IV of the GATT, cover films.

The services examined by the Task Force in the cultural area (broadcasting, film, sound recording and advertising) represent revenues of about $3-billion and employ over 70,000 Canadians. Ownership is mostly Canadian, except in the recording area and in film distribution.

(b) Trade

There have always been Canadian trade deficits in this sector; exports are very low compared to imports. Compared to other sectors in the economy, cultural industries export only a small percentage of their production/services (e.g. 6% of private film & video production, or some $6.5 million in 1979). Broadcasting programming exports amounted to only $8-million in 1979, while $55-million worth of programming was imported into Canada. The cultural sector thus presents a picture of massive imports, primarily from the United States, equivalent to several times the amount of exports. (This is accepted as true even though good quality recent statistics in this sector are incomplete).

(c) Legislation, Policies and Regulations of Governments in Canada

Since broadcasting is the facet of culture that has influence on most Canadians, it follows that government intervention in this area has preeminent importance. In this connection, the CRTC and the CBC are enjoined by the Broadcasting Act to give effect to national policy affecting the cultural, political and economic fabric of Canada. In addition to this legislation, other federal Acts have been used to enforce government policies in the cultural area. Furthermore, most provinces have regulations affecting advertising in the media. Several agencies and departments of the federal government as well as provincial governments are also involved in various forms of aid to cultural industries. The range of policy actions at both levels of government which could be perceived by other countries as impediments include the following:

- CRTC regulations on Canadian content, advertising and services offered by cabletelevision companies.
- Sections of the Income Tax Act regarding advertising in foreign media.
- FIRA decisions and criteria.
- Canadian cable T.V. immunity from copyright liability.
- The Canadian Film Development Corporation (C.F.D.C.).
- The Capital Cost Allowance for the Canadian film industry.

Each can be defended on various grounds.

(d) Impediments to Canadian Exports

The sales of Canadian cultural services and the entry of Canadian firms into markets abroad are limited in many markets. In the United States, there are restrictions on foreign ownership in broadcasting, and most developed countries have regulations affecting trade in cultural services. In this regard, the Canadian film sector would encounter the same type of restrictions as do American films (described in OECD Document TIR(82)1, a submission by the U.S.).

Furthermore, the Canadian film and television production industry has yet to establish a solid international demand and the necessary distribution system for its product. In film and sound recording sizable portions of the market are controlled by the same major foreign-owned producers/distributors active in Canada and more interested in selling American production. These are not impediments in themselves, but they are factors which affect Canada's cultural trade in a negative manner.

10. Tourism

(i) Structure

Tourism is not an industry which is easily defined or measured. It is a bundle of services encompassing components of a large number of service sectors which are utilized simultaneously by both Canadians and foreigners. A variety of information procedures have had to be devised to separate out and estimate the volume of tourism.

Tourism is described as Canada's largest single employer, providing in 1981 jobs either directly or indirectly for over one million people - 9.8% of the work force. The industry generates some $14.8 billion (1980) or 5% of GNP. There are over 100,000 inter-related businesses, usually small, but the sector also includes large accommodation and transportation companies. Tourism is highly labour-intensive, but at the same time its transportation, accommodation and food service industries are highly capitalized. Most of the demand for the Canadian product is generated by Canadians. In 1981 72% of travel expenditures by Canadians were expended in Canada, compared with 68% in 1978.

Both federal and provincial governments are actively involved with tourism. Through Federal/Provincial consultations, a National Tourist Plan is being developed which will address issues of structure and economic performance in the industry.

(ii) Trade

To analyse tourism in the context of trade, one needs to reverse normal perspectives. Exports are considered to be the foreigners coming to Canada, imports are Canadians going abroad.

In global terms, tourism is one of the world's fastest growing industries, although recent economies have slowed this growth to a considerable extent. Through the 1970s, the competitive position of Canada has been constantly eroded. In receipts, Canada ranked sixth in the world in 1965 and ninth in 1980. In payments, Canada ranked fifth in 1965 and third in 1980. From 1962 to 1974, Canada enjoyed a favorable balance with the U.S. After that year, the balance became negative and expanded rapidly. Americans are coming to Canada in ever-decreasing numbers, but with some signs in 1981 suggesting that this U.S. decline is bottoming out. Growth from the U.S. market in the medium term is likely to be negligible and should remain at approximately 14% of the total tourist market. Other markets are more promising, accounting for 8.3% of the tourism market in 1980. Visitors from other countries showed an annual growth rate of 13% through the 1970s, with some decline in the 1980s due to increased world wide energy costs, inflation and negative economic developments.

...../60

As for Canadian tourist destinations, the U.S. received 65.7% of Canadian expenditures abroad in 1980. The U.K. (7.3%) and France (2.9%) rank second and third. Thereafter there is a wide variety of destinations and favoured sun spots.

Balance of payments figures show Canadian travel receipts reached $3.8 billion in 1981 and payments amounted to $4.9 billion in the same year. Historically, the early 1970s were not so significantly in deficit. In 1971, for example, the deficit in this account was only $0.2 billion. It widened substantially however, until a deficit peak (of $1.7 billion) was reached in 1978. Since then, the travel deficit has improved substantially and has been hovering close to the $1.1 billion mark. The value of the dollar is a key factor. As the dollar moves up or down in relation to other currencies, Canadians feel more or less inclined to travel abroad, and foreigners coming to Canada receive less or more value from Canadian tourist facilities. World energy costs, inflation and world economic conditions also play a major role.

(iii) Legislation, Policies & Regulations of Governments in Canada

Canada imposes few if any restrictions on its nationals travelling abroad. Passports are normally easily obtainable, no exit visas are required, no currency restrictions are imposed, and provision is made for duty free importation of a certain amount of goods purchased by Canadians while out of the country (while of course the amount of goods subject to the duty free allowance by Canada and other countries could be proposed for negotiations, such negotiations would be over goods, not services).

(iv) Impediments to Canadian Exports

There are some impediments to international tourism in general. The OECD Tourism Committee is actively involved in developing an inventory of obstacles to tourism and will be submitting a report in 1982. Preliminary identification of impediments reveals obstacles which affect the individual intending to travel, companies providing services to facilitate travel, companies providing transportation, and companies providing reception facilities.

There are some restrictions on some nationalities in their ability to exit their country. In some countries, obtaining an exit visa is very difficult. For most "western" developed countries, restrictions tend to be minimal. But there are currency restrictions in some countries, some customs allowance restrictions which discourage tourist expenditure abroad, and a variety of specific legislation established for other purposes but which can discourage persons from travelling abroad. Canadian requirements for obtaining a visitor's visa, or "inflexible" border formalities at Canadian ports of entry, can also act as deterrents.

...../61

Businesses in the tourist industry often encounter restrictions which affect their right of establishment or the way in which they are permitted to do business. Impediments such as restrictions on the ability of Canadian companies abroad to solicit for customers can be a serious obstacle in facilitating travel to and within Canada. A case in point are those companies providing transportation. A special problem is limitations on access to reservation systems, where, for example, Air Canada flights are not part of the reservation systems of most European networks. Consequently, travelling Europeans are not given the knowledge necessary to choose an Air Canada flight even if it were the most convenient.

In essence no surface impediments between the U.S. and Canada exist. State and provincial licensing fees and regulations on motor vehicles can be awkward but are not at present applied in a discriminatory way.

Other restrictions can be found in legislation on business practice for companies which provide facilities such as hotels, resorts, car hire firms, etc. These relate mostly to right of establishment parameters, currency restrictions, imports of essential goods, or placing of contracts (e.g. see consulting engineers).

It is recognized that activity by Governments, in cooperation with industry, to increase the flow of tourists to Canada could have significant and positive effects on the total economy given the size and nature of the tourist industry.

11. Other Service Sectors

As already indicated, the scope of this report has been limited by the lack of information in certain cases about the Canadian situation. An example is franchising, a sector on which the U.S. has considerable information and which they might identify as a topic for negotiations. While some work was done for the Task Force, Canada is unprepared at the present time to discuss this matter: very little is known about franchising, especially of the relationship between trade and its impact on Canada's interests.

Another surface which was barely scratched relates to fisheries services. Canada has a crew exchange/ship repair policy under which the Department of Fisheries and Oceans (DFO) has negotiated arrangements with several foreign countries providing for crew transfers for foreign fishing vessels only as part of a ship repair programme in Canadian ports. Similar efforts are underway in regard to use of domestic Canadian air carriers.

A third factor involves the issue of including in negotiations those service industries which trade in goods. The distributive trades (wholesalers, brokers, retailers, etc.) are major players in international trade but it is commodities rather than services which are traded.

The service sectors covered in the ten parts above are to be considered only a first approximation of where Canada's interests would lie should trade in services become a topic of international negotiations. Many service sectors have not been covered, although during the course of the Task Force's existence it became evident that any further preparatory work would have to cast its net wider than has been done here. Establishment of contact points within the Government would help industry and business to direct their views more effectively.

E. HORIZONTAL ISSUES

1. Government Procurement

(i) Status of Government Procurement

Government procurement on services has seen rapid growth during the 1970s. By 1980, federal purchases of services exceeded those of goods (figures extrapolated from DSS contracts only). Provincial expenditures show a more rapid rate of increase on services, but still proportionately less on services than on goods.

Other OECD countries which have mature economies also show a high proportion of total government expenditures on services, with differences based on policy orientation and economic structure. Less mature OECD areas and Newly Industrializing Countries still have majority expenditures on goods with a rapidly increasing service component; Developing Countries have a small service expenditures pattern. Worldwide, government procurement provides substantial amounts of services business; for some sectors it provides the bulk of biddable contracts. In other sectors, various countries have established internal government arrangements to perform the service functions (e.g. self-insurance) or have established monopolies which preclude the possibility of trade (e.g. national telecommunications systems).

Government uses procurement for any number of purposes. It is always seen as a major job creation mechanism. Canadian experience shows 76 jobs created for every $1.0 million spent in service procurement. It is also used to direct and stimulate R&D, maintain competitive advantage in certain sectors, advance control over technology, and overall to maximize the wellbeing of the country.

(ii) Trade Impediments

Any discussion on trade impediments revolves around the size of the market available for bidding at international levels or the ease with which bids can be won. All governments have certain sectors which are under government jurisdiction and thus the market size is reduced. Certain service sectors (e.g. health, education, telecommunications) are part of the government domain in many countries, or governments have allowed only specialized niches to develop for private enterprise. When the market is zero or severely limited in size due to public ownership, then the services function is thought to be neither tradeable nor part of a government procurement exercise. That different governments have different sectors under their jurisdiction indicates - at least theoretically - that negotiations could open up these markets to international competition.

Where the market is open to competition, then trade impediments can occur which would direct demand to local firms and limit or

...../64

eliminate competition from foreign entities. Every country has established legislation, policies, regulations and practices which direct government procurement to domestic suppliers of the service, but each sector and country is different in both the degree and extent to which domestic firms are favoured.

Some countries have legislated that certain types of expenditures are exclusively the domain of national firms. Countries with "open markets" in some sectors often grant a preferential margin (as a percentage of the price) on the overall value of contracts. Other forms of impediments include lack of transparency, limited and unreasonable time frames in which to bid, attitudes and practices which effectively direct contracts to local firms, peculiarities in specifications, etc.

In LDCs, there is a wide variance in legislative restrictions but in general the LDCs are still learning how to utilise government procurement as a tool to achieve particular governmental objectives. There is a tendency to set conditions contract by contract depending on the sector and the degree to which countries want financing, job creation or technology transfer. The trend in LDCs is towards greater restriction, with the rate of progress in government restrictions being often determined by a lack of resources rather than a lack of will to intervene in support of domestic industries. Thus for certain markets in the NIC's, government procurement is almost completely closed.

Where contracts flow through international funding bodies such as the World Bank or the regional banks, there does seem to be an internationally competitive market. For Canadian companies, these agencies are very often the preferred routes to obtain business in LDC's as most of the trade impediments imposed on normal government procurement disappear or are substantially reduced.

(iii) GATT Code on Government Procurement

The Code, which came into force January 1st 1981, establishes the principles of non-discrimination and national treatment as between domestic producers and suppliers of other participating countries, with respect to laws, procedures and practices regarding government procurement by specified entities. Services are covered only to the extent that they are incidental to the supply of products and cost less than the products themselves. Even with regard to goods sales, the Code contains various derogations. Article IX:6(G) provides that, no later than the end of the third year, i.e. December 31, 1983, and periodically thereafter, the parties will undertake negotiations with a view to broadening and improving the Code; services will likely be discussed for possible inclusion in their own right in the first round of discussions.

Preliminary reports on the application of the Agreement as it currently exists indicate that signatories are moving to enhance transparency and open up procurement to foreign bidders in those restricted areas covered by the code. To a certain extent, this exposes other trade distortions to greater scrutiny and highlights the extensive lack of competition which still exists.

2. Investment, "Right" of Establishment

(i) Introduction

Services industries, particularly those in the financial sector, such as banking and insurance, frequently require or prefer to conduct foreign business through permanent establishments abroad. Restrictions on the establishment of a new operation or on the purchase of an existing one in whole or in part have been identified as important issues in the OECD sectoral studies. In a number of cases it is only after establishment has been effected that other impediments have any relevance. Canada as well as other countries maintains legislation which qualifies the ability of foreign companies to invest or establish permanent operations.

(ii) International Instruments

It appears that no international instrument provides for right of estabishment. Neither multilateral instrument that has been developed within the OECD relating to internatonal investment (the binding OECD Code on Liberalization of Capital Movements, to which Canada is not a party and the non-binding 1976 Declaration on International Investment and Multinational Enterprises) relates to right of establishment. OECD legal opinion is that the Capital Movements Code does not provide for right of establishment in the sense of the right of entry. The 1976 Declaration and guidelines explicitly states, under the section on national treatment, that it does not deal with the right of member countries to regulate the entry of foreign investment or the conditions of establishment of foreign enterprises. In addition, the OECD guidelines clearly state that every state has the right to prescribe the conditions under which MNEs operate within its national jurisdiction, subject to international law and to the international agreements to which it has subscribed. The entities of a MNE located in various countries are subject to the laws of these countries. In discussions within the UN on a Code of Conduct on Transnational Corporations, all participants in the negotiations agreed that the right of establishment is a sovereign right and not subject to customary international law or constraint.

...../66

(iii) Canadian Legislation

In Canada, both the federal and provincial governments have legislation and policies which qualify foreign investment/right of establishment. The major piece of federal legislation is the Foreign Investment Review Act which applies to the acquisition of control of a Canadian business by foreign investors and to the establishment of a new unrelated business in Canada by foreign investors or by foreign investors who have an existing business. An application is allowed if it is of significant benefit to Canada. One criterion of the Act is that account be taken of federal and provincial industrial and economic policies.

Sector-specific legislation includes the Canada Oil and Gas Act, under which proposals by oil companies seeking exploration and production rights in "Canada Lands" are scrutinized for industrial benefits to Canada. In the financial sector, legislation relating to banks, insurance companies, loan companies, trust companies and sales finance companies reflects the broad government policy of maintaining Canadian control of financial institutions. Legislation in the cultural sector is designed to ensure a strong Canadian presence and includes, among others, the Broadcasting Act which generally limits the granting of a licence to operate a broadcasting station to a Canadian citizen. There is also federal legislation in a number of other areas, such as air transport. Provinces have legislation on financial services which limits foreign participation in areas such as trust companies and collection agencies as well as in real estate services, security agencies and liquor distribution. Provinces also control professional accreditation, e.g. of architects, doctors and engineers.

(iv) Foreign Investment in Canada's Service Industry

The level of foreign control in Canada's non-financial services industry in 1978, based on assets, was about 12.5%. The services industry, which for this purpose included construction, utilities, wholesale trade, retail trade and personal and business services, had total assets of about $190 billion in 1978, of which foreign companies controlled about $24 billion. Foreign control is more significant in specific segments, e.g. highway and bridge construction, truck transport, pipelines, telephones, and other communications, gas distribution, wholesale trade in energy products, retail trade for some manufactured products, etc. Foreign control in a number of segments is limited because of the participation and dominance of agents of both the federal and provincial governments: e.g. Ontario Hydro and Hydro Quebec in the public utilities industry; Air Canada, Canadian National and municipally controlled transit networks in transportation. Other services, such as education and health, are also largely in the public sector.

Foreign participation in the financial sector has been limited by the federal and provincial legislative and regulatory structure. Until the December 1980 revision of the Bank Act, foreign banks were not allowed to operate in Canada as banks. Foreign control is relatively significant in sales finance, consumer loans, and other credit agencies. While foreign control in the securities industry was about 10% in 1978, regulation in several provinces affects further foreign penetration.

(v) Canadian Direct Investment Abroad in Services

As well as being a host country for international investment Canada also has interests as an investor abroad. In 1978 (the most recent year for which such data is available from Statistics Canada) Canadian direct investment abroad in the services industry represented 28% of total Canadian investment abroad, or $4,633 million, broken into merchandising (13.2%), utilities (43.4%), financial (37%) and other (6.4%). About 41% of this investment was in the U.S., about 5% in the U.K., and about 30% in South and Central America. On a sectoral basis, utilities and other services investment grew at a less than average rate (6% compared to the average of 10%) over the period 1970-1978, while financial services investment grew at a faster (19%) pace than average. A number (13%) of Canadian enterprises with investment abroad are non-resident owned to a significant degree.

(vi) Foreign Legislation

Canadian services companies which desire to set up an establishment abroad or to purchase, in whole or in part, an existing foreign services company face a variety of impediments. In the important U.S. market, while there is no formal investment review mechanism, Canadian investors may face scrutiny and opposition of various types from business, Congress and administration sources. There are prohibitions or restrictions on foreign investment in inter-coastal shipping, radio, telegraph and television, domestic air travel, dredging or salvage, mining, and communications satellites. In addition, U.S. defence regulations can prohibit foreign investment in any service sector which otherwise would not be subject to any regulation. In Western Europe, there are significant impediments to investment in French services industries. Prior authorization is required from the Ministry of Economics and restrictions are based on a "detriment to France" criterion. There is, in the U.K., an unwritten rule that takeovers in any sensitive or key service sector will not be permitted and there are particular restrictions on films, air transport and broadcasting. In Japan the climate is generally restrictive. Foreign investment must be approved by the Bank of Japan, the Department of Finance and the relevant sectoral department. Specific restrictions apply to foreign ownership in agriculture, forestry and fisheries, mining, oil and leather.

There are many restrictions in developing countries, designed usually to foster infant industries. These include the takeover of existing investment, forced localization of existing establishments, restrictions on the type of establishment permitted, local partnership, technology transfer and outright prohibition. The range and severity of restrictions vary. Singapore and Hong Kong provide virtually free access. Others, such as Brazil and Mexico, employ a broad range of barriers. Many of these affect financial institutions, especially banking and insurance, e.g. the area of operation and entry of foreign banks is restricted and marine insurance must often be taken out in the country of importation.

(vii) Canadian Policy Considerations

A number of new arrangements, not mutually exclusive, could be envisaged to deal with investment questions in the service industries. Any Canadian initiatives in this area, however, would need to be based on broader consideration of Canadian interests than just those in the service sector.

In principle Canada, as a liberal capitalist country, favours an international trading and investment environment as free of impediments as possible. But the extremely high levels of foreign control of some vital sectors mean that Canada is unwilling to commit itself unconditionally to instruments which, whether or not binding, require us not to impede the right of establishment of foreign inward direct investment or to grant national treatment to foreign firms already established in Canada. The service industries present particular problems because many of them are sectors of vital economic or cultural significance where it is considered essential to maintain or obtain majority Canadian ownership.

3. Financing and Other Assistance for Services Exports

(i) Introduction

Canada has a variety of measures to provide financial assistance to exporters of goods and/or services, including those offered through the Export Development Corporation and the Canadian International Development Agency. Canadian companies which met with the Task Force expressed general satisfaction with the kinds of programs available although it was felt that greater flexibility might be injected to deal with services exporters' needs and that the programs should be given greater publicity. Concern was expressed over the export subsidy practices of a number of developed countries as well as the more advanced developing countries. In addition it is felt that there are inadequacies in Canada's tax treaty network and in respect of the tax treatment of individuals' income earned overseas, which place Canadian companies at a disadvantage.

...../69

(ii) Canadian Financing for Services Exports

The Export Development Corporation provides a variety of financial services to Canadian exporters and foreign buyers in order to facilitate and develop export trade. It does this through a wide range of insurance, guarantee and loan services not normally provided by the private sector. EDC has traditionally supported Canadian services exports with export financing on the basis of their association with the sale of large integrated packages of capital goods and services. Since early 1980, the Corporation has been prepared to provide greater direct loan assistance in respect of certain specific types of services exports, i.e. engineering and consulting studies and services, feasibility studies, and management or other consulting services. Previously, these services had been eligible for insurance but were not normally considered for direct loan assistance. In addition to its financing facilities, EDC provides a wide range of insurance and guarantee services in support of Canadian exports. Almost any kind of transaction involving the export of goods, services or technology may be insured against a variety of credit and political risks beyond the control of the exporter.

EDC has recently undertaken a number of initiatives in the provision of more effective parallel financing with international lending agencies. EDC continues to offer parallel financing with CIDA, as a preferred approach to crédit-mixte financing and the two organizations are currently working further to improve co-ordination in arranging timely lending packages. A crédit-mixte program can be made available as a defensive mechanism if it is needed to counteract crédit-mixte financing being offered by other countries. It is not a mechanism to provide low cost financing across the board.

The Cost Recoverable Technical Assistance Program is a federal program designed to improve Canada's performance in exporting goods and services by providing government expertise on a cost recoverable basis to Canadian firms and to developing countries. The type of technical assistance made available is generally compatible with Canadian supply capabilities in order to maximize the possibility of developing exports. This is particularly relevant for countries with similar geographic or resource characteristics to Canada. Foreign customer countries or Canadian firms pay, in advance, agreed amounts to defray the costs of technical assistance.

The Program for Export Market Development (PEMD) helps Canadian businesses develop, increase and sustain exports through recoverable cost-sharing arrangements in specific marketing efforts. PEMD shares the cost of bidding on specific projects anywhere outside Canada, helps companies undertake market identification trips to potential markets, helps companies to participate in trade fairs and industrial exhibitions outside Canada, and encourages Canadian manufacturers to make co-operative arrangements for the development of joint export

...../70

sales by forming export consortia. Companies whose efforts are successful are required to repay the Crown contribution.

While the primary objective of Canada's program of aid to developing countries, carried out by CIDA, is to assist in their economic and social development, expenditures in this area ($1.24 billion in 1980/81) affect Canadian exports directly or indirectly. CIDA's bilateral, multilateral and industrial co-operation programs are relevant. Under the bilateral program, the Agency disbursed $582 million in 1980/81, of which 80 percent was "tied" to the purchase of Canadian goods and services and which took the form of grants or highly concessional loans. Canadian contributions to international agencies, such as the World Bank and the United Nations Development Program which are made under the multilateral program are not "tied" to Canadian exports. The procurement benefits of the funds expended by these organizations generally go to those exporters who are most aggressive in international bidding; Canadian performance has not generally been very strong. The Industrial Co-operation Program was recently established to encourage the involvement of the Canadian private sector in developing countries. Under this program, the Canadian Project Preparation Facility assists Canadian consultants in pre-feasibility studies of projects which will accelerate developing country industrialization. The Canadian Technology Transfer Facility assists in testing and adapting Canadian technology to developing country needs.

Canadian consultants can also take advantage of "tied" technical assistance funds established by Canada at certain International Financial Institutions, e.g. the Asian Development Bank has a Technical Assistance Special Fund, to which Canada contributed $2.25 million in November 1981 for a three year period. These funds provide for Canadian assistance in project preparation, feasibility studies, managerial and administrative advice, and other services.

(iii) International Arrangements at the Intergovernmental Level

Th OECD Arrangement on Guidelines for Officially Supported Export Credits regulates the use of export credits with a repayment term of two years or more. The definition of coverage thus focuses exclusively on medium and long term credits rather than export credits supporting sales relating to specific industrial sectors and economic activities. The Arrangement explicitly lists industrial sectors (Aircraft, nuclear power plants, military and agricultural products) which are covered under separate understandings.

There was a discussion in late 1981 as to whether the Arrangement applies to services. It was decided that it applies both to "pure" services as well as services related to exports of goods.

...../71

The Export Credit Arrangement is an agreement among OECD countries. Other countries, such as Korea, Israel and Brazil, some of which are major exporters of services, are not bound by its guidelines.

4. Taxation

Services exporters frequently complained to the Task Force of problems with Canada's tax system. The major difficulties were with the Overseas Employment Income Deduction and the tax treaty network. These were felt to be at least as much Canadian problems as foreign impediments. More generally these companies felt that the tax system is less favourable to them than it is to manufacturers. Services companies do not benefit from the reductions in the rate of tax available to manufacturers, nor are they in a position to benefit from various accelerated depreciation provisions on machinery and equipment.

(i) The Overseas Employment Income Deduction

Services exporters maintain that Canada's taxation of individuals' overseas income is less favourable than that of our competitors, creating higher labour costs for services exporters and making them less competitive. A number of companies claim to have, at least in part due to Canada's tax laws, hired citizens of the U.K. or the U.S.A., to work on their contracts abroad. Taxation of personal income earned abroad is particularly important to the overall competitiveness of services exporters. Many, such as consulting and engineering companies, are labour intensive, and a significant portion of work on a foreign contract is often done by Canadians posted abroad.

The size of the Canadian deduction is smaller than that of a number of our competitors. Canadians temporarily employed abroad remain "residents" and are taxable on their worldwide income, although there is a partial exemption available to those employed abroad for longer than 6 months. Under this exemption, individuals may deduct from income for tax purposes a maximum of $50,000. i.e. the lesser of $50,000. times the fraction of the year spent abroad OR 50% of income and allowances attributable to overseas employment. The United States as of January 1st, 1982, provides an exemption from tax of U.S. $75,000. of income which is being increased to U.S. $90,000. by 1986. France permits total exemption of foreign income from income tax, with no limit, if tax in the country of employment is 2/3 of the French rate, or an individual is abroad more than 183 days in a 12-month period. In the case of the United Kingdom, an employee working abroad for at least one year is not subject to taxation of income and allowances earned abroad.

In addition to the relative size of the Canadian exemption it was pointed out that the exemption does not cover all services activities which Canadian companies engage in abroad. For example, management consultant services are not included. There are also difficulties in the operation of the exemption which may cause cash flow problems to employers who are required to continue deducting Canadian tax from employees and compensating them for foreign taxes paid subject to later reimbursement.

(ii) Tax Treaties

Many companies maintained that Canada's network of tax treaties is inadequate and that they encounter serious problems in countries where Canada does not have a treaty. While Canada has 32 tax treaties and is in the process of negotiating treaties with some 30 other countries it is not expected that the Canadian network will be as large as that of some of our competitors for several years. Most of the countries where we do not have a treaty are developing countries. This is an area where it is expected that there will be significant future opportunities for Canadian services companies. In some cases these countries were not interested in negotiating a treaty when approached by Canada, as they do not wish to agree to a possible reduction in their tax revenue which could result from the implementation of a tax treaty, at least in the short term.

The specific problems which have arisen due to the above include high rates of withholding taxes and cases where both Canada and the foreign jurisdiction claim the same income as being domestically sourced and subject to their tax. In addition developing countries may use a complex variety of different taxes to capture income from foreign companies. Not all of these may be acceptable as tax credits in Canada. A deduction from income is permitted in this case. Linkages have also been established between tax and non-tax questions and payments withheld pending the resolution of tax problems. Representation from a number of services exporters concerning the above topics are under consideration by the Department of Finance.

5. Immigration

(i) Introduction

Many services are labour intensive particularly in the consulting field and exporters have to send Canadian personnel to the importing market in order to provide their service, whether the export is undertaken on a "cross border" or an "establishment" basis. Immigration policies can therefore be an impediment to trade in services. There is a large flow of services companies' employees across the Canada/U.S. border and visa issues have arisen both in this connection and *vis-à-vis* third countries.

In the course of our consultations with industry a number of companies indicated that foreign immigration policies can be serious impediments to their "exports" of services. In many cases, companies have had problems with U.S. immigration authorities requiring pre-authorization for business trips to the U.S. After a company has established a U.S. subsidiary, however, such problems tend to disappear. This practice leads to speculation that U.S. immigration policy is used as a mechanism to encourage Canadian exporters to set up permanent offices in the U.S. It would appear to be the case that enforcement may vary according to economic circumstances. It has also been contended that Canadian immigration policy is basically similar to the U.S. but is not enforced as strongly.

(ii) Canadian Legislation and Policy

Canadian policy regarding the admission of foreign workers for employment, in general, permits the entry of such persons only in those instances where it can be determined that no qualified citizen or permanent resident is available and willing to take the employment in question. This reflects our desire to ensure that, to every possible extent, job opportunities are protected for Canadians. We are also concerned that Canadians, whatever their occupation, should have the chance to obtain the experience necessary to progress in their fields. This objective cannot be realized if foreign workers are consistently admitted for the more senior positions.

When an employer wishes to recruit a foreign worker, he must first contact the local Canada Employment Centre (CEC) in order to complete a formal job offer. The validation of this job offer by a CEC certifies that the employment in question cannot be filled by a Canadian or permanent resident of this country. This procedure is followed in all immigrant applications, including those in the managerial and executive positions.

Notwithstanding the above, when the present Immigration Regulations were enacted, a small number of temporary foreign workers were given an exemption from the need for CEC validation when reciprocal arrangements existed with other countries, the entry of foreign workers created additional employment opportunities for Canadians, or in situations where Canadians were not adversely affected by the entry of foreigners. In cases of reciprocal arrangements with the United States, as with other countries, the objective is to afford greater reciprocal opportunities for Canadian citizens and permanent residents to take temporary employment abroad for the purpose of gaining international experience, taking advantage of seasonal opportunities, or pursuing occupations of a multi-national character.

CEIC has on file a number of recognized agreements between Canada and the United States, covering certain specific technical programme needs:

...../74

Employment and Immigration Canada (CEIC) does not agree with the comment that Canada does not enforce its policy as strongly as the United States does. It is obvious that in specific areas of the labour market, for instance presently the field of specialized engineer and computer personnel, Americans have the knowledge required to perform skills which cannot be met from within the country and therefore CEIC must validate job offers to enable Canadian employers to meet skill needs. There are also instances where the skill is available in Canada but not anywhere near the locality where the services are required. In those instances, we would have to agree to the use of American or other foreign manpower resources.

In connection with the above, it should be noted that statistics available to CEIC show that there has been a progressive percentage increase in the last two years in the total number of employment authorizations issued with a Canada employment clearance. While in 1980 only 38% or 42,551 employment authorizations were issued with a C.E.C. clearance, in 1981, more than 42% or 53,832 employment authorizations were issued in the same category. The figure for the first quarter of 1982 is even more positive and shows that 49% or 11,538 of all employment authorizations were granted with a C.E.C. clearance. These statistics suggest that CEIC has been increasingly restricting the intake of selected workers in these times of low employment in this country.

6. Canadian Import Regime As It Affects Services

(i) Introduction

As indicated in the section on the GATT and Services, GATT provisions at present cover a certain range of services. Canadian import legislation, i.e. the tariff, valuation and non-tariff measures, deals with services to various degrees.

(ii) Customs Tariff and Valuation Provisions

Although the main objective of the Canadian tariff is to provide protection to manufacturers of goods, it also has the effect of providing tariff protection to services that are embodied in goods or on goods which are necessary to transfer services, e.g. telecommunications equipment. The impact of the tariff on services depends on the dutiable status of the good as well as on the way in which the good is valued for payment of duty. In a number of cases, for various policy considerations, the tariff has been removed, e.g. duty-free entry as in the case of many books. However most goods which incorporate services are dutiable at varying rates. The value established on which duty is paid generally includes the value of services incorporated in the good. Two of the exceptions to this rule are worth noting. In the case of computer software, tariff protection is not accorded to the service embodied in the good as the value established for payment of duty is limited to the value of the physical medium. More generally the Canadian valuation base for all imported goods does not include the value of the international transportation of the goods to Canada.

(iii) Non-Tariff Measures

There is little experience in regard to the possible use of non-tariff measures to deal with "unfairly" traded services. Indeed, there is no specific provision at present in Canadian import legislation in this area, although there is a proposal in the Discussion Paper on Import Policy Proposals to authorize, upon a reference from the Governor-in-Council, the investigation of a particular problem related to services imports. The proposal does not authorize the imposition of anti-dumping or countervailing duties on services as such, although it would allow their imposition on goods to compensate, where appropriate, for dumped or subsidized services; in view of the lack of experience with services trade issues, it is designed to elicit greater information on any problems which arise and provide a better basis on which to draft any specific provisions which might be needed. To date this proposal has not generated any significant degree of public discussion.

The knowledge available about unfairly traded services is mainly anecdotal and involves essentially services as adjuncts to traded goods. There is only vague knowledge of problems involving services alone or where the value of the service exceeds the value of the associated goods. Although engineers and other consultants do have fee schedules, in some respects the trade in services of engineering consultants, computer system consultants, etc., resembles the problems in dealing with capital goods: they are often one-time operations, unique in their design and application and "lumpy". These characteristics make it difficult to determine normal value as is required in anti-dumping and countervail procedures and also to use these procedures as effective protection to injured Canadian producers of such services, as services are generally based on contracts which are awarded and binding before any service actually crosses the border. It seems however that where problems might first arise in the future is in such areas as computer programs and advertising where services developed for the U.S. market can be sold with few modifications in Canada and thus result in a temptation to sell in Canada at marginal cost.

7. Services Classification and Data Availability

To delimit more precisely the extent of current knowledge of the field, the Task Force commissioned two statistical reports.

(i) Classification

The first study was of a possible classification system, prepared by Mr. Neil McKellar, a retired official of Statistics Canada and a classifications expert of international repute. Although many classification schemes cover goods production, no coherent system covering services has yet been agreed upon.

Of the three basic types of classification (by commodity, by industry, by activity), Mr. McKellar chose a commodity system. This avoided problems which might stem from the same service being produced by more than one industry, and from differing statistical treatment of the services producing enterprises in other countries. The McKellar classification includes a number of service activities that do not enter international trade much, since it is designed to cover all service production. In general, baskets of service commodities are avoided unless they are conceptually coherent and inherently distinguishable from other services; thus "health" and "education" service baskets are included, but "tourism" is not - it is the nationality of the consumer and not the nature of the service that distinguishes tourism from domestic travel expenditures.

The classification provides not only a hierarchical structure for the classification of services but also a set of definitions and a framework which would assist in collecting, organizing or tabulating, and presenting data on the production, distribution and consumption of services, including their importation and exportation. It would also assist in providing a consistent set of classes of services to be used in discussions or negotiations concerning services. To provide such a tool a classification structure must be complete to ensure that any type of service that is encountered can be accommodated and the classes of services at each level of the hierarchy must be mutually exclusive so that any type of service that is encountered can be fitted into one and only one of the classes.

The Sections (broadest groupings) of the classifications structure are:

Section 1 - Services Directly Related to People
Section 2 - Services for the Propagation and Care of Plants and Animals
Section 3 - Services Related to Land, Water, Air and Minerals
Section 4 - Services Related to Buildings and Other Fixed Assets
Section 5 - Services Related to the Manufacture and Marketing of Goods, Except Transportation Services
Section 6 - Transportation Services
Section 7 - Services Related to Records and Information
Section 9 - Services of General Application

To complete the structure the above eight sections were subdivided into forty-four Divisions which, in turn, were further subdivided into one hundred and fifteen Groups. Finally, an alphabetical index provides a detailed list of services, with code numbers, to assist in the use of the classification, as well as of data obtained through its use.

(ii) Data Availability

The second statistical report was an analysis by Mr. Randall Geehan (a former Statistics Canada official who is now a professor at Carleton) of current data in the light of the McKellar classification system. He took the figures available for 1977 (which include the most recent published results of the quadrennial survey) and fitted them to the new system. Having regard for the fact that they were not collected within any particular framework (save, generally, the Balance of Payments), a fairly good fit was made between the available and the desirable. Indeed, Mr. Geehan concluded that the results demonstrated the feasibility of classifying service exports and imports according to the system developed by McKellar. As shown in the reconciliation table at the end of the Geehan report, the one major component of the Balance of Payments service account which could not be readily allocated was the large non-fare component of travel receipts and payments. Apart from this, only about 10% of services could not be classified, at least approximately.

In addition, Mr. Geehan compared British and American data and found current Canadian statistics, although susceptible of improvement, to be at least as good, if not better - in terms of available detail and reliability of the estimates.

The report, however, brings out that two major kinds of problems remain. First, existing data have not been collected with the classification of services in mind and therefore the allocations made in the report are sometimes "forced" and components which should be split out cannot be, owing to lack of detailed data. Second, there are quite a number of significant gaps in the data which it would be desirable to see filled. It is also important to note that, as a particular matter, the implementation of the classification of services can only be done if some classes are aggregated to the two- or even one-digit level, as has been done in the Geehan report. (But some services are not very important in international trade and it would constitute a misuse of resources to attempt greatly improved data quality in such areas.)

The areas where much greater disaggregation of current data would be more useful include travel receipts and expenditures (since the basket item does not, as noted above, appear in the McKellar commodity-based classification), financial and insurance services (fees, commissions, etc.), education, and various consultancy and business activities. In addition, disaggregation by trading partner would be very useful.

(iii) Follow-up

The Tas orce believes the whole area of services classification and data collection should be a priority for attention of a future services focal point in Ottawa; and that steps should be taken to provide essential additional resources to Statistics Canada in order to ensure early and adequate arrangements be made in this regard.

8. Services Policy Within Canada

As already noted, the Task Force was not directed to study domestic policy and programs. And although the mandate does contain some words on interprovincial services trade, the Task Force has had to make the international scene the main focus of its work, in view of developments and pressures from that quarter.

In the course of the work of the Task Force, however, notably including the travel to provincial capitals and other major Canadian cities, some respondents both provincial and business were as interested in talking about matters Canadian as about international negotiations. There was a feeling that, while international negotiations may be long and uncertain, developments within this country are matters we should be able to influence. A summary of (mainly business) views heard is set out below.

(i) There was sometimes a sense that services, as compared to mining or energy or high technology or manufacturing, are overlooked. This view was voiced mainly by a range of consultants, rather than e.g. financial services representatives.

(ii) There was praise for several export assistance programs (e.g. PEMD) but a view that they do not always cover services adequately, or publicize the fact that they do cover services. For some it was not so much a matter of seeking large sums of money as of ensuring that services are covered as adequately as goods are already.

(iii) A number of interlocutors did go on to argue that their key competitors in Europe, Japan and certain NICs received highly subsidized support from their governments and that we should be prepared to match that assistance. The other way to tackle this problem, of course, would be to try to negotiate an understanding among governments to limit such practices.

(iv) Many respondents commented on problems caused either by the absence of or gaps in our tax treaties with other countries; or by the Overseas Employment Income Deduction issue under which it appears employees abroad of Canadian firms have a less advantageous position than they had earlier or than nationals of other countries have now (see Chapter E.4.).

(v) Interprovincial barriers to services trade came in for some criticism. These apply for example to government procurement of services; to operations in other provinces by professionals whose services are regulated at provincial level (e.g. lawyers, engineers etc.); and in other respects. The fear was expressed that governments may be working at cross purposes.

(vi) Although it must be pointed out that one or two members of the private sector expressed some concern at the thought of Government becoming involved in another area, quite a number of the Task Force's interlocutors appeared to favour a look at the domestic situation regarding services, including consideration of policies and programmes by governments. (As mentioned in Chapter C.4., work commissioned by Task Force suggested that a strengthening of services exports could have positive economic development and employment benefits within Canada.)

(vii) Some provinces have expressed their desire to have arrangements put in place for federal/provincial discussion - and perhaps consultation and coordination - in the future.

F. INTERNATIONAL ASPECTS

1. Country Views

(i) The United States

Since services were included under the Trade Act of 1974, the United States has increasingly worked to promote domestic and international (government and non-government) study of trade in services and consideration of ways to overcome "impediments" to its expansion. The U.S. has a large surplus on "tradeable" services which, with its returns on investment capital, it uses to offset its $30 billion plus deficit in goods. (In fact, the 1980 U.S. surplus on "tradeable services" of U.S. $6.6 billion is roughly the same size as the overall U.S. current account surplus of $7.1 billion).

Various private level groups (including the American Chamber of Commerce, the Coalition of Services Industries and the Council on Foreign Relations) are active in the U.S. and American firms are an important element in the work of the International Chamber of Commerce and of the OECD's Business and Industry Advisory Committee.

In addition there are two committees providing for government/industry liaison and consultation. One is the Industry Sector Advisory Committee, for services, established under the 1974 Trade Act; it is at the level of Vice President/Corporate Affairs and is chaired jointly by the Office of the U.S. Trade Representative (USTR) and the Department of Commerce. The second is the President's Services Policy Advisory Committee, at the level of Chief Executive, chaired by USTR Brock.

The U.S. Administration has produced a series of studies, in consultation with business, on impediments to trade in services, including a comprehensive (if not entirely accurate) inventory of impediments by subsector and country. This is being revised and updated with a view to a GATT work programme. They have contributed a number of papers to the OECD work and are in the process of developing a general approach to negotiations for use in the OECD and the GATT (see also discussion in Parts 3 and 4 below).

A number of bills on services issues - including a Trade in Services bill - have been brought forward in Congress, some involving a unilateralist and dangerously narrow version of trade "reciprocity" aimed in part against Canadian interests. (USTR Brock has spoken out against such a version). As there is at present no generally effective multilateral instrument providing a fabric of international discipline on services, some in the U.S. may on their own try to create undesirable precedents for the treatment of services trade, and regarding the establishment of services firms abroad. Canada would be vulnerable to such actions. These bills also provide a clearer mandate to the USTR and Commerce to activate and strengthen their services policy and programmes.

The following table gives some indication of the sectors of U.S. interest in external services transactions. It must be read with considerable caution, however, because it has been constructed by its authors so as to include revenues from establishments abroad, not just services trade. The categories and figures accordingly do not compare with those used elsewhere in this Report. The figures are only for U.S. receipts.

TABLE SIX

Estimate of U.S. Stake in External Services Sector

1980 Foreign Revenues Generated By

	Billion U.S. $
Accounting	2
Advertising	2
Banking	9
Business, Professional & Technical Services	1
Construction & Engineering	5
Education	1¼
Employment	½
Franchising	1¼
Health	¼
Information	½
Insurance	6
Leasing	2
Lodging	4½
Motion Pictures	1
Tourism	4
Transportation	14
Total (approx)	$U.S. 55 billion

Source: Economic Consulting Services: "The International Operations of U.S. Services Industries: Current Data Collection and Analysis" June, 1981.

(ii) Other Developed Countries

Other developed countries are not as enthusiastic as the U.S. in wanting a multilateral, horizontal, well developed work programme and negotiating framework to be established. To a certain extent those with trade surpluses in the service sector such as Britain are perceived as generally supportive of work being done but in a prudent and deliberate fashion. Probably no country has done sufficient work to be as forceful in setting out their interests as the U.S. appears to be. There are also few signs to date that non-U.S. business generally is as keen on action as some of their American counterparts seem to be.

The British are perhaps as well prepared as any other country. A speech by the Trade minister in 1980 on services suggested a good deal of interest, since downplayed to some extent. They are, however, putting a work plan in place and may again become more vocal on the issue. Services are important to the UK balance of payments where, like the US, they have a surplus. A joint government industry advisory body - the Committee on Invisible Exports - has been studying the subject. It has recently been supplemented by the new Liberalisation of Trade in Services Committee (LOTIS), which includes representatives from banking, insurance, shipping and consultancy. LOTIS plans to make representations on what the British position should be in any international negotiations.

The French have doubts about the appeal of a broad multilateral approach to trade in services. They have started an extensive interministerial study on a sector by sector basis, to define where their national interests lie. Their official position thus far is to wait until an assessment of the Tokyo round is done before launching a new wave of liberalisation (e.g. in services). Germany has commissioned a major analysis of trade flows in the service sector which should be ready in mid-1983 and has adopted a fairly positive posture on the subject in the meantime. Denmark and Holland are also reported to be quite positive.

With regard to the E.C. as a whole, the Treaty of Rome set out four fundamental freedoms: free movement of goods, people, services and capital. Whereas the free movement of goods has been accomplished to a large extent, progress has been much more difficult in the other areas. The legislative, regulatory, and administrative provisions with respect to services remain largely the preserve of individual Member States. A "harmonizing" function is on-going but is a very slow, painstaking process. Thus, within the E.C. there has been considerable effort in the trade in services area albeit focussed inward and with few conclusions reached. The Community recognizes that it does have a substantial interest in the liberalization of services, provided it is in the right framework. In connection with the GATT Ministerial Meeting, the E.C. Commission has proposed to its members that the Community should declare itself in favour of the proposed programme of detailed studies due to take place over the next couple of years, in

...../83

order to be in a position to assess whether and how GATT disciplines could be extended to this area.

The European Free Trade Agreement countries have no specific initiatives planned, but have referred the trade in services question to their various capitals for consideration. Both Sweden and Switzerland have done some investigation on the subject and both have specific services agreements with the European Community. Switzerland for example has just initialled an agreement on non-life insurance with the EC, which enshrines the results of negotiations on such matters as establishment and other aspects of national treatment (an intriguing precedent in light of the discussion in Part 5 below).

Japan has reportedly adopted very recently a consensus position definitely favouring discussions, and possibly negotiations on trade in services, as part of the GATT work programme. They have however begun to do their detailed homework.

Other OECD countries are probably in the starting gate to assess their national priorities vis-à-vis services trade but so far as is known have devoted little or no resources to the question so far. Of course, OECD countries are involved in some international organisations such as the International Civil Aviation Organisation, the International Telecommunications Union and various U.N. bodies, all of which focus on certain aspects of trade in services.

Generally, the OECD countries feel comfortable that the trade in services thrust should begin within the OECD structure. The next two to three years may see an OECD consensus developing, or at least an extensive groundwork laid in investigation and analysis. At the same time OECD countries can be expected to support the U.S. desire for a GATT Ministerial decision on the establishment of a programme to investigate international trade in services.

(iii) Developing Countries

(a) Introduction

Developing countries play an important role in trade in services both as markets for services exports and - on the part of the NICs - as competitors in third countries. There is an increasingly diverse range of developing countries. The more advanced developing countries have become an important source of dynamism in the world econmy, while the low income countries, taken as a whole, are stagnating in the current world economic environment. Overall, although developing country markets are small relative to those in developed countries, there is often not a firmly established domestic services industry so that international competition is possible. In addition these markets are, in some cases, growing more rapidly than developed country markets. While a number of developing country markets are open to international competition, Canadian exporters face serious impediments in many others, both in terms of "establishment" as well as "cross border" trade. Efforts are being made to encourage the more advanced developing countries to assume more obligations in the international trading system.

(b) LDC Motives and Position

Apart from sovereignty and "anti-colonial" type considerations, a major motivation for developing countries raising impediments to imports of services is the desire to protect and foster "infant industries". In particular in the financial sector, the desire is to build and control the domestic capital market and to ensure that savings are channelled into favoured areas of the domestic economy. An additional measure is various controls on foreign exchange - though not necessarily so much a matter of discrimination against foreign imports as a control of the use of a scarce resource. Such controls may result in a prohibition on imports, in a particular sector or more broadly, and in the case of foreign enterprises established in the domestic market prevent dividends and royalties being repatriated to head office. Actions by developing countries may be taken either on an individual basis or as part of a regional (i.e. Andean Pact) or more broadly based group.

Assistance is often provided by international bodies. UNCTAD for example is active, inter alia, in assisting developing countries to develop their maritime transportation industries, insurance, reinsurance and marine insurance industries; and it appears that UNCTAD is looking more broadly into services from a developing country viewpoint. Developing countries are trying to co-operate among themselves through plans to further "Economic Co-operation among Developing Countries".

(c) Impediments

The impediments erected by developing countries affect most sectors of interest to Canada. It is worth noting however that impediments are often eliminated in cases where the funding is received from an international institution such as the World Bank or where official bilateral Canadian funding, e.g. through CIDA, is present.

Illustrative examples of restrictions in a number of major sectors follow. It is generally considered critical that financial institutions be owned and/or controlled by nationals or by the government. Consequently, banks are often nationalized or there are requirements of majority foreign ownership for new banks as well as established banks. If foreign banks are permitted to enter the country and operate, their activities are often limited, e.g. to servicing subsidiaries of multinational enterprises or foreign nationals. The insurance industry faces similar restrictions. Developing countries place particular emphasis on the marine insurance industry and often require that imports be insured in their market. In the area of transportation, the desire to build up a domestic capacity has resulted in requirements that a proportion of trade be carried by national vessels. To obtain construction and engineering contracts companies must often establish a subsidiary in the country involved frequently with a local partner and an obligation to transfer technology. In areas where there are local companies available, international competition may not be permitted. More generally many developing countries restrict foreign investment unless it conveys substantial local benefit; and many also have restrictions on the movement of people (visas) or requirements for the use of nationals.

The more advanced developing countries such as Mexico, Korea and Brazil not only maintain considerable restrictions on access to their markets but also are increasingly competing with developed countries for construction and engineering contracts. Such efforts are frequently highly subsidized.

Section 5(i) of this chapter outlines several categories of impediments, many of which are applied by LDCs.

Canadian companies which met with the Task Force placed considerable importance on developing country markets due to their dynamism and growth. In general they understand the motivations for the erection by LDCs of impediments to international trade - though they may not be happy with the results - and in some cases are prepared to work within the context of a reasonable set of restrictions, e.g. on the basis of a joint venture. These companies do wish to be able to continue operating in developing countries and would appreciate any negotiations that would facilitate that purpose and make it possible to continue remitting profits and head office expenses. Companies in the construction and engineering sectors are particularly concerned over the export subsidy practices of both developed and the more advanced developing countries and would like to see these countries brought under some discipline.

Any consideration of Canadian interests in services exports has to give an important place to the developing countries. These countries should be part of any international discussions on this topic. Canadian services exporters would benefit from acceptance by these countries of restrictions on their ability to impede international competition. There would also be considerable benefit if it were possible to negotiate an agreement with a number of countries to restrict export subsidies. Moreover, Canada shares some interest with the developing countries as "host countries" to foreign investment and their participation could be of assistance in ensuring a balanced consideration of investment and right of establishment questions.

...../86

2. Existing International Agreements

(i) Bilateral

Canada's bilateral trade relations are mainly governed by the multilateral General Agreement on Tariffs and Trade. For the United States, the EC and Japan - as with most of our other trading partners - the GATT regulates our bilateral trade. However, as is made clear in section 4 below, the GATT broadly does not cover services, which are thus generally exposed to unilateral steps by our trading partners.

There are, of course, bilateral agreements with many countries covering a variety of specific service sectors or issues. These include air agreements, double taxation agreements, cultural agreements, and a number of agreements relating to patents. Several rather more general economic cooperation agreements touch fairly extensively on services (e.g. with France, Iraq, Nigeria). The Agreement on Trade and Economic Cooperation between Canada and New Zealand, in force January 1, 1982, provides that the two countries should encourage and facilitate trade in services.

The Task Force files contain a lengthy compendium of bilateral agreements prepared for it by the Legal Bureau of the Department of External Affairs.

(ii) Multilateral

Canada is a party to the legally binding OECD Code of Liberalization of Current Invisibles Operations (Invisibles Code) approved in 1961 but is not party to the OECD Code of Liberalization of Capital Movements approved at the same time. All OECD members are parties to the Invisibles Code though Turkey has been "temporarily" exempted from the liberalization obligations since May 1962 though it is complying with certain provisions on a voluntary basis.

In summary, parties to the Invisibles Code undertake to eliminate restrictions on current invisible transactions and transfers subject to validly lodged reservations and derogations, public order and security provisions, and existing multilateral agreements. Annex A to the Code lists a number of transactions for which parties shall grant any authorization required subject to any reservations they may have lodged. These transactions include, among others, operations relating to contracting, intellectual property royalties, business travel, transport insurance, films, tourism, advertising by all media, and professional services. Annexes 1-4 to Annex A of the Code deal with Insurance, Air Transport, Travel and Films. Annex B of the Code lists reservations to the Code made by member states which have been accepted by the OECD Council.

...../87

The Invisibles Code also provides that where members are not bound by virtue of the provisions of the Code to grant authorizations in respect of current invisibles operations, they shall deal with applications in as liberal a manner as possible. As well members shall endeavour to extend the measures of liberalization to all members of the IMF and to their own overseas territories. No members shall discriminate as between other members in authorizing current invisible operations listed in Annex A to the Code and which are subject to any degree of liberalization. However, members of special customs or monetary systems may extend additional liberalization measures to one another without being obliged to extend these additional measures to all OECD members.

Annex D to the Invisibles Code contains a Decision of the OECD council recognizing that the Canadian government does not have exclusive jurisdiction over all matters covered by the Code and stating the undertaking of the Canadian government to carry out the provisions of the Code to the fullest extent compatible with the constitutional system of Canada. The OECD Council believed that the provinces' jurisdiction was unlikely to have a significant practical effect on the operation of the Code.

Canada is also party to a considerable number of specific multilateral agreements regulating service sectors to various degrees. These include Maritime, Air, and Road Transport. Telecommunications is regulated by a number of specific multilateral agreements, but computer processing is not. Advertising and cultural services, including recorded entertainment, are covered by multilateral cultural agreements and intellectual property agreements, especially regarding copyright.

So far as it has been possible to determine, engineering/construction and related consulting services, insurance, other professional services, banking and other financial services, franchising, health and tourism are not specifically subject to any specific multilateral agreement to which Canada is a party. However, each, except for franchising, is subject to the OECD Invisibles Code as outlined above.

3. The Organization for Economic Cooperation and Development (OECD)

Many of the OECD Committees are currently examining issues common to a number of service industries or more specific approaches to problems peculiar to individual service sectors. The Secretary-General in 1981 had recommended that "the Organization give high priority to efforts directed at reducing barriers to trade in services, improving international cooperation in this area and improving the functioning of service sector markets". Broad support was given this proposal as evidenced by the Communique of the 1981 Ministerial Meeting which stated, Ministers .....

"Welcomed the increased attention given within the Organization to the service sector in view of the important role played by services in Member countries' national economies and in international trade. They recalled that the principles and objectives concerning the liberalisation of international transactions contained in the OECD Convention and referred to in the Declaration on Trade Policy of 4th June, 1980 covered the exchange of services as well as of goods. Ministers expressed the wish that the on-going OECD activities in the field of services be carried forward expeditiously. They agreed that, in the light of the results of these activities, efforts should be undertaken to examine ways and means for reducing or eliminating the identified problems and to improve international co-operation in this area."

The OECD Ministerial Meeting in May 1982 gave similar encouragement to the work in progress. An analytical and fact finding effort is to be made in order to examine ways of removing unjustified impediments to trade and to improve international cooperation in the service area. Behind that general positive position, however, there is still a host of issues which need to be resolved. The service area is seen as one where OECD countries can keep up the momentum for trade liberalization, but no agreement has been reached on how or when, or what it really means in terms of economic development or international structures.

The Trade Committee in 1979 agreed to undertake work focussed on obstacles to trade in services and a considerable amount of preliminary investigation has taken place in engineering/construction and related consulting services. Other committees have conducted parallel work on banking, insurance, and maritime transport sectors and the latter two are fairly well advanced. The Tourism Committee is conducting an exercise which will identify trade impediments for that sector. The transborder data flow issue is actively being pursued in the Scientific and Technological Policy Committee.

Even though impediments are being identified in some sectors, there is still to come an assessment of the implications for trade. The Committee on International Investment and Multinational Enterprises (CIME) is assessing the National Treatment instrument as it relates to trade in services. A full review of this instrument will be undertaken over the next year or so, with a report to be made to the 1984 Ministerial Council Meeting. Also of particular interest to Canada will be the CIME's assessment of how the Guidelines for Multinational Enterprises relate to the services sector. The Committe on Capital Movements and Invisible Transactions (CMIT) is assessing how the Capital Movements Code and the Invisibles Code apply to services trade. A number of important obstacles to trade have been identified in the insurance and maritime transport sectors, with those related to establishment to be considered on an urgent basis. The CMIT is also

...../89

updating the Invisibles Code inter alia in regard to the consulting engineering, tourism and banking sectors. The CMIT expects to make an assessment report in December, including suggestions for negotiations. The Trade Committee will in the same time frame be assessing its work to date (see below).

Work done so far has been mainly sectoral with the U.S. being the most prolific in its documentation. Particular problems, emerging in an analysis of one or more sectors and believed to be of importance for others, may provide the basis to start horizontal work. One of the first horizontal issues which might provide an analytical structure relates to statistical problems and the need to establish a common knowledge base so that international comparisons and assessments can be made for the total service sector.

The total programme is recognized as one of several years' duration. The Trade Committee will deliberate on its investigation in October. A consensus seems to be developing that conclusions should have two aspects; first a summary of results on the consulting engineering investigations and second an attempt to draw conclusions which might be applied to trade in services more generally. Specific results might be very modest given the inadequacies of the original data base but work on generic problems might allow some reasonably useful conclusions to be drawn. The Secretariat has proposed that results (obstacles identified) should be assessed in terms of whether problems are significant, whether there is acceptable justification for them, are they unique to construction/engineering, are there international instruments which could apply, and finally do problems appear negotiable. Meaningful answers to those questions would require a substantial commitment on the part of all governments.

The OECD will remain an important forum for consideration of trade in services. Useful work can be done there, both in itself and also to facilitate discussions elsewhere, e.g. in the GATT.

4. The GATT

(i) Introduction

Trade in services seems certain to be on the agenda of the Ministerial Meeting in November of the Contracting Parties to the General Agreement on Tariffs and Trade (GATT) - largely at the initiative of the U.S.A. The GATT is a possible forum in which multilateral discussions on services could be undertaken if an international consensus is reached on this issue; it is also a possible locus for negotiations of services.

(ii) The GATT Ministerial and the U.S. Initiative

The U.S. Administration has pressed for discussion of trade in services to be on the agenda of the GATT Ministerial in November. Others seem ready to agree, in view of the U.S. insistance, and it is one of a number of topics which are likely to be included in a future GATT work programme, which the U.S. now seems prepared to accept would last a number of years. Behind the U.S. initiative lies pressure from a number of U.S. business interests, such as the Coalition of Services Industries, which appear to favour situating international discussion of this question in the GATT rather than in other institutions and who, while they may have no precise idea as to what should be decided in November, are anxious that the opportunity presented by the Ministerial be utilised to set the stage for future discussions. Neither are the Administration's ideas fully elaborated; however, it is clear that they favour the GATT as a location, at an earlier or later date, for international discussions on services.

In contrast to the OECD, where basic background work on identifying impediments to services trade is being undertaken, the GATT's membership is broader and its agreements are of a more binding or contractual nature. It is possible however that work will move ahead for some time on a fact-finding basis in the OECD and there may be considerable cross-fertilization, at least on the analytical side, with the GATT.

(iii) Applicability of GATT Principles and Practices

Although the GATT has been developed to deal with trade in goods, it appears that many of the principles underlying it and many of the practices it has developed could apply to trade in services, with one possible exception relating to national treatment. To investigate these questions in some detail, the Task Force commissioned a study from Mr. M. G. Clark, a retired officer of the Department of Industry, Trade and Commerce and Deputy Head of Canada's Delegation to the 1970's Multilateral Trade Negotiations in Geneva. The remainder of this section and the next section largely summarize his report to the Task Force.

Mr. Clark concluded that many of the principles, practices and procedures of the GATT not only could but should apply to trade in services - that, in fact, it would be difficult, if not impossible, to reduce or eliminate obstacles to trade in services unless GATT-type principles and practices were applied. Broad objectives of the GATT would appear to be adaptable, i.e. that countries conduct their relations in the field of trade with a view to developing the full use of the resources of the world and expanding the production and exchange of goods, as could the related principle that competition and the effective operation of the price mechanism are beneficial and should generally be strengthened. Another principle that might be transferred is that of providing for a basis for protection of domestic producers if countries believe that is in their interest. It would be necessary subsequently to select the measures to provide such protection in the case of services, since a tariff, tax, or other charge might not be appropriate for many services. Due to the heterogeneous nature of service industries the appropriate protective measures might differ from industry to industry or between groups of industries.

Following a decision to permit protection for domestic service industries, three additional GATT practices could be considered, i.e. periodic negotiations directed to reducing that protection; binding the level of protection agreed in negotiations against increase; and the right to increase the bound level of protection by negotiation and agreement with other signatories. Negotiations could be scheduled, as in the aircraft and government procurement agreements, or held when a consensus develops to negotiate.

The GATT principle of most-favoured-nation treatment could be applied at a minimum among the signatories of an agreement (although there are dangers in a two-tier system). National treatment however would give problems if it were adopted and is discussed further below.

As exports of services can be subsidized and dumped, and injure or threaten to injure industries in other countries, careful consideration should be given to provisions that would permit signatories to neutralize injurious subsidies and dumping and, in the case of subsidized exports to third countries, to restore the balance of rights and obligations. It is likely however, that practical difficulties, due to the characteristics of services, would make it very difficult to proceed on this point very quickly. Accordingly, GATT-type exceptions to permit signatories to take protective action against imports that are causing, or threatening to cause, serious injury to domestic producers, to safeguard the balance of payments and to protect essential security interests, might also be a useful element. Exceptions for emergency protection against injurious imports and measures to safeguard the balance of payments could be clearly defined and conditional to prevent misuse and protect the rights of exporters. To the extent possible, security and cultural exceptions should be clearly defined (see Chapter E.6. above for a description of Canada's import regime).

Additional provisions which could be considered include: provisions relating to state trading enterprises; transparency; a best endeavours obligation to facilitate obtaining the observance of regional and local governments to an agreement; a balance of rights and obligations permitting negotiation of compensation or retaliation; and a system for adjudicating disputes. Government Procurement is treated above in Chapter E.1.

A technique to establish a basis for negotiations would be to undertake a work program for services in the GATT similar to the non-tariff measures program initiated shortly after the Kennedy Round of negotiations. Interested Contracting Parties could notify the Secretariat of obstacles to trade in services maintained by others, the Secretariat could classify and catalogue the notifications and a committee could be formed to examine the notifications and consider appropriate ways to deal with the obstacles. In this way, governments would increase their knowledge of obstacles to trade in services, develop views and subsequently, perhaps, a consensus on the most effective way to deal with such obstacles. (See also some further thoughts on negotiating techniques in Section 5 below).

An interdepartmental group of trade policy officials met to discuss the report with the author. There was general agreement with most of the overall conclusions and a consensus that the report was valuable and well prepared. Nonetheless there were some reservations expressed. The most serious one concerned the adoption of the GATT "national treatment" provision (see below). Moreover, participants did not wholly agree with the assumptions that countries would necessarily negotiate a contractual agreement covering trade in services and that the objectives of such an agreement would invariably be to liberalize trade (rather than to, say, clarify or harmonize the rules). The question was raised as to whether the GATT would be an appropriate forum and what could be offered to developing countries to induce them to participate in a negotiation. The necessity to engage subnational entities as appropriate was stressed. It was noted that there would be real problems in regard to the control of unfair trade practices such as subsidies, e.g. in defining normal price for "anti-dumping" purposes. Despite these comments, there was agreement that the paper could make a useful contribution to the broader discussion of this subject.

(iv) <u>Impact of GATT on Services Trade</u>

Although the protective measures in the General Agreement are designed to apply to trade in goods, they apply also to trade in some services. (Indeed, in a very broad sense all goods embody to a lesser or greater degree a certain services element in their production). GATT's provisions affect services which are embodied in traded goods and <u>certain</u> services that are complementary to traded goods. Generally the GATT does not apply to services that substitute for trade in goods, services that are traded without a relationship to goods and a range of other services that are complementary to traded goods.

The GATT most clearly covers services which are physically embodied in goods, such as motion picture films, books and computer tapes. These are generally subject to tariffs which have been negotiated and bound against increase among GATT members. The value on which the tariff is levied generally reflects the value of the service component of the product. Other GATT provisions also apply to these products, such as most-favoured-nation and national treatment.

The GATT has a much less significant impact on services complementary to trade in goods, such as shipping, brokerage, insurance, and banking, and no application to services that substitute for goods, such as chartering, leasing and franchising, or to services such as banking unrelated to trade and life insurance that have no relationship to goods. In the case of complementary services, relevant GATT provisions include sections of the Customs Valuation Agreement whereby certain services may be included in the value for duty of the goods. These include certain commissions and brokerage charges, costs of packaging, certain types of engineering and artwork and the cost of international transportation of exports. The Agreement on Government Procurement covers services incidental to the supply of goods, if the value of these incidental services does not exceed that of the products themselves; but it does not cover service contracts per se.

5. International Summary

It is far from clear that there will be a negotiation on trade in services. Nor has Canada decided whether it should favour such a development and, if it did, how it might participate.

To facilitate this process of reflection, it might help to set out a few items that would need consideration in the context of a negotiation. These include the matter of impediments or barriers, the question of a general framework for services, and national treatment.

(i) Impediments to Services Trade

As a subject for international discussion, services are usually proposed as an exercise in dismantling barriers. Impediments or barriers to services trade are the subject of a growing literature, especially in the U.S., as the prospect of negotiations increases. There is a perception, certainly in the U.S., that the number and kinds of barriers are growing. Lists and categories have been drawn up by researchers and organisations, including by the International Chamber of Commerce, Gordon Cloney of the U.S. Chamber of Commerce, Brian Griffiths in his classic Invisible Barriers to Invisible Trade, and R.K. Shelp in his recent book Beyond Industrialization - Ascendancy of the Global Service Economy. The list that follows is illustrative:

(a) access to markets

As used here, this term covers imports of services on a "trade" basis. It includes whole or partial blockage of importation, licensing or registry requirements and other government measures which affect importation of a service.

(b) <u>permission for establishment</u>

Sometimes referred to as a "right", this item is often lumped with access to markets. However, as this Report brings out, there is a distinction to be drawn between service <u>trade</u> (where access to markets is the key) and services transactions effected through <u>setting up</u> in the recipient country (where issues of establishment are the crux). The first is more easily assimilable to traditional trade negotiations than the second where there are, as we have seen, serious conceptual and practical difficulties - not to mention policy issues for a country like Canada.

(c) <u>interference with transactions and financial behaviour</u>

This includes regulatory practices, taxes or tariffs, foreign exchange regulations or practices, capital movements, and remittances.

(d) <u>interference with access to production inputs</u>

Rules may affect the access to equipment, personnel (visas) or other necessary services. There may be local content regulations, or difficulties over proprietary knowledge.

(e) <u>interference with marketing</u>

This applies to quotas, technical or other standards, government procurement, local monopolies, etc.

(f) <u>other trade distorting government behaviour</u>

This can take many forms, not all intentionally trade distorting. Many regulations have a good basis in public order and policy. Subsidies may also have a solid rationale. Competition policy can affect trade in services.

The U.S. has done most work in identifying barriers to trade in services; it has produced a thick compendium of impediments by sector and country (including a number allegedly imposed by Canada). The list is not fully up to date nor entirely accurate. But it has received wide circulation among OECD countries (and, no doubt, others) and preparation of something like it may well be on a proposed agenda for a GATT work program. Impediments are already the main focus of the work in the OECD sectoral committees.

Discussions with Canadian business and provincial representatives led to identification of a number of impediments to Canada's export of services, i.e. barriers imposed by foreign governments. These are treated in Chapter D on a sectoral basis. Although our selective and partial discussions with business cannot be regarded as a scientific survey of business views, it may be of some interest that the most frequently mentioned impediments were as follows:

Government Procurement preferences and procedures	11%
"Unfair" subsidies and credit facilities by other countries in competition with our exporters	11%
Restrictions on remittances/foreign exchange	11%
Tax issues	9%
Immigration/visa (especially with the United States)	8%
Access to bidding/transparency	5%
Licensing restrictions	4%
Local preferences/flag discrimination	4%
Other	41%

(ii) General Framework

Given that there is at present no effective overall framework to provide a fabric of multilateral discipline for trade in services, as a general proposition it would be quite legal (if not always prudent) for one country to act unilaterally to restrict or harm the services trade of another country. Over the years, a number of countries have so acted and there is growing irritation in the U.S. about the perceived imbalances.

At the same time, some of the bills now before the U.S. Congress are unilateral and could harm Canadian interests (e.g. in communications). If the U.S. or other governments set the precedent of acting against services imports in a way that would be incompatible with its GATT obligations if applied to goods, it can be expected that pressure for similar action in other areas would escalate.

Another effect of some current draft U.S. legislation might be to establish unilaterally new principles which they would expect to apply to international trade in services e.g. to be adopted in multilateral negotiations. Some of these ideas, e.g. a rigid, narrow version of national treatment and right of establishment, and of what constitutes "reasonable" and "justifiable" behaviour on services, seem at best not fully thought through and at worst dangerous for international trade generally and harmful to specific Canadian export interests.

Such steps by the U.S. would undoubtedly trigger comparable actions by other trading countries such as the European Community or Japan. There would seem therefore to be advantage for Canada in exploring what sort of - not too cumbersome - multilateral framework or umbrella it might be possible to achieve as a bulwark against unilateral action by one or other country or group of countries. With certain exceptions, a number of existing international trade principles could probably be adapted for trade in services, as might at least some of the notions in the Preamble to the GATT.

(iii) National Treatment and a Negotiating Technique for Services

The notion of national treatment as a general, a priori concept for services trade is questionable. In general terms, this is a GATT principle under which foreign goods, once they pass the frontier, are to be treated in the same manner as domestic goods (the OECD version of national treatment is not identical). The GATT provides for protection at the frontier (e.g. tariffs) and for negotiations to change the level of such protection. But for most services the frontier is irrelevant - the services transaction takes place directly within the recipient country. Thus if this principle were automatically applied to services, no opportunity would be provided for a country to decide whether or not to protect its services, or for negotiations on the level of that protection.

It seems strange therefore for some to suggest that the principle of national treatment be automatically applied to services and that anything less would be an unfortunate (and presumably temporary) derogation from this universal principle. To adopt such a course would be equivalent to having decided at the outset of the GATT that completely free trade in goods should serve as the basic principle of that Agreement and that any remaining tariff (of which there of course were - and are - many) was an admitted derogation from accepted principle. That did not happen for goods and it seems both impractical and unwise to propose it today for services.

Rather, it is suggested that a "bottom up" approach should be adopted for those services sectors on which it may be decided to negotiate, as it has been for goods from the beginning of the GATT. Note would be taken of each country's import regime for services. This would in practice add up to a catalogue of the measures (tax, investment, establishment, prudential regime, immigration, currency etc.) applied by various countries against foreign exports to those countries, sector by sector. States would then decide whether or not to negotiate and, if so, on which measures and in which sectors negotiations would take place. Negotiations thereafter would be broadly comparable to those for goods (where different approaches have been found appropriate for, e.g., forest products as compared to raw materials, agriculture, fisheries or manufactured products). This would include the notion of possible binding of an agreed degree of

...../97

openness to services imports (and indeed this action could be a first step in some cases). Transparency, harmonisation, as well as liberalisation, are other possible techniques. Progress would be perceived as a plus and the atmosphere would thus be more propitious for productive negotiations.

If services negotiations take place, the above approach would be more suitable than would the automatic application to services of the concept of national treatment, which would effectively place many countries "in the dock", including most developing countries. The latter are important to the success of services negotiations in many sectors. It will need to be brought out that this approach provides a more effective way to get at the real issues for many services - the impeding regulations - in a less confrontational and charged atmosphere, with less likelihood of failure.

(iv) Timetable

International discussions and, a fortiori, negotiations (if they proceed) will take years before many concrete results can be expected. Though based on little more than experience and intuition, one could imagine a scenario along the following lines assuming the GATT Ministerial Meeting approves inclusion of services in its 1980s work programme. On that basis, the work programme might last some three years (e.g. 1983-85). Negotiations proper might begin about the middle of this decade and last again for two to three years (e.g. 1985-88). Implementation could also be phased over some years i.e. it could be the end of this decade before obligations would begin to bite.

This leaves time both to develop a strategy to take advantage of openings abroad and to work out adjustment measures which might be appropriate domestically.

(v) Toward a Canadian Position

A position which would appear to be consistent with the interests - positive and negative - outlined above, might be described as follows:

(a) Data and conceptual issues

Canada could urge work on data problems e.g. in the OECD. This would include consideration of some of the conceptual problems outlined earlier in this Report.

(b) Framework for services

While adopting a realistic approach to the more grandiose versions of this concept, Canada could indicate readiness to explore what might be obtainable in this area, as a way of restraining unilateral actions by our major trading partners. Many GATT type principles could be examined in this regard.

(c) Trade versus investment

Canada could favour a focus on traded services, rather than establishment transactions. In this regard, issues of access to markets should be highlighted, along with problems of unfair competition. We should at the same time be ready to deal with proposed work, notably in the OECD, on investment related issues; sections of this Report provide some suggestions on handling this subject.

(d) National treatment

Canada could work to increase understanding of the implications of this notion for services trade - as contrasted to its place in goods trade. It should not become an absolute principle but could possibly be envisaged ultimately as the terrain for negotiations, issue by issue, sector by sector.

...../99

G. REFLECTIONS

The following emerge inter alia from the work of the Task Force.

1. Canada has a major interest in the service sector and both strengths and weak points in services trade. These affect what happens to many regions of Canada. The intensification of international discussions which look to negotiations on services and related investment issues would seem to call for a knowledgeable and reasonably active Canadian presence in order to defend and promote our interests, policies and programmes.

2. Internationally, it seems clear the subject of trade in services will continue to gather steam and is likely to take its place in multilateral discussions and perhaps negotiations. This process will probably (and should) evolve over a number of years, which would allow Canada time to work out more specifically whether it is in its interest to negotiate and, if so, formulate its negotiating goals and tactics, and develop a long term strategy designed both to cushion within Canada as appropriate the effects of negotiations and to take advantage of expanded access abroad. The process will at the same time require some degree of current and ongoing involvement and attention. The following factors will influence this involvement.

3. Significant problems arise from the lack of data and from conceptual and classification uncertainties and gaps regarding services and services trade. It would seem desirable to intensify our work in these areas within Canada and to encourage a collaborative effort internationally, e.g. in the OECD. Canada could make some contribution to such an international effort, drawing on work done for the Task Force.

4. There is no effective overall instrument providing a fabric of discipline on services trade, although quite a number of existing multilateral and bilateral agreements bear on services. This gap could work against a number of specific Canadian trade interests. Accordingly, it would seem valuable to explore multilaterally - initially without commitment - the kinds of principles and understandings that might be made applicable to services. These include such notions as comparative advantage in services trade, dispute settlement, most favoured nation treatment. Work done for the Task Force could serve as a contribution to this exploration.

5. The most fruitful course could lie in encouraging discussion of "traded" services, i.e. questions of access to markets across frontiers, rather than establishment and investment issues. In any event, we would no doubt need to bring out the fact that the notion of national treatment does not readily translate from goods trade to services trade. Many countries would suffer if it were

...../100

automatically so applied. It would appear to be in the Canadian interest to adopt a "bottom up" approach to services negotiations, as previously for goods.

6. From the indications gleaned by the Task Force incidentally to its designated work, it appears there may be value in an examination of the possible elaboration of a more structured domestic policy on services and an overall approach within Canada to the services sectors and to services trade. This would have to be done in close consultation with provinces and the private sector, as well as carefully co-ordinated within Ottawa. If put in hand, it would facilitate our development of a long term approach to services access problems abroad and the identification of key markets for our exporters in the latter part of this decade and into the 1990's. It could also help domestic economic development and employment.

7. For economic, constitutional and political reasons the provinces have a good deal of interest in many services and will need to be closely associated with the continuing work in these areas - though it is premature to be overly precise about the nature of that association as yet. Arrangements should be made to inform the provinces on the outcome of the Task Force's work and the direction of Government thinking.

8. Arrangements should be made for feedback to the business and other private groups which have evinced interest in the Task Force and whose future cooperation will be needed.

TABLES AND CHARTS

Table Seven

THE CURRENT ACCOUNT, B.O.P.

Note: Lateral totals for 1968 and before do not agree with current account balance owing to exclusion of service receipt item, "Gold production available for export".

BALANCES OF THE CONSTITUENT COMPONENTS IN MILLIONS OF CURRENT DOLLARS

	1. Merchandise	2. Investment Income: interest, dividends & misc. income	3. "Other" Services			Other		4. Transfers[1]	CURRENT ACCOUNT Balance
			Overall Balance	Travel	Freight & Shipping	Govt.[2]	Business[3]		
1960	-148	-537	-499	-207	-91	-30	-171	-205 (-126)	-1,233
1961	173	-606	-463	-160	-82	-31	-190	-188 (- 72)	- 928
1962	184	-646	-371	- 43	-86	-41	-201	-144 (- 19)	- 830
1963	503	-720	-293	24	-85	-28	-204	-155 (- 28)	- 521
1964	701	-768	-337	- 50	-35	-30	-222	-154 (- 14)	- 424
1965	118	-853	-395	- 49	-93	-25	-228	-138 (29)	-1,130
1966	224	-944	-417	- 60	-65	- 2	-290	-152 (52)	-1,162
1967	566	-1,051	20	423	-31	- 7	-365	-146 (72)	- 499
1968	1,471	-1,042	-534	- 29	-40	-50	-415	- 25 (184)	- 97
1969	964	-1,008	-782	-214	-61	-18	-489	- 91 (143)	- 917
1970	3,052	-1,117	-713	-216	20	1	-518	-116 (153)	1,106
1971	2,563	-1,306	-814	-202	-12	-25	-575	- 12 (266)	431
1972	1,857	-1,264	-976	-234	-74	-43	-625	- 3 (284)	- 386
1973	2,735	-1,502	-1,147	-296	-66	-73	-712	22 (344)	108
1974	1,689	-1,925	-1,351	-284	-224	-58	-785	127 (557)	-1,460
1975	-451	-2,202	-2,019	-727	-433	-71	-788	- 85 (380)	-4,757
1976	1,388	-2,835	-2,421	-1,191	-150	-142	-938	26 (530)	-3,842
1977	2,730	-4,018	-2,892	-1,641	- 26	-221	-1,004	-121 (413)	-4,301
1978	4,007	-5,367	-3,043	-1,706	131	-306	-1,162	-532 (50)	-4,935
1979	4,150	-6,573	-2,407	-1,068	309	-371	-1,277	- 64 (690)	-4,894
1980	7,810	-7,108	-2,892	-1,228	368	-492	-1,540	286 (1,281)	-1,904
1981	6,636	-10,674	-3,030	-1,158	243	-491	-1,624	492 (1,602)	-6,576

1. Transfers: Receipts of inheritances and immigrants funds, personal and institutional remittances, and withholding tax, net of payments of inheritances and emigrants' funds, personal and institutional remittances, and official contributions. For purposes of this table withholding tax has been subtracted (actual transfer balance in brackets): formal BOP practice lists it as transfer receipt and service payment.
2. Government Transactions 3. Business services and other services . MORE RECENT FIGURES (LAST 5 YEARS) - SUBJECT TO REVISION.

Table Eight

SERVICE IMPORTS AS A PERCENTAGE OF ALL IMPORTS

	Merchandise Imports	Services:	Travel	Freight & Shipping	Gov't Transactions *	Business Services	All Services	TOTAL IMPORTS %	TOTAL IMPORTS value (millions $Can.)
1970	77.8		8.0	6.2	1.2	6.7	22.2	100	17,817
1971	78.6		7.4	6.1	1.1	6.8	21.4	100	19,479
1972	80.4		6.4	5.8	1.0	6.4	19.6	100	22,722
1973	81.3		6.2	5.6	1.0	5.9	18.7	100	27,942
1974	82.9		5.3	5.5	0.9	5.4	17.1	100	37,268
1975	82.3		6.2	5.2	0.9	5.4	17.7	100	41,251
1976	81.3		6.9	5.0	1.0	5.8	18.7	100	45,033
1977	81.4		7.2	4.7	1.2	5.6	18.6	100	51,014
1978	82.0		6.8	4.3	1.2	5.6	18.0	100	59,782
1979	83.8		5.4	4.3	1.0	5.4	16.2	100	72,910
1980	83.5		5.6	4.3	1.1	5.5	16.5	100	81,882
1981	84.0		5.3	4.3	1.0	5.4	16.0	100	92,234

* Includes some expenditures on goods.

Note: Totals may not agree due to rounding.

Table Nine

SERVICE EXPORTS AS A PERCENTAGE OF ALL EXPORTS

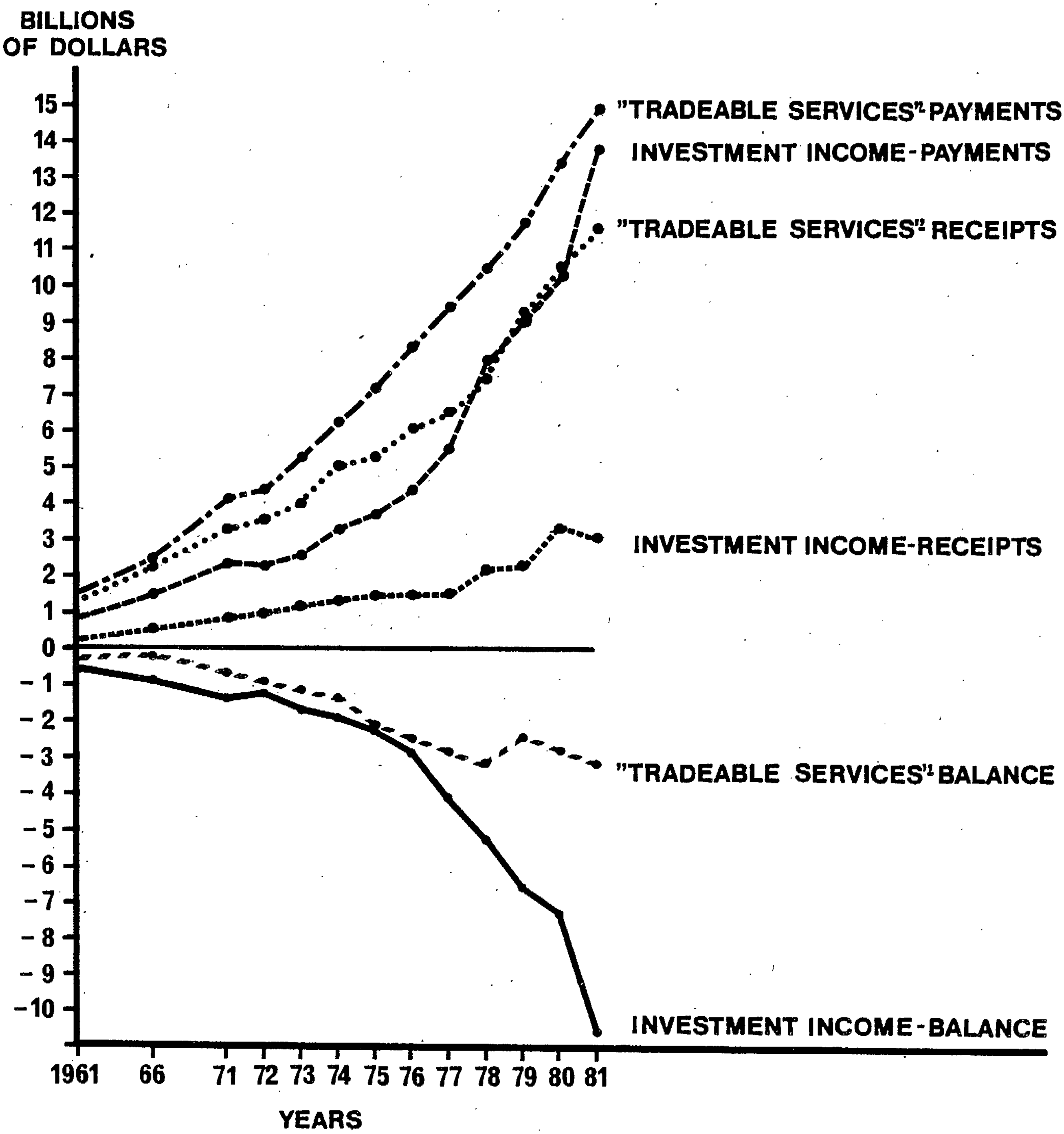
	Merchandise Exports	Services:	Travel	Freight & Shipping	Gov't * Transactions	Business Services	All Services	TOTAL EXPORTS	
								%	value (millions $Can.)
1970	83.9		6.0	5.6	1.1	3.4	16.1	100	20,176
1971	84.2		5.9	5.6	0.9	3.5	15.8	100	21,228
1972	85.3		5.2	5.3	0.8	3.5	14.7	100	23,603
1973	86.2		4.9	5.1	0.7	3.2	13.8	100	29,530
1974	86.7		4.5	4.8	0.7	3.3	13.3	100	37,606
1975	86.4		4.7	4.4	0.8	3.7	13.6	100	38,781
1976	86.4		4.4	4.7	0.7	3.8	13.6	100	44,000
1977	87.0		4.0	4.7	0.7	3.6	13.0	100	50,852
1978	87.3		3.9	4.5	0.7	3.6	12.7	100	60,746
1979	87.4		3.9	4.6	0.5	3.5	12.6	100	74,653
1980	87.8		3.9	4.5	0.5	3.4	12.2	100	86,800
1981	87.8		3.9	4.4	0.5	3.5	12.2	100	95,840

* Includes some expenditures on goods.

Note: Totals may not agree due to rounding.

Chart One

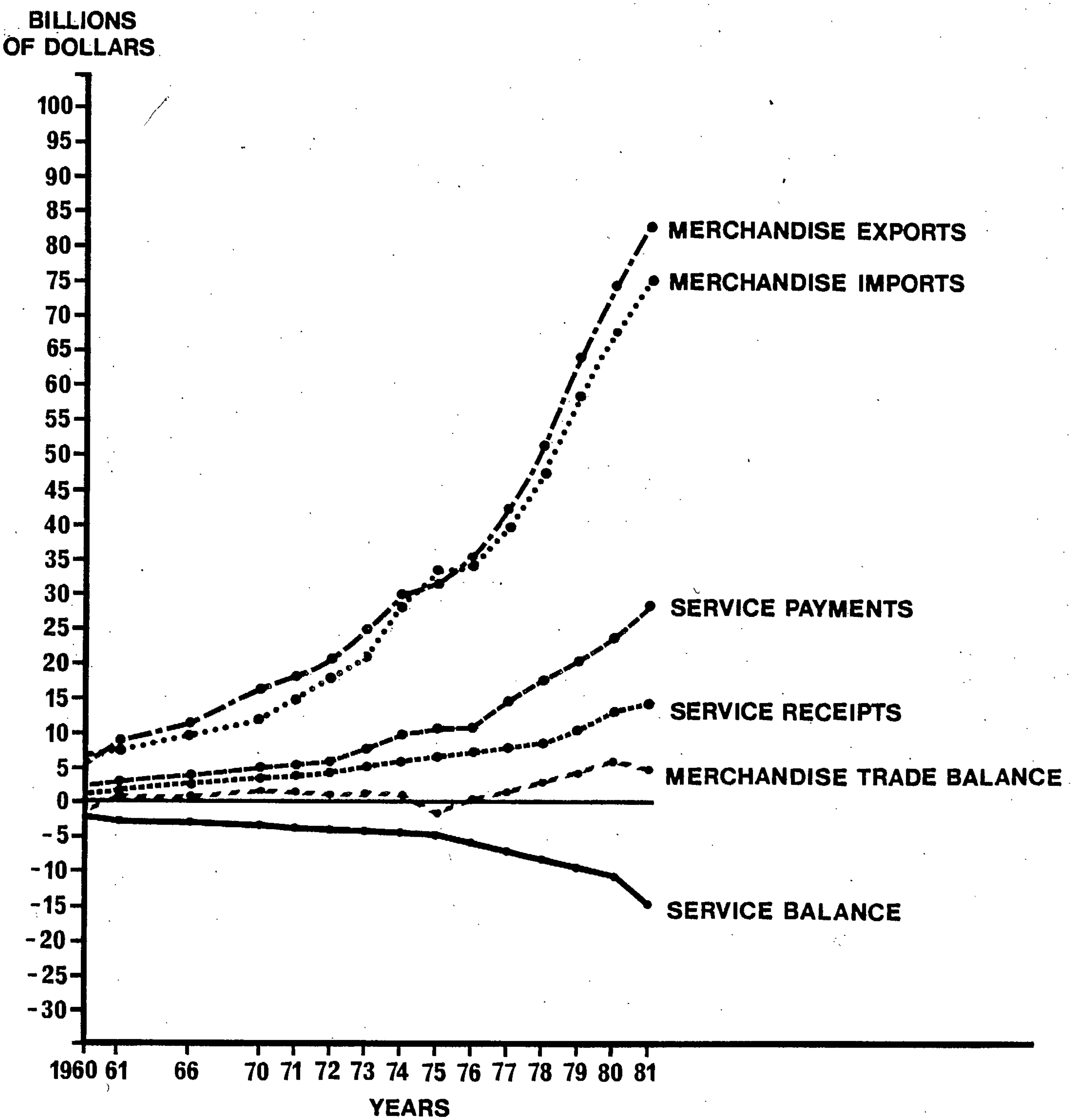
BALANCE OF PAYMENT ON"TRADEABLE SERVICES" AND INVESTMENT INCOME 1961-1981



Source: Statistics Canada Cat.No. 67-001,1981

Chart Two

CANADIAN BALANCE OF PAYMENTS ON MERCHANDISE TRADE & SERVICES 1961-1981



Source: Statistics Canada Cat. No. 67-001,1981

CACC / CCAC
78831

QUEEN HD 9985 .C22 T3 1982 c
Canada. Task Force on Trade
Task force on trade in servi s:

HD

DATE DUE

JUN JUIN	1 9 1996		