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**Trade in Services:  
The Negotiating Concerns  
of the  
Developing Countries**

by

**Janette Mark  
and  
Gerald K. Helleiner**

**December 1987**

**Discussion Paper  
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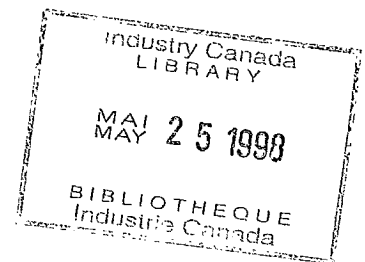
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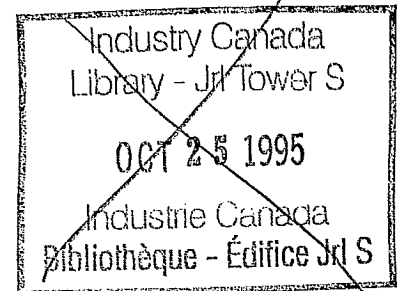
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OF THE DEVELOPING  
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Gerald K. Helleiner \*\*



December, 1987

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## PART ONE: FRAMEWORK AND BACKGROUND

### 1. Introduction

The introduction of the services trade issue into the multilateral trade negotiations touches on some sensitive issues for developing countries. On many of them there has been longstanding North-South dispute (e.g. transfer of technology, multinational corporations, access to information). Indeed, the U.S. proposal to liberalize trade in services through expanding the coverage of the GATT seemed at first to highlight, for many developing countries, the asymmetry of power and advantage between the post-industrial North and the dependent and underdeveloped South in the international economy and the grievances of the latter in respect of the former. However, the debate has since moved beyond those early perceptions. Developing countries have now begun the difficult task of examining their service sectors with one eye firmly placed on the negotiating agenda, an agenda that now provides for discussion of a possible framework for an international regime for trade in services within the General Agreement on Tariffs and Trade (GATT).

The primary purpose of this paper is to examine the services issue from the perspective of developing country interests and perceptions. It seeks to link analysis of development policies - and the role of the services sector in the development process - with analysis of developing country trade policies and negotiating strategies.

Each developing country faces unique concerns with respect

to trade liberalization in general and services issues in particular. Some aspire to service exports of various kinds; others do not. Some treat inflows of foreign technology and foreign direct investment liberally; others control them in efforts to increase rational gains therefrom. Each will thus come to the negotiations with different objectives and policy preferences. One obvious difficulty for this paper then, will be to present the concerns of developing countries as a group. It has already been difficult for them to maintain a single group position; as was evident even prior to the Punta del Este meeting, they have come to behave more as a group of groups.

## 2. Developing country starting positions

When the U.S. first proposed that services be introduced into the GATT, developing countries showed little willingness to consider the idea. Many were immediately suspicious about what they saw as a crude attempt to free the flow of U.S. investment and technology into their economies, even into some of the most sensitive areas. Many were also critical of the narrowness of the proposed approach, in particular the failure of the U.S. to recognize the movement of labour across borders as an important requirement for successful service exporting by many Third World countries.

As the U.S. continued to press the services issue in the GATT, developing countries built on these initial reactions to develop a more substantive response to the U.S. proposals. Some

participated in the informal discussions about services with other GATT members and started studying their own service sectors; the majority sought to block the inclusion of services on the agenda for a new round of multilateral trade negotiations, using what leverage they had to draw attention to their three main concerns.

In the first place, there was a general fear of the unknown; despite a concerted effort by interested parties, there was still considerable confusion over definitional, data, and conceptual issues. It was therefore difficult for most countries to be confident as to where their interests actually lay; these uncertainties were compounded for developing countries since they were years behind the developed countries (who at least could draw on their experience in the OECD) in understanding the dimensions and nature of their actual or prospective service sectors. They therefore sought, in the first instance, to slow the process and not commit themselves to any kind of negotiations until they had done some analytical catching-up. In defence of their position they reiterated their need to protect what they traditionally had seen as "sensitive" industries. Many expressed doubts as to whether, in the event of liberalization, their indigenous firms could compete against service firms from developed countries, especially large and experienced multinational corporations.

Their second area of concern centered on American insistence that the issue be raised in the GATT. Developing countries

argued that the GATT had no jurisdiction over services trade and that, given its mandate on investment and related issues, UNCTAD would be a more appropriate forum for such discussions. Moreover, they argued, the GATT agenda was already overburdened with more important matters left unresolved from the Tokyo Round, and escalating protectionism thereafter. Developing countries also pointed out that many other organizations already had or were developing rules governing individual service activities; for example, UNCTAD on shipping and technology transfer, the UNCTC on transnational corporations (TNCs), WIPO on the protection of intellectual property and IATA and ICAO on air transport. They noted as well that the U.S. had consistently opposed "legal binding" in other UN codes in related areas (e.g. transfer of technology, restrictive business practices, and the conduct of transnational corporations). They were therefore suspicious of its enthusiasm for the firm legalities of the GATT, presuming that the U.S. had different codes to suggest that were more to their liking.

Finally, the services issue was simply not high on the list of Third World trade policy priorities. The U.S. introduction of services and such other new issues as intellectual property, trade-related investment policies and trade in high technology products, was seen as an attempt to impose its own priorities (or, more precisely the priorities of a small, influential lobby within the U.S.) on the new trade talks, thereby diverting attention from other issues that are much more important to



developing countries (e.g. safeguards reform, textiles and clothing, agriculture, etc.). American bullying, and threats that the U.S. Administration was willing to proceed without the developing countries, merely served to heighten their sense that the GATT was biased in favour of the industrial countries and that it could not protect their interests. They also foresaw the possibility that during a negotiation that included both goods and services, progress on the 'old' issues would ultimately be linked to concessions in the services area, a prospect they adamantly opposed.

Despite the strength of these arguments, Third World unity broke down during the months of debate over the content of the negotiating agenda for the MTN prior to the Uruguay ministerial meeting. Thus, while much attention was given to the adamant - and, according to some Northern perceptions, "irresponsible" - 'Third World' resistance to including services on the GATT trade agenda, in the end it was only a small group of 10 countries, led by India and Brazil, that carried the 'hardline' position through the preparatory process and into the final hours of the ministerial meeting.

A few developing countries were willing to support the U.S. proposal on services from the beginning - either on its own merits (for example Singapore and Hong Kong, who tend to favour liberalization efforts because of the strength and openness of their own service sectors) or for other national reasons (for example, South Korea, where exports of goods account for 36

percent of GDP and where there was already intense bilateral pressure from the U.S. on the services front).

However, the majority of "moderate" developing countries accepted the inclusion of services on the proposed negotiating agenda in the hope that by so doing they could achieve an early launch for a new GATT round. Many clearly feared the consequences of escalating protectionism and the possibility of a complete breakdown of the trading system in the absence of trade negotiations. The initial opposition of most developing countries to the inclusion of services was thus tempered - but not eliminated - by their more immediate trade policy concerns: halting protectionism and enhancing market access, particularly for their manufactured exports. The leading "hardline" developing countries, which have maintained their opposition to the inclusion of services in the GATT, are much less dependent on international trade; India and Brazil have very low export to GDP ratios (6 and 9 percent respectively). Together, the 10 hardline countries account for less than 5 percent of world trade (GATT 1986, Table A14).

Given the decision at Punta del Este to include services in parallel with the new GATT round of negotiations (a decision which will be discussed in greater detail in the second part of this paper), individual countries - from both North and South - must now identify their own interests and build negotiating positions. The starting point of this process is to examine what, if anything, makes services different from goods.

### 3. Developing country participation

Given the developing countries' immediate negative reaction to the idea of negotiating liberal rules for international trade and investment in services, some proponents of a new services regime suggested that it might be better if they were not included in the discussions. This idea appealed to some because there appeared to be practical advantages to limiting the negotiations to a more homogeneous group (Gray, 1983, p. 387); the smaller the group the more chance there would be of successfully meeting negotiating objectives and the less chance there would be of having to settle for the lowest common denominator. Besides, the bulk of international services trade and investment takes place among industrial countries and, accordingly, the major disputes are among these countries (Schott and Mazza, 1986, p.271). Excluding the developing countries could also mean that the OECD, which, unlike the GATT, has experience in the services area on both the trade and investment side, could act as the institutional umbrella for the negotiations.

However, it was never the intention of the developed countries to exclude the Third World from such an important undertaking; the strength and integrity of the entire multilateral system of economic governance is at issue. For large numbers of countries to leave the "rules system" would be prejudicial to the attainment of the stable (and equitable) world order to which all aspire. The fact that the OECD already has

agreements among its members on invisibles trade, transborder data flows and foreign direct investment (including national treatment) demonstrates their general desire to seek more complete participation in whatever regimes can be multilaterally agreed. Developed countries have also argued that it is necessary to expand the GATT's jurisdiction to include services in order to ensure its relevance in the years to come.

Of course, the industrialized countries are also interested in improving their access to Third World service markets and bringing developing country barriers in this sector under closer international scrutiny; they are evidently not content with the status quo. In the absence of agreed multilateral provisions on matters such as national treatment and market access there is likely to be continued resort to bilateral reciprocity agreements in which countries generally treat foreign firms in the same way that their own firms are treated in those firms' home countries; such arrangements are often buttressed by Treaties of Friendship, Commerce and Navigation or Treaties of Amity and Economic Relations. Since developing countries (and other smaller countries) are likely to host more foreign firms at home than they will send abroad, they will have few incentives to offer or accept bilateral reciprocity in this sense.

From the perspective of the developing countries, there are still no conclusive answers to such questions as what they stand to gain from freer trade and investment in services, whether they will be able to secure a balance of advantages/concessions from

the negotiation, or whether liberalization in this sector will assist their overall long-term development. If their interests are to be protected, it is nevertheless, important that they participate in the rule-making process in this new sphere right from the beginning. While developing countries often see themselves as disproportionate losers from the GATT's apparent inability to maintain respect for the rules governing goods trade, they (and all smaller and middle-sized countries) have a disproportionate interest in multilateral rules and discipline. The stability and predictability of the multilateral trading (and financial) system matters greatly to them - more than to wealthier and more self-sufficient powers.

Thus, while the "liberal" advantages of transparency, predictability, and nondiscrimination may appear to have limited appeal to developing country governments practicing or contemplating protectionist policies in the services sectors in pursuit of developmental or other sovereign objectives, they must realize that multilateral approaches to international agreements and the resolution of international disputes are almost always preferable to bilateral or anarchic ones for the countries with the fewest bargaining chips.

Some developing countries have already experienced problems due to the lack of agreed rules. For example South Korea and Brazil have been on the receiving end of bilateral pressure from the U.S. concerning insurance and informatics policies respectively. They can be sure that such bilateral tensions will

continue, and could easily get much worse, if a multilateral system governing services is not forthcoming. Moreover, the 'deals' that result from such bilateral pressure are often discriminatory and/or protectionist, rather than liberalizing, in effect. In the case of the U.S.-South Korea dispute over restricted access to the lucrative Korean insurance market (which was initiated as a Section 301 unfair trade practice), the end result was the extension of the Korean domestic cartel to include U.S. firms rather than domestic liberalization of the restrictive system or "opening" to external competition. (Yoon Je Cho, 1987)

The proposed multilateral agreement(s) in services will not provide the developing countries with the unconditional nondiscriminatory (MFN) treatment that Article I of the GATT might lead them to expect. The U.S. and other industrialized countries prefer a "conditional MFN" approach in a services regime, to reduce the prospect of "free-riders" such as may, in their view, be found in the traditional unconditional MFN approach. They argue that Article I applies only to merchandise trade and that, in any case, further-voluntary agreements and codes, such as those on nontariff measures can be based, and now are based, on conditional MFN. While the developing countries prefer unconditional MFN, many, including Brazil and India, have already in effect conceded this point by signing the Tokyo Round's conditional codes. Before the Tokyo Round, it might have made sense for some of the developing countries to insist on the inclusion of services within the GATT - to try to preserve the

unconditional character of any new multilateral services regime. This is now, however, only an academic point: GATT's Article I has already been effectively neutered.

#### 4. What makes services special?

It can be argued that services production and trade raise no issues that are not addressed in the traditional theoretical literature on goods trade. And yet there are some important differences in some kinds of service activities.

Services are typically consumed at the same time that they are produced. They are thus not storable. This characteristic frequently generates the need for close proximity between the supplier and the consumer of services. In this case the supply of the service necessitates an international factor movement - of either capital or labour - in order for the transaction between buyer and seller to be possible. An international framework for trade in services may therefore have to incorporate provisions relating to international factor flows, that is, to foreign direct investment and immigration. The U.S. proposes to address this problem by writing provisions for the "national treatment" of suppliers of services rather than, in analogy to the GATT's provisions for goods, for the services themselves; and this implies provisions relating to rights of establishment and rights to commercial presence for supplier firms. At the same time, they propose to regard labour flows as matters for immigration, not trade, authorities.

Another feature of services trade is the frequent prominence of issues of access to supplies, e.g. to information, technology, the electro-magnetic spectrum, etc., rather than access to markets. Similar issues have arisen in some aspects of goods trade in the past, e.g. with respect to access to global oil or food supplies, but they were not addressed in the GATT.

The nonstorable character of services also suggests that, where supplies are of particularly strategic importance to domestic productive activities or national security, vulnerability to interruptions of imports may be greater than in the case of strategic goods (Streeten, 1987). There may therefore be a strong case for self-reliance in such services activities and the discouragement of imports.

In some aspects of producer services trade, there may also be very high proportions of international transactions taking place on an intra-firm basis. Quite a lot of goods trade, of course, also moves within international firms. There has been longstanding disagreement about the implications for trade theory and policy of such "internalized" trade. The U.S. has not previously favoured provisions in international codes (such as the UN principles and rules governing restrictive business practices), that required their application, or even encouraged transparency, in intra-firm transactions. Despite this kind of resistance, the high profile of the trade in services discussions is bound to generate increased attention to intra-firm trade.

Services also differ from goods in terms of the means that



governments have chosen to influence production and trade. Although developing countries are often singled out as being overly regulated, protective and interventionist, all countries recognize the sensitivity of many service industries and cite a variety of economic, political, cultural, security and sovereignty reasons to justify market structures (e.g. monopolies) and regulatory policies (including price fixing) in service industries that are generally prohibited in other industries. (See, for example, Shelp 1981, Krommenacker 1984, and UNCTAD 1984). In such important industries as banking, transportation and insurance, governments use an array of policy mechanisms to regulate and monitor these activities to try to ensure that the 'national interest' is being served and protected. When examining 'trade' barriers in many service industries, one must look first at the relevant domestic regulatory framework; this often causes bureaucratic problems because few government officials are familiar with both the domestic and the trading sides of the issues. (This accounts for the failure of many analysts to differentiate between regulation/deregulation and the trade issues of protection/liberalization).

For example, legislation governing the banking system has a wide range of objectives, the most important being the prudential ones of protecting depositors promoting the overall stability of the financial system. It also typically seeks to ensure that the banks function efficiently. Rules are also designed to maintain

governmental control over macroeconomic management of the national economy. The pursuit of these objectives typically involves all manner of regulations, and some of them often relate differentially to foreign suppliers of banking services, e.g. prohibitions or regulation of foreign participation.

Transportation and telecommunications industries are often also targeted for domestic regulation. In part, this is because scale economies in these industries make them "natural monopolies". Efficiency requires that there be only one or very few firms, yet concentration of market power may, without some degree of public control, be abused. Moreover, activities in these sectors may have important externalities. Because they provide the vehicles for the movement of people, goods and information they are seen by many as central to overall economic activity. In this light governments may feel obliged, in the name of national security and sovereignty, to secure these industries from foreign intrusions while at the same time ensuring that their services are available in all parts of their countries. Some specific parts of the telecommunications industry are also often singled out for protection from foreign participation and competition on grounds of cultural sovereignty. Policies may thus affect trade and foreign investment even when such effects are not their sole - or even their primary - intention. Regulations may appear to be 'protectionist' in a trade sense even when they are governed by wholly unrelated domestic considerations and constraints. Approaching these

restrictions from a trade liberalization perspective, therefore, often arouses sensitivities far beyond the realm of trade departments.

'Trade' protection

Some restrictions, however, are introduced with the intention of protecting domestic service producers from foreign competition. Each country must decide for itself what amount, if any, of foreign participation and/or competition should be allowed in any particular industry and many of the same socio-political, security and cultural variables as were discussed above can be factored into such decision making. Developed and developing countries often protect their service industries for the same reasons that they protect manufacturing industries. Sheltering specific 'infant' industries or firms from the rigours of international competition, for example, is a common element of an industrial strategy.

This paper is not the place to rehearse the pros and cons of the traditional case for infant industry protection. The case for its use rests upon capital market imperfections and/or externalities in learning processes, and depends upon the present value of social gains exceeding that of its costs. The argument, however valid, has undoubtedly been frequently abused; and a great many "infants" have never grown up to competitive maturity. The first-best policy instrument for infant industry protection is, in any case, not a trade barrier but a production subsidy. In the context of this paper, it should suffice to say that there

is no inherent difference in the argument in the particular case of service-producing industries as opposed to goods-producing ones.

Governments in developing countries also often adopt import substitution policies using protectionist instruments as major elements of their overall development strategies. Again, the arguments for and against such practices are not inherently different in the case of service industries.

#### 5. The role of the service sector in development

When the United States first suggested that services be included in the next round of multilateral trade negotiations, most developing countries (or developed for that matter) knew very little about their individual service sectors let alone what the implications of global liberalization would be. Some exploratory research on the role of the service sector in the Third World had been undertaken in the past (for example in the World Bank, see Sapir and Lutz, 1980 and 1981). For the most part, however, developing countries had little domestic research to draw on (and accordingly many initiated national studies). The traditional academic literature dealt with the service sector only in very general terms e.g. its importance as a generator of employment and a contributor to GDP (see Riddle, 1986 for a review of this literature). More recently, as attention has been drawn to this issue, the debate has moved on to such questions as the policies developing countries should adopt to get the most

out of the sector and, the gains or losses that the liberalization of trade and investment in services might provide in terms of economic development and foreign exchange earnings. The Ministerial declaration at Punta del Este explicitly spoke of the objective of expansion of trade "as a means of economic growth and development". Liberalization and transparency are not described as ends in themselves but only as conditions within which development-oriented trade expansion was to take place. India and Brazil continue to argue that this requires that negotiators acquire a deeper understanding of the role of services trade in the development of developing countries, and not assume, as they might be inclined to do in the GATT, that liberalization necessarily will promote that primary objective.

The purpose in this section is, first, to provide a very brief summary of the data problems that continue to plague serious analysis of this sector and what the available data tell us about the importance of services to developing countries in the domestic and international context. We then turn to the more important task of examining some of the current perspectives on the role of the service sector in developing countries. This discussion is meant to provide background for the discussion, in part two, of developing countries' likely positions during the international negotiations on services, and the issues and concerns they might or should raise.

#### Services data

One of the most obvious problems before governments trying

to study the role of the service sector in their own economies in preparation for international negotiations is the paucity and low quality of data (The need for data is one of the first items on the agenda in the group negotiating services in the Uruguay Round). It is not the purpose here to give a detailed accounting of these data problems but it is important to flag some of the limitations of the major limitations. (For a good summary of the data and information problems see UNCTAD, 1983.)

There are two main data problems that impede careful and detailed analysis of the service sector in both developed and developing countries (obviously, the limitations are much greater in the latter group). First, the existing data, at both the national and international level, are too highly aggregated to allow detailed analysis of domestic service activities on a sector-by-sector basis. While part of this problem is due to the fact that until recently, there was very little demand for better information about the service sector it is also a reflection of the second problem: that no one has yet developed either an acceptable definition of what constitutes a service or an adequate method for measuring the output (let alone trade) of such activity.

Most national accounting systems include everything that does not fall into the industry or agriculture categories as a service. International services trade data are taken from the balance of payments accounts wherein only four categories of non-factor service transactions are listed (see Table 4) The fourth

category, "Other Private Services and Income", is a residual catch-all. Furthermore, these trade data offer no indication of the direction of the 'trade' in services.

Allowing for the inadequacies of the data, one can employ Tables 1 and 2 for some indication of the significance of the service sector in developing countries. Table 1 substantiates the generally accepted view that the more 'developed' an economy is, the higher the proportion of people who find employment in the service sector. Likewise, Table 2 indicates that the contribution of the service sector to a country's GDP also increases with the level of development. It is noteworthy, however, that the service sector accounts, on average, for almost 50 percent of GDP in developing countries; Table 3 shows that the growth of the service sector was greater in low-income developing countries than in the industrial countries since 1965.

The trade data indicates that the developed countries continue to dominate international trade in both goods and services. Contrary to popular belief, however, the relative importance of export receipts from both non-factor and factor services is practically identical in the developed countries and the non-oil developing countries (Table 5); both derive over 20 percent of their export earnings from services, an indication that the services trade issue is not just a developed country issue that has little immediate interest for Third World countries. It is also interesting that, in the aggregate, both non-oil developing and developed countries carried surpluses on

both their factor and non-factor services accounts in 1985 (Table 4).

### Services and development

Some observers have been arguing for some time that developed countries, led by the U.S., are moving into a 'post-industrial' phase of development. American interest in liberalized services trade is consistent with such an interpretation of the structural evolution of the "industrialized economies". Such interpretations of change are also consistent with much of the traditional literature of economic development. In the earlier empirical analysis of development, countries were perceived as typically passing, more or less sequentially, through "stages" as they developed from an agrarian-based society to an industrial economy and then finally into a service economy. Without denying that developed countries have been expanding service activities and absorbing new service technologies at a rapid pace, especially in the information (processing and storage) sector, some analysts now question this conventional 'stages of growth' theory as an accurate description of the development process. A recent UNCTAD study, for example, starts from the premise that, "In many cases development of tertiary production may not be a result of growth, but rather one of its preconditions." (UNCTAD 1984, p.vi). Dorothy Riddle, in her path-breaking book (1986), also details the role that the service sector plays in economies at all stages of development using an "interactive model" of economic development to



...highlight the fact that services are process industries that stimulate and facilitate growth in the other sectors, both domestically and internationally...Services are the glue that holds any economy together, the industries that facilitate all economic transactions, and the driving force that stimulates the production of goods.(Riddle, 1986, p.28)

If the service sector truly is central to the development process, Third World governments will have to fully integrate service activities into their national economic strategies to ensure that they expand in tandem with manufacturing and agricultural capabilities. Riddle takes this argument one step further and suggests that the service sector can even serve as the engine of growth. Countries should therefore, provide incentives to develop the sector, she argues, and, as appropriate, actively encourage foreign participation in it - promoting services for export as well as domestic consumption. She goes so far as to suggest that extractive and manufacturing activities cannot provide the growth multipliers that the service sector can. In fact, she cautions developing nations about putting scarce capital into the manufacturing sector:

Increased manufacturing production is irrelevant if these products cannot be distributed for sale. More important, overemphasis on the manufacturing sector ignores the clear relationship between sector growth and growth of the whole economy...In an increasingly interdependent global economy, all sectors play their part. Of them all, it is the service sector, not the manufacturing sector, which is indispensable. (Riddle, 1986, p.104)

The service sector incorporates such a wide variety of activities that such generalizations are of limited policy relevance. One of the important questions that each developing country government will have to ask is what particular service

(and other) industries, if any, it should encourage. It must then try to determine whether trade and investment liberalization will help or harm the achievement of stated goals in these (and other) industries.

This debate presents developing countries with a major dilemma; on the one hand, they could invite foreign investment, and take advantage of the latest service technology, for example in the area of telecommunications; on the other hand, this 'open' policy could result, over the long-term, in increased dependence on foreign companies and the discouragement of indigenous capabilities in the sector. Some fear that by linking into the transnationalization of services, developing countries face ".the danger of their being allocated the 'bottom rung' of the intra-firm and international division of labour, as suppliers of relatively unskilled labour (e.g., card punching) and merely as marketing and distributional outlets for transnational corporations." (UNCTAD, 1984, p.48)

Other analysts do not share the view, however, that developing countries are faced with such dangers stressing, rather, that it is in their best interests to import the most advanced service technology available. The ability of developing countries to improve their standard of living or, in the trade context, to compete with developed countries in a variety of other activities, will be enhanced by - and perhaps dependent on - access to efficient and modern services, particularly producer services; developing countries cannot afford to wait for the

development of indigenous service industries to appear (Shelp, 1985 p.10).

There is widespread agreement that the availability of efficient producer services will promote more competitive manufacturing and agricultural activities and that access to foreign investment and technology can stimulate the development of these services. But many now argue that

...dependence upon foreign services should not be permitted to the extent that it undermines efforts to develop and create a dynamic producer service sector capable of supporting the longer-term establishment of a capacity to adapt to, and compete in, world markets. In the present world, economic development cannot be "imported"; it depends essentially on the mobilization of resources, innovative capacity, willingness to take risks and political decisions in developing countries. (UNCTAD, 1986, p.8)

With such contrasting views to draw upon, developing countries will themselves have to address a variety of issues in their own national studies and negotiating plans. Brazil, India and other developing countries consider that they have agreed to discuss only development encouraging expansion in services trade in the Uruguay Round, and not liberalization per se. But most of the crucial questions remain unanswered or in dispute.

What role does the service sector play in promoting development and improving the quality of life in developing countries? Within the sector, which industries might take a leading role in economic growth? What kind of positive externalities can the sector, or parts of it, provide and how can governments maximize them? What are the "critical" producer services for the encouragement of other productive activities in

the development process? Are domestic spin-offs greater from services that are provided by nationally owned or controlled firms than those from foreign firms. Does national control of some service activities reduce overall uncertainty and risk?

#### What Does Trade Theory Say?

Although the trade literature in this 'new area' has been quickly expanding, the applicability of existing trade theory to the services area is still seen by some as a contentious issue (and one that is being dealt with by other participants in this project). On the central question of whether the theory of comparative advantage applies to services as well as goods trade, many economists simply turn the question around and ask why it would not apply (Hindley and Smith, 1984). The special circumstances in which it might not apply continue to attract special attention. Non-storability, the need for producer-consumer proximity, and the role of externalities are among the attributes of services trade that have been addressed in this connection. Overall, there can be little doubt that comparative advantage still applies. In services, as in goods trade, however, qualifications to allow for "infant" industries, externalities, risk aversion, etc., can be offered. Analysts still know less than they would like about dynamic, rather than static, comparative advantage. (See Deardorff, 1985 for a good discussion of the theoretical issues).

For a variety of reasons (most of which relate to data limitations) very little empirical work has been done on the

elements of comparative advantage in services. One pioneering study examined the factor-intensity characteristics of a limited number of service activities, and concluded that "...conventional trade theories can go a long way in explaining trade patterns in services." (Sapir and Lutz, 1981, p.21) The results showed that those countries well endowed in capital and technology, i.e. the developed countries, export services that are intensive in the use of those factors (e.g. insurance, banking, shipping). This implies that developing countries can be expected to have a comparative advantage in labour intensive services just as in goods production.

Will it be possible to exploit the Third World's potential strength in labour-intensive services? Developing countries do quite well in the catch-all category of "Other" services (see Table 4) which includes such activities as advertising, medical services, construction and engineering, areas where labour, and to some extent knowledge, are key inputs. South Korean and Taiwanese construction-engineering firms are already prominent in international markets. India has moved effectively into the global market for computer software. The Philippines has emerged as an important source of cartoon animation, architectural drafting and other services. Honk Kong and Singapore have become important centers in the supply of international financial services. Other examples abound - and some of them, like airlines and international communications, are in service sectors that would not, on the face of it, have been

predicted by traditional trade theoreticians.

Some labour-intensive services exports do not require the (temporary) migration of labour to the export market, e.g. tourism, where the consumer migrates to the supplier, or satellite data processing services. Many do, however, and where they do, the developing countries can only expand exports if they can acquire market access for their labour, i.e. rights to migrate. Bhagwati has noted that

the export possibilities become even more compelling for developing countries if the issue of unskilled labour mobility, in the context of execution of specific short-term contracts (as in the Middle East), is resolved in favor of its inclusion in the "right to establish". (Bhagwati, 1987 p. 560)

In the longer-run, comparative advantage does not depend purely on the original resource endowments and location. Technical change, other "dynamic" influences in development processes (unfortunately still not well understood), and government policies may also influence the evolution of international competitiveness. Even in the medium term, other influences may be of significant importance. The degree to which infrastructure facilitates trade and investment, political alliances, cultural and linguistic attributes are among the elements that can give a country an edge over its competition - and ones that, "once identified, can be developed." (Riddle 1987, p.99-100) Although these influences operate in all sectors, they may be more relevant in the service sector simply because so few services depend on natural or physical endowments.

## PART TWO: SUBSTANTIVE AND PROCESS ISSUES

### 1. The Punta del Este Declaration and Thereafter

As has been seen, most developing countries were immediately suspicious of the American proposal to include services in the new round of multilateral trade negotiations; in fact, they felt so strongly that from the time of the GATT Ministerial meeting in 1982 until the months immediately preceding the Ministerial meeting in Punta del Este in September, 1986, the developing countries refused to endorse a new round of negotiations that included services. The negotiating framework for services finally agreed to at the Punta del Este meeting reflected, for the most part, the substantive concerns of the majority of developing countries; to view the outcome merely as a procedural compromise that responded to essentially political and ideological posturing by a few "hard-line" developing countries, as some seem to, is to be misled.

Two characteristics about the Ministerial Declaration reflect the specific concerns of the developing countries. To address their hesitation about introducing this new area into the GATT, the compromise reached in Punta del Este separated the mandate in Part II for Negotiations on Trade in Services from the detailed agenda in Part I for the Negotiations on Trade in Goods. Furthermore, in a strict legal sense, the decision to undertake negotiations on goods was made by the Contracting Parties to the GATT, whereas the services negotiation was to be undertaken by governments; while the Group Negotiating Services (GNS) is part

of the Uruguay Round and will report to the Trade Negotiating Committee, it is not formally taking place in the GATT. (To illustrate this point examine the letterhead of any official GNS release and note that "GATT" is nowhere to be found.) As the Indian delegate states, "The Punta del Este Declaration embodies the compromise which preserves the MTNs as a single political undertaking, but ensures that the Negotiations on Services (GNS) are conducted as a distinct process outside the framework of the GATT." (Randhawa, 1987, p.164)

This separation recognized the developing countries' concern about the GATT's uncertain mandate to discuss services. More importantly, it implied that there was no legal basis for introducing cross-linkages between the goods and services negotiations, linkages which the developing countries opposed.

The second important point about the Ministerial Declaration is that, as has been seen, the "development of the developing countries" as well as the "economic growth of all members" are stated as objectives of the services negotiations; the stated goal is to achieve these objectives through the expansion of trade in services and not through liberalization per se (see Appendix). This carefully crafted wording goes some way to legitimize the desire of developing countries to place their development concerns at the centre of the negotiations and not liberalization.

Following the agreement to include services in the new round of trade negotiations, the GNS set out to establish a framework



for the ensuing discussions. Although there were some early problems concerning how to proceed, within a few months the participants had decided to structure their discussions around five elements:

1. definitional and statistical issues;
2. broad concepts on which principles and rules for trade in services, including possible disciplines for individual sectors, might be based;
3. coverage of the multilateral framework for trade in services;
4. existing international disciplines and arrangements;
5. measures and practices contributing to or limiting the expansion of trade in services, including specifically any barriers perceived by individual participants, to which the conditions of transparency and progressive liberalization might be applicable.

The meetings held thus far have concentrated on the first issue; as mentioned earlier, many developing countries have been hesitant to proceed until there is a better understanding of what exactly is being discussed. In late October, however, the U.S. submitted some firm proposals on the general considerations and concepts it believes should govern a multilateral framework for trade in services. Moreover, the U.S. reiterated its desire to negotiate, and if possible implement, such a framework "at an early stage of the Uruguay Round" with the desire that "The framework could then be the point of departure for the negotiation of sectoral agreements during the later stages of the Round." (U.S. proposal, 1987)

## 2. Conceptual Issues

The Punta Declaration states that the current negotiations aim at establishing a multilateral framework of principles and rules to facilitate the expansion of trade in services "under conditions of transparency and progressive liberalization". Such a framework, at the same time, is to "respect the policy objectives of national laws and regulations applying to services". Thus, a balance will have to be maintained throughout the negotiation between the desire to capture the expected gains from trade expansion via liberalization on the one hand and the need to protect national goals and policy objectives on the other.

Some of the reasons why countries regulate and protect service industries were discussed earlier; in the context of GATT negotiations, the mechanisms that are used by governments to meet their national objectives present the negotiators with a variety of conceptual problems. These problems are relevant to all countries in that they raise serious questions about how to isolate the trade issues from the domestic regulatory framework; for developing countries they raise particularly difficult questions about how 'trade' negotiators will address investment and development policies.

Probably the most difficult and sensitive conceptual problem that will have to be dealt with during the course of the multilateral discussions concerns the relationship between international factor mobility and international 'trade' in

services. One of the special characteristics that differentiates goods and services is, as has been seen, that many services have to be consumed as they are produced (since they cannot be stored), making it necessary for service providers to have a presence in the market. It follows that for these providers to 'export' they have to be present or established in foreign/importing markets, and this appears to make investment and immigration restrictions nontariff barriers in the trade sense.

Countries control the transborder movement of capital and labour for a variety of legitimate reasons. Investment restrictions have always been used by developed and developing countries alike in their development policies - for example, as means to channel scarce capital into key sectors, to keep foreign investors out of particular sectors or to establish performance requirements for foreign firms. Many developing countries will be careful not to give up national control in this sensitive area. Indeed, they have expressed their deep concern that the services initiative represents an attempt by the U.S. to introduce investment issues into the GATT by a "back door", thereby opening the way for freer investment in the goods producing area as well.

They take every opportunity to reiterate that there must be a distinction between trade in services and investment in services.

Similarly most countries also rely on immigration restrictions (work permits, quotas, and the like) to ensure a

high level of local participation in certain sectors either for simple employment creation purposes or, especially in certain services, to facilitate the transfer of the technology to their work-force. Immigration policy is also a key mechanism for controlling population growth and managing the size and composition of the domestic labour market.

There are essentially two ways in which immigration restrictions can impede international service transactions. In the first instance, an obvious problem arises for those services that can only be produced and traded/delivered in person (e.g. lawyers, doctors, construction workers, domestics etc.). In the second instance, immigration restrictions can also hinder goods exporting firms in providing after sales service for their products (computers for example) in the importing country; in the same vein, service producers often depend on sending their specialists to set up the distribution system needed to make trade possible (e.g. franchises, computer networks, etc.).

To the extent that the above conceptual problems act as barriers to services trade, it remains to be seen how they could be approached within a GATT agreement on liberalization. The U.S. seeks to apply the GATT concept of national treatment previously applied to goods that have entered a national market, to foreign suppliers of services. This amounts to a significant redefinition of a traditional GATT concept, and it would alter the conditions of market access for foreign firms. Such a redefinition would logically carry with it a foreigner's right to

establish and right to do business - which together would go a long way in solving the 'problems' of immigration and investment regulations and even of competing with public sector firms. The wide ranging implications of such redefined principles guarantee that these will be controversial issues on which the developing countries (and some others as well) are unlikely to concede easily, if at all. In particular, developing countries will likely seek to confine the provisions relating to "market access" to cross-border trade, fully reserving their rights in respect of policies affecting the operations of foreign firms, and their employees, within their countries. In this position, they remain in strict conformity with current GATT practice on goods.

Another important conceptual problem arises regarding the treatment of public sector firms, often "natural" monopolies, used as tools for developing and protecting service industries (for example, public utilities, communications networks and transportation facilities). Quite often competition in the domestic market is governmentally restricted in a particular industry or a public-sector monopoly controls the distribution system (e.g. telecommunication lines). Such circumstances make it difficult, even impossible, for foreign service firms to conduct transactions there - whether transborder or internal. Domestic monopolies and public companies often benefit as well from special rules for government procurement, for instance restricting it to domestic suppliers. The predominance of large public firms also raises the possibility of 'unfair' competitive

practices in the domestic market; government influenced pricing practices may not be market-driven whether they are monopolistic or not. Where a public sector monopoly also competes in non-monopoly activities it can cross-subsidize its activities and thereby "unfairly" underprice its competitors. The establishment of liberal rules governing these cases - that preserve national rights to pursue development policies - will be a challenge to negotiators.

### 3. Coverage

Although the Punta del Este Declaration provided a mandate to negotiate liberalization of international trade in services, no consensus has yet been reached on what particular service industries will be included in the resulting agreement; the current mandate provides that "Negotiations in this area shall aim to establish a multilateral framework of principles and rules for trade in services, including elaboration of possible disciplines for individual sectors."

As discussed earlier, many services are widely seen as unsuitable for liberal trading arrangements because of their perceived importance for national sovereignty, independence and/or development - notably banking and financial services, domestic transport and communications, and artistic, cultural and mass media-related services (including advertising). Insurance activities may also fit into the latter category, although they are not usually seen as quite so strategic as banking. Again,

fear of loss of control over foreign direct investment may also influence potential service importers' attitudes in these sectors. These concerns are particularly relevant for many developing countries intent on expressing their national independence and moderating their dependence on the international economy. Still, given the interests of many participants, it is unlikely that such a broad list of 'sensitive' activities could be realistically excluded from the current undertaking.

Another factor to consider is that some services are already covered in non-GATT international agreements - notably air transport and shipping; it is unlikely that GATT-based agreements would be permitted to infringe upon them - at least in the first round of negotiations. A framework agreement might nonetheless incorporate broad principles that could eventually impact upon the evolution of such non-GATT arrangements unless there were specific exclusions. The Punta declaration stipulates that the framework "shall take into account the work of relevant international organizations"; the expertise of these organizations is to be consulted throughout the negotiations.

Beyond these cursory observations lies the much more fundamental issue of how an agreement can be constructed to ensure that the coverage is balanced and that the interests of all participants are taken into account. Developing countries were quick to observe that the trade in services issue was heavily biased, in the manner in which it was raised by the U.S., toward the interests of developed countries - especially the U.S.

- and multinational corporations, since only capital and technology intensive services were being mentioned. On one level, this bias seems rational given the source of the initiative. Other things being equal, countries can be expected to seek in trade negotiations maximum freedom of maneuver in respect of goods and services they typically import, and maximum obligations on the part of others in respect of those they produce for export.

For their part, developing countries have argued subsequently, with the logic of economic theory behind them, that if the freer flow of investment is an objective of the services agreement (for those services that require an investment presence in the importing country), then the issue of freer labour flows should also be included in the negotiations. Of course, this logic also reflects their trade interests. For many developing countries, the remitted income of their nationals working abroad is a major source of foreign exchange (in the same way that earnings on foreign direct investment are for many developed countries; see Table 4). Moreover, since developing countries are currently more likely to export relatively unskilled and other labour-intensive services than other kinds, they may be interested in developing liberal trading rules for such service sectors as personal services, construction, engineering, data processing and various types of consultancy. (In some such areas, most may be fairly indifferent, e.g. tourism.) Developing countries will therefore continue to press for an international



regime for international labour flows - whether seasonal, project-related (e.g. construction), or longer-term - in parallel with any efforts to liberalize the international flow of capital or foreign direct investment.

Before deciding what particular sectors should or should not be covered by an international agreement each country will have to isolate its particular sectoral interests on both the importing side (i.e. to increase access to international services) and the exporting side (i.e. where it can potentially compete in the global marketplace). Given the diversity of developing countries, there will be differences of opinion among them about what sectors should be included or excluded in the current discussions. Many poor countries, for example, acknowledging their comparative disadvantage in high-technology activities, may be content with liberal arrangements in such high-technology service sectors as computer and data services, telecommunications, and certain other producer services. Some developing countries with more skills and industrial experience, however, see these latter sectors as of potentially strategic significance for their own longer-run development and security. The reluctance of Brazil and India to discuss liberalized trade in services is undoubtedly related to such aspirations for domestic high-technology services and related directly productive activities. It is also due to their desire to protect what they see as a natural advantage in Third World and regional markets for their own service exporters from increased Northern

competition. To the extent that many of these sectors are associated with foreign direct investment, there may be even greater caution concerning their inclusion on the part of some - but not all - developing countries, lest they be drawn into concessions on investment flows "through the back door" of the services regime.

Limitations on sectoral coverage in a new GATT services agreement, may be achieved via explicit exclusions from a general framework for services, or via a limited and explicit list of those sectors to which the framework does apply. Developing countries, for the present, favour the latter approach - on the ground that they thus minimise the risk of inadvertently giving away more than they realize. On the other hand, it will be difficult to negotiate sectoral agreements in the absence of agreed general principles. Only if there is a deadlock at the level of general approaches would a sector-by-sector approach alone be sensible. Even then, the number of sectors on which agreement could then be found would probably be small. Another possible approach is to build appropriate safeguards, exceptions and special provisions into a generalized and all-inclusive services regime, although such an agreement might have to include so many escape clauses that it would be rendered unacceptable to some countries.

#### 4. Integration of "development concerns"

As mentioned above, the developing countries secured a commitment that their development concerns would be a key component of a multilateral framework on services trade. Thus a major preoccupation of all GATT members - from both North and South - will be how to integrate these concerns into an agreement.

One approach would be to use GATTs's existing rules governing merchandise trade as a model of how developing countries' special needs are taken into account. There are four specific areas within the General Agreement where developing countries have different obligations from those of other contracting parties. First, Article XVIII allows developing countries to protect infant industry from foreign competition and makes it is easier for them to introduce import restrictions when they experience balance of payments problems. Secondly, Part IV of the General Agreement, which was added in 1965, releases developing countries from the obligation to grant reciprocal concessions during trade negotiations and in turn, developed countries are not to insist on full reciprocity. The third difference is found in the general waiver that legalized the Generalized System of Preferences, the agreement under which developed countries can introduce tariff preferences for Third World processed and manufactured exports. (This would have little practical applicability in much of services trade given the general difficulty of appraising the value, or even detecting the

entry, of a service at the frontier.) The final, and most sweeping, instrument is the enabling clause, agreed to during the Tokyo Round, providing developing countries with the right to differential and more favorable treatment within the GATT.

In addition to these specific channels, developing countries also have recourse to the host of escape clauses and safeguard measures that all Contracting Parties can use to justify import protection (e.g. regional preferences including free trade areas under Article XXIV, emergency safeguard actions under Article XIX, national security under Article XXI, general exceptions under Article XX, etc.)

Probably the most contentious approach, using the GATT as a model, would be to pursue special and differential treatment (S&D), as it is called, for developing countries. Third World demands for, and subsequent complaints about, S&D have been at the centre of North-South divisions within the GATT for much of the post-war period. However, there is now widespread doubt, both within developing countries and elsewhere, as to whether their preferences and special status—as embodied in the GSP, Part IV and the enabling clause have worked to their advantage; many hypothesize that they have helped to legitimize discriminatory practices and the erosion of the MFN principle, largely at the cost of Third World exports.

Many developed countries, too, have made no secret of the fact that they are no longer willing to accept the open-ended application of S&D; one of their major objectives for the Uruguay

Round is to press some of the more advanced developing countries to "graduate" i.e. take on more responsibilities and obligations within the international trading system. Appropriate definitions of beneficiaries and provisions for graduation from special status are now and will continue to be highly controversial within the traditional bounds of GATT jurisdiction. In this environment, developed countries are in no mood to grant a wide ranging, open-ended, package of concessions and special treatment to the "Third World". On the other hand, most developed countries might consider including some formulation of S&D in a services framework as long as it was not automatically granted or universal; in other words developing countries would have to participate in the negotiations and the ensuing agreement would have to include a graduation clause and timetable.

While developing countries might have gained some negotiating leverage by not easily conceding the issue of S&D, both Brazil and India made it clear in their early statements to the GNS that they did not themselves want special and differential treatment in the new services agreement. Instead, they wanted to ensure that their "development concerns" were an integral part of the agreement rather than a mere "add-on". In the words of the Indian delegate,

We believe that we should not base our approach on the assumptions borrowed from [the] familiar area of trade in goods supplemented by carving out exceptions in terms of special and differential treatment for developing countries. The objective of development should not be considered as an adjunct or an after-thought. The approach to the multilateral framework itself should be such as to ensure the achievement of this objective and it is here that one

intensely feels the inadequacy of the GATT model. (India, 1987)

Given the controversy over S&D, and taking into account the valid concerns expressed thus far by some developing countries, it would probably be more conducive to early agreement in services if the developing countries drew up their defenses around exceptions, safeguards and developmental clauses, building on the existing GATT rather than around new areas of preferential treatment. If structured properly, such approaches could well be the first step to ensuring that the role of some services in their development strategies will be protected. For example, a reworking of Article XVIII to include a more responsive and flexible infant industry clause could go a long way in protecting their current interests and safeguarding their future options with respect to services. Developing countries have long resented the many requirements they must meet to use the current GATT infant industry clause as it is now written and have instead used - and thus probably misused - the second part of Article XVIII that allows them to protect domestic manufacturing for balance of payments reasons. Both should probably be reformed if the GATT is to be taken seriously over the longer run. The balance of payments provision could be tightened and given a time limit; but such a tightening would be resisted by developing countries without a parallel expansion and improvement of IMF credit facilities (and that does not appear to be on the horizon). Similarly, the little-used infant industry provisions should be clarified for the day when developing countries may

want to employ it; but there will be little pressure toward this end before the balance of payments provision is tightened.

In short, existing GATT rules and practices leave plenty of room for developing countries to protect their industries. To the extent that the corresponding provisions and practices in a new services regime might follow the GATT lead, developing countries would have the leeway to protect their services industries. However, such "improvements" as are suggested above will have to be sought under current arrangements in the 'mainstream' GATT regime for goods trade first (or in tandem). A new regime for services should not lead the rest of the system in this regard.

If there is to be developing country participation, it will probably still be necessary to add to the exceptions and safeguard clauses now found in the GATT within any generalized and across-the-board framework for services trade. A clause relating to the preservation of local arts and culture for example, might find widespread favour. So might a clause that granted seniority to other existing or pending international agreements relating to the treatment of foreign direct investment, other capital flows, intellectual property, etc. Clauses relating to "reasonable" or "appropriate" domestic measures (in particular, various types of regulation) in support of specified national development objectives might also be made for cases of domestic monopoly in the service sector - whether state-owned or private; such cases are more common in the

developing countries than in the industrialized world. A longer phase-in period for developing countries would be another way of meeting some of their concerns; they could slowly introduce the necessary reforms and avoid having to deal immediately with the resulting major adjustments.

##### 5. Negotiating options and strategies

To some degree the weak can influence the definition of rules in a multilateral system, even if realpolitik still dominates in actual trading practices. Certainly, if they do not make their views heard their concerns will not be addressed in the bargaining among the strong. The numerical superiority of the developing countries within the GATT may be an under exploited resource. Even if eventually they decide that the agreed framework governing international services trade is not, after all, acceptable, it is important that the developing countries at least participate in the construction of a system of rules to which all may be led to adhere.

By virtue of the agreement to begin a new round of multilateral trade negotiations, developing countries are involved - at least for the time-being - in parallel negotiations that include services. As discussed earlier, developing countries were able to exert some leverage prior to and during the ministerial meeting to stall progress toward the launching of the new round; the effect of their lobbying is also reflected in the carefully crafted Ministerial Declaration (see Appendix).



Their main task now is to examine where their strengths lie and to use what leverage they might have as a group, or as part of a broader coalition, at the bargaining table - especially until there is an agreement on what the framework agreement should look like.

In one of its early presentations to the Group Negotiations on Services (GNS), the American representative indicated that the U.S. wants a framework in place by the summer of 1988 (as part of the "early harvest"). As emphasized throughout this paper, a major element in the developing countries' response to the proposal to negotiate a more liberal framework for international trade in services has been their (and others') limited understanding of where their interests truly lie in this field. In part this has been the product of the lack of clarity in the U.S. (and other) proposals. In part it has followed from the analytical ambiguities and confusions surrounding the concept of "trade in services" which are only now beginning to be sorted out. For many, it is the result of a continuing lag in the formulation of local interests and positions in this new complex arena. Until the issues are more clearly understood and, above all, until choices move beyond the level of gross and ideologically-based generalizations, it is quite rational for the developing countries to stall.

Reluctance to move quickly forward with services negotiations in the GATT may also have negotiating advantages. For example, even if the developing countries begin to perceive

the ultimate desirability of certain "deals" incorporating trade in services into the overall trade regime, they might sensibly continue to drag their feet, demand better data and more considered studies of the issues in the GATT and elsewhere. Then, if they do agree to move more quickly towards some sort of framework for services trade they could insist, in the first instance, on forms of agreement that are fairly "loose" in their demands of the signatories, e.g. "principles and rules" such as the non-binding ones on restrictive business practices agreed in the UNCTAD, declarations of "best endeavors", voluntary guidelines, and the like. All of these would be consistent with the aspiration to transparency agreed at Punta del Este, and, at the same time, permit experience to be gained, and knowledge of the relevant issues to expand.

At its broadest, the North-South dimension of the choice in respect of services issues, is between (i) a narrowly-defined, tortuously negotiated, and extremely contentious agreement on services and related issues, with limited coverage and probably limited membership, as against (ii) a much more ambitious "goods for services" deal in which the developing countries' immediate merchandise trading interests are more effectively secured in return for their cooperation in a new services regime (within which their longer-run development interests remain assured).

The possibilities for tradeoffs within the former, more limited approach, are endless - a fertile field for the emerging new breed of trade lawyer. Within this approach, there may be

room for quid pro quo North-South deals in which advantages in services trade of greatest interest to low-income countries are offered in return for the broad services concessions sought by the industrialized countries, as Bhagwati has suggested (Bhagwati, 1987). Alternatively, or additionally, coverage of a services agreement may be sectorally or otherwise limited so as to reduce what might otherwise be gross imbalance of advantage. A more imaginative way of sealing an agreement in accordance with the "equal sacrifice" concept of traditional GATT negotiations might be to incorporate liberal rules governing international labour flows, technology transfers and restrictive business practices within a multilateral framework for services.

But it is the second option, i.e. a "goods for services" deal, that is far more fundamental, and more important to focus upon. Given the possibility that a "services-only" agreement will not provide enough benefits or incentives to induce developing countries to sign it, all countries should be thinking about a broader plan that would reach beyond the bounds of the service sector. Despite the obvious attractions of a more ambitious approach, the developing countries have been scrupulous in their avoidance of this kind of linkage between services negotiations and GATT negotiations on goods trade. They fear, understandably, that the existing GATT obligations of their more powerful trading partners will be increasingly at risk if such "new" agreements, from which the developing countries have little to gain, are so linked to them.

In principle, they are correct to proclaim that they should not have to make concessions in order to induce others to respect the rules and refrain from measures that contravene the spirit and even the letter of existing international agreements. However, in a world in which large countries, notably the U.S., are already pressing individual smaller ones to introduce more "open" regimes for trade in services (and related policies) on pain of retaliation against their merchandise trade, it is somewhat academic for the developing countries to demand that there be no such goods-for-services tradeoffs. From this standpoint, the services and other "new" issues are their most powerful current bargaining chip in antagonistic trading relationships in which they have not recently been faring well. Strict legality and equity have rarely figured importantly in the practicalities of international economic relations; one must start from where one finds oneself.

Even if developing countries gained little or even suffered losses from liberalised domestic trade in goods and services, the developing countries stand to gain greatly from a more liberal international regime for their goods exports and from international order and predictability more generally. As a first step they could seek a rollback of current discriminatory "grey" measures (and practices and firm commitments to refrain from them in the future), an appropriate rewriting of the safeguard clause (Article XIX), and a final winding down of the Multi-Fibre Arrangement.

The Uruguay Round Ministerial Declaration set up a two track system of negotiations on goods and services in response to developing countries' unwillingness to consider goods-services issue linkages. These countries will not lightly discard the diplomatic toehold they thereby acquired. But the pressure on them to consider such linkages has not abated. Developing countries may soon have to consider proposals for cross-sectoral linkages more seriously since, as recent events have indicated, they are already a reality anyway; governments usually take such a broad range of issues into account when developing a trade policies or negotiating positions and developing countries may, in this context, have to do the same.

Unfortunately (but predictably), a major problem in achieving such a deal might be that the developed countries will not be able, politically, to deliver in the goods area. (There are also those who are unsure as to whether the U.S. could even garner enough domestic support for a services-only agreement [See Shelp, 1986-1987, pp. 77-78 and Stalson, 1985 p. 173]). There is a long history of protection in the manufacturing sectors of particular interest to developing country exporters. It is not therefore surprising that American labour has already stated its concern that "...in trade negotiations the United States will grant concessions in manufacturing sectors to gain concessions in services". (Shelp, 1986-87, p. 78)

## 6. Institutional Alternatives and Broader Approaches

This paper has been speaking primarily to the possibilities for negotiating a services agreement within or parallel to the GATT and the current MTN - the Uruguay Round. However, as alluded to earlier, the fact that the current services trade discussions are taking place in association with the GATT puts some obvious limitations on how imaginative the end product can be. In particular, fully incorporating development concerns - or meeting developing country demands may, as suggested by the above discussion, demand a broader framework than provided for in a GATT context. Given a broader framework, a whole range of other issues could possibly be drawn into the negotiation; with a little imagination, negotiating savvy and political energy, those might include technology transfer codes, rules on restrictive business practices, the code of conduct for transnational corporations, and developing country "rights" of access to the electro-magnetic spectrum and to foreign information and software. Many of these issues - now emerging in the services group of the Uruguay Round - have already been discussed at length in other multilateral fora. At a minimum, the Uruguay Round negotiations on services should avoid "re-inventing the wheel". (Dell, 1987)

More broadly still, some developing countries see possibilities for linking international monetary and financial reforms with the resolution of disputes regarding the trade regime. This obvious logical link between trade and financial

issues is increasingly recognized in international discussions. A key outcome of the Uruguay Round might be increased cooperation between the GATT, the IMF and the World Bank, although this is usually seen by developing countries, long concerned with what they see as asymmetric applications of IMF and Bank surveillance and conditionality, as likely to be detrimental to their interests.

Citing the specific case of improving the efficiency of domestic capital markets in developing countries, Canada's Ambassador for the MTN, noted what she sees as an important gap in the services discussions thus far in terms of institutional cooperation:

Among economists in Fund/Bank circles there is widespread agreement that improved financial markets are essential for mobilising domestic savings, improving the efficiency of domestic investment, securing new equity capital and the repatriation of flight capital, facilitating debt-equity swaps and other financial options... Yet no trace of this analytical framework surfaced during the prolonged debate on services among trade officials at the GATT. Nor, on the other hand is there a coordinated strategy of financial market reform in developing countries, involving the GATT in cooperation with the Fund and Bank, in utilising opportunities offered by the Uruguay Round negotiations on services. (Ostry, 1987, p.17)

Fund and Bank views are not universally shared in developing countries (or elsewhere for that matter). Her statement will certainly not ease concerns about GATT/Fund/Bank cooperation in the Third World. The developing countries would prefer to hear more discussion of such cooperation in the form of expanding access to external credit, and debt relief, at the same time as they are being asked to offer concessions on trade.

In the wider global context of the current North-South stalemate, rather than at the narrow level of conditionality for developing countries, the introduction of formal multilateral trade cum finance consultation procedures would probably be welcomed by the developing countries. Proposals for such procedures have been afloat at least since the report of the IMF's Committee of Twenty in the early 1970s. Institutional reforms of this kind might go some way toward resolving the cross-cutting problems that the international community has found difficult to address within the existing institutional machinery. Unfortunately, such an extensive "package deal" could only be the product of "high politics", for which the global environment does not at present seem ready.

At the other extreme, some observers prefer an approach that is much less ambitious than even the limited GATT agenda that now seems likely. Some of those who believe that it is unlikely that a multilateral negotiation will come up with anything more than non-binding codes or statements of principles, suggest working within the bilateral treaty context that has served some countries quite well in the past (Grey, 1985 p.35-36). Smaller and weaker countries would likely do much better, however, negotiating in a multilateral setting rather than one-on-one with more powerful trading partners.



## 7. Canada and the Developing Countries

Canada supports efforts to develop a multilateral framework to liberalize trade in services under the aegis of the GATT and, at the same time, has negotiated a free trade agreement with the United States that, if ratified, will include provisions relating to both services and investment. Because of this, the Canadian government - in consultation with the provinces and the private sector - has been steadily expanding its knowledge and understanding about services issues.

As a middle-sized and open country, Canada depends on the smooth functioning of the international trading system and, like developing countries, benefits from multilaterally agreed, transparent and predictable rules. For this and other reasons, Canada has actively encouraged developing countries to support and participate in the multilateral discussions on services.

While Canada has been a keen supporter of the U.S. initiative to broaden the scope of the GATT (and sees many export opportunities in both Northern and Southern service sector markets), it also shares many concerns with developing countries. Canadian anxieties about the potential role of U.S. services and U.S. firms in the domestic economy parallel the concerns of the developing countries (and others) about the maintenance of cultural and economic sovereignty, the protection of sensitive industries, and the right to control the inflow of foreign investment.

Given these similarities in interests, and considering

Canada's generally good relations with the developing countries, Canada has been well situated to play a mediating role within the context of the Uruguay Round negotiations on services. This could be pursued by simply working to bridge the gap between North and South or by seeking to build a broader services coalition that included other developed countries as well as Third World nations.

However, the potential for a Canadian role as mediator in the multilateral context will be affected by the outcome of its current bilateral initiative with the United States. Many developing countries have been apprehensive about the services issue, and generally suspicious about American intentions. Canada has already significantly allied itself with the U.S. on the services issue in the Round. In the draft agreement with the U.S., it has undoubtably demonstrated even further commitment to the U.S. approach.

The proposed bilateral agreement lays out a set of disciplines to govern trade and investment for the covered service sectors and incorporates the following principles: national treatment, right of establishment, right of commercial presence, transparency and dispute settlement. Cultural industries are the only ones specifically exempted (and there is an attempt to define what these - primarily service - industries are. Advertising appears to fit the definition. This proposed agreement also contains clarifying annexes on architecture, (a prototype for other professional services?), tourism,

telecommunications, computer services, financial services, and, later, transportation. Contrary to expectations, the U.S. was less interested in some elements of services trade liberalization than was Canada. The lesson may be that, like Canada, the developing countries should not be assumed to be "protectionists" resisting U.S.-supported across the board liberalization. In the service sector, just as in goods trade, U.S. trade negotiators have domestic interests to appease.

No doubt some will attempt to promote the bilateral agreements on services as potential models for future services agreements in the Uruguay Round. If so, the developing countries will certainly argue that since Canada is now a major foreign direct investor and exporter of services, its interests are much closer to those of the U.S. than to their own. The U.S.-Canada services agreement, on present evidence, does not sufficiently address Third World concerns to be influential in multilateral discussions.

On one point, however, an important precedent of interest to developing countries appears to have been set. The U.S.-Canada draft recognizes the need for "temporary entry of business persons and recognised professions and persons engaged in sales or after sales service functions." This provision for certain limited liberalization of labour flows is said to have been extremely difficult for U.S. labour interests to accept; it raises, for them, the spectre of eased immigration flows of a more general character. It will be interesting to see how this

issue fares in U.S. Congressional discussion.

The other principle feature of the U.S.-Canada deal is the absence of an agreement on intellectual property. In view of the importance accorded this subject in Washington policy circles (and indeed its prominence in the bilateral debate over pharmaceutical patents policies) this is a surprising omission. Perhaps it illustrates that there is an infinite variety of bargains that can be struck in goods plus services trade: and one cannot expect to incorporate all subjects and all objectives within agreements that have to be struck within specific time horizons.

Also worth noticing is the explicit recognition by the U.S. of the Canadian right to control foreign investment. While it is true that the effect of the agreement is to reduce Canadian (and U.S.) rights in this sphere, it is also true that the U.S. has hitherto been reluctant to recognize others' rights in this area at all.

While the Canadian government insists that it is committed equally to the bilateral and multilateral negotiations, it may now have lost much of its capacity to act as an effective mediator on the controversial services issues. If, however, the detailed negotiations with the U.S. break down or drag on (or if the agreement is rejected in the political process in either country), there may still be important opportunities for the Government of Canada to play a constructive multilateral bridging role. Given that the services issue is at the heart of both

discussions, Canada, for its own benefit, should build whatever bridges it can between them. By so doing Canada achieves several objectives at the same time. In the first instance it increases what bargaining leverage it has left vis-a-vis the U.S. by introducing some multilateral concerns into its inherently disadvantageous bilateral bargaining with a much more powerful partner. Secondly, broader consultation may still offer some prospect that an agreement achieved with the U.S. in the "new" areas like services may be "open" to others later, and/or may serve, at least in some respects, as a "model" for fully multilateral approaches (rather than marking a further step toward trading blocs and a disintegrating global system). Finally, it may build goodwill with other countries, particularly with some of those developing countries, e.g. Brazil, India, China and Korea, with which Canada aspires to build stronger trading ties, by strengthening such countries' hands as they themselves negotiate bilaterally on these issues with the U.S. and others. Regardless of the outcome in the Canada-U.S. agreement, Canadian negotiators are now at the forefront of understanding of the services sector; they have acquired a wider and deeper familiarity with the key, controversial services trade issues (and U.S. goals) than is typical in other countries and this expertise could and should be used to inform others.

## Appendix

GATT Multilateral Trade Negotiations  
Ministerial Declaration

20 September 1986

PART IINEGOTIATIONS ON TRADE IN SERVICES

Ministers also decide, as part of the Multilateral Trade Negotiations, to launch negotiations on trade in services.

Negotiations in this area shall aim to establish a multilateral framework of principles and rules for trade in services, including elaboration of possible disciplines for individual sectors, with a view to expansion of such trade under conditions of transparency and progressive liberalization and as a means of promoting economic growth of all trading partners and the development of developing countries. Such framework shall respect the policy objectives of national laws and regulations applying to services and shall take into account the work of relevant international organizations.

GATT procedures and practices shall apply to these negotiations. A Group of Negotiations on Services is established to deal with these matters. Participation in the negotiations under this Part of the Declaration will be open to the same countries as under Part I. GATT secretariat support will be provided, with technical support from other organizations as decided by the Group of Negotiations on Services.

The Group of Negotiations on Services shall report to the Trade Negotiations Committee.

**Table 1**  
**Sectoral Breakdown of Employment**  
**(% of total labour force)**

Percentage of labor force in:

	Agriculture		Industry		Services	
	1965	1980	1965	1980	1965	1980
Developing Economies	70	62	12	16	18	22
Low-Income Economies	77	72	9	13	14	15
China and India	77	72	9	14	14	14
Other Low-Income	79	71	8	10	13	19
Middle Income Economies	57	44	17	22	26	34
Lower Middle-Income	66	56	12	16	22	29
Upper Middle-Income	45	29	23	29	32	42
High-Income Oil Exporters	56	36	15	21	28	44
Industrial Market Economies	14	7	38	35	48	58

Source: World Bank World Development Report 1987 (Table 32)

Table 2

Sectoral Breakdown of Gross Domestic Product  
(% of GDP at current factor prices)

	Agriculture		Industry		Services	
	1965	1985	1965	1985	1965	1985
Developing Economies	29	20	29	34	42	47
Low Income	41	32	28	33	32	35
China & India	41	31	30	37	29	32
Other Low Income	41	36	17	19	42	45
Middle Income	20	14	30	34	50	52
Lower-Middle	29	22	24	32	47	47
Upper-Middle	15	10	34	35	51	54
High Income Oil Exporters	5	2	5	8	30	39
Industrial Market Economies	5	3	40	36	55	61

Source: World Bank World Development Report 1987 (Table 3)



Table 3

## Sectoral Breakdown of GDP Growth

(Average annual growth rate (percent))

	GDP		Agriculture		Industry		Services	
	1965-80	1980-85	1965-80	1980-85	1965-80	1980-85	1965-80	1980-85
Developing Economies	6.0	3.3	3.1	4.0	7.6	3.5	6.4	2.8
Low-Income Economies	4.8	7.3	2.7	6.0	7.6	9.3	5.0	6.3
China and India	5.3	8.3	2.9	7.1	8.2	10.0	5.5	7.5
Other Low-Income	3.2	2.8	2.0	1.9	4.4	3.7	4.0	3.0
Middle-Income Economies	6.5	1.7	3.5	2.1	7.6	1.2	6.7	1.9
Lower Middle-Income	6.3	1.6	3.3	1.9	8.5	0.6	6.4	2.3
Upper Middle-Income	6.6	1.7	3.7	2.3	7.2	1.4	6.9	1.7
High-Income Oil Exporters	7.5	-2.2	--	7.8	--	-8.3	--	5.1
Industrial Market Economies	3.7	2.3	1.2	1.5	3.6	2.5	3.9	2.0

Source: World Bank World Development Report 1987 (Table 2)

Table 4

COMPOSITION OF INTERNATIONAL SERVICE TRANSACTIONS  
(SDR billions)

	INDUSTRIAL COUNTRIES			NON-OIL DEVELOPING COUNTRIES			OIL-EXPORTING DEVELOPING COUNTRIES		
	1985		Balance	1985		Balance	1985		Balance
	Exports (credit)	Imports (debit)		Exports (credits)	Imports (debit)		Exports (credits)	Imports (debit)	
<b>Non-Factor Services</b>									
<b>Services Trade</b>									
Shipment	42.4	47.1	-4.9	10.1	20.5	-10.4	0.75	12.5	11.75
Other Transport	51.6	55.6	-4.0	17.2	12.6	4.6	1.2	4.3	-3.1
Travel	69.8	73.1	-3.3	26.6	14.9	11.7	1.2	4.3	-3.1
Other Private Services and Income	105.9	93.0	12.9	33.0	28.2	4.8	6.5	20.1	-13.6
<b>Total</b>	<b>269.5</b>	<b>268.8</b>	<b>0.7</b>	<b>86.9</b>	<b>76.2</b>	<b>10.7</b>	<b>9.42</b>	<b>38.3</b>	<b>-28.88</b>
<b>Factor Services</b>									
Direct Investment Income	52.3	28.7	23.6	1.1	9.1	-8.0	0.0	7.2	-7.2
Private Unrequited Transfers	14.4	18.8	-4.4	21.4	3.2	18.2	0.6	11.6	-11.2
<b>Total</b>	<b>66.7</b>	<b>47.5</b>	<b>19.2</b>	<b>22.5</b>	<b>12.3</b>	<b>10.2</b>	<b>0.6</b>	<b>19.0</b>	<b>-18.4</b>
<b>Total Services</b>	<b>336.2</b>	<b>316.3</b>	<b>19.9</b>	<b>109.4</b>	<b>88.5</b>	<b>20.9</b>	<b>10.0</b>	<b>57.3</b>	<b>-47.3</b>

Source: IMF Balance of Payments Statistics, Vol. 32 Yearbook (1981) and Vol. 37 Yearbook (1986)

Table 5

COMPOSITION OF WORLD EXPORTS, 1975, 1980, 1985  
(%)

	World <sup>a</sup>			Industrial Countries			Non-Oil Exporting LDCs			Oil Exporting LDCs		
	1975	1980	1985	1975	1980	1985	1975	1980	1985	1975	1980	1985
Merchandise FOB	78.1	79.2	79.2	77.4	77.0	78.3	71.1	74.8	77.0	95.3	96.6	93.9
Non-Factor Services	17.4	16.3	16.7	18.3	18.3	17.4	20.9	18.2	18.3	4.1	3.2	5.7
Factor Services <sup>b</sup>	4.5	4.5	4.1	4.3	4.7	4.3	8.0	7.0	4.7	0.6	0.2	0.4
Total Export (SDR billions)	100.00 (754.0)	100.00 (1772.2)	100.00 (2188.2)	100.00 (585.0)	100.00 (1199.3)	100.00 (1548.2)	100.00 (103.5)	100.00 (337.2)	100.00 (475.2)	100.00 (61.2)	100.00 (235.8)	100.0 (163.8)
As a % of World Total	100.00	100.00	100.00	77.6	67.7	70.8	13.7	19.0	21.7	8.1	13.3	7.5

<sup>a</sup> Refers to IMF Members<sup>b</sup> Not including government transfers or official transactionsSource: IMF Balance of Payments Statistics, Vol. 32, Yearbook (1981) and Vol. 37 Yearbook (1986).

**Table 6**  
**COMPOSITION OF DEVELOPING COUNTRY<sup>a</sup> EXPORTS,**  
**BY REGION**  
**(%)**

	Africa		Asia		Western Hemisphere	
	1980	1985	1980	1985	1980	1985
Merchandise FOB	86.4	84.6	81.8	82.1	81.0	82.0
Non-Factor Services	10.2	10.8	14.4	14.8	17.5	16.4
Factor Services <sup>b</sup>	3.4	4.6	3.8	3.1	1.5	1.6
Total Export	100.0	100.0	100.0	100.0	(100.0)	(100.0)
(SDR billions)	(83.2)	(76.7)	(146.6)	(235.1)	(95.0)	(120.6)

<sup>a</sup> Refers to IMF Members

<sup>b</sup> Not including government transfers or official transactions

Source: IMF Balance of Payments Statistics, Vol. 32, Yearbook, Part 2, 1986.

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