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by

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on
Trade in Services

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TRADE IN SERVICES: THE NEGOTIATING INTERESTS, OBJECTIVES AND CONCERNS OF THE EUROPEAN ECONOMIC COMMUNITY

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Henryk Kierzkowski *

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* Graduate Institute of International Studies, Geneva

I. Introduction

"... We went on to consider how well Community service industries would cope with the increase in international competition if these [trade] obstacles were to be done away with, and we were pleasantly surprised to find that on the whole our producers of services regard themselves as among the world's most competitive. It is no coincidence, apparently, that the Community's service exports are three times higher than the United States. Where trade in goods is concerned, we are the world's largest exporter; but when it comes to trade in services, we are the "superpower"!.." So spoke Willy de Clercq, the commissioner in charge of the European Community's external relations and commercial policy, when addressing the issue of GATT negotiations on trade in services.

The message put across by Commissioner de Clercq is that, given its strength in services, the Community has nothing to fear from liberalization of international trade in this area, and in fact it is only too eager to become a major force in establishing a liberal regime. This assessment needs to be carefully examined because, indeed, the position and the attitude taken by the Community in the ongoing negotiating process will be a crucial factor in shaping the future trading system.

This paper attempts to analyze negotiating interest, objectives and concerns of the EC with regard to trade in services. Section II develops a statistical picture of the European Community's external and internal trade in services. The very magnitude of this trade makes the Community a major force in international negotiations.

Trade in services has been dealt with in the Treaty of Rome and Section III looks at the Community legislation in this area. This section also investigates the extent to which the Treaty of Rome has been implemented in practice.

The process of international negotiations on services is accompanied in many countries by domestic deregulation of numereous tertiary activities. Section IV focuses on the interrelationship between liberalization of the internal market and international competitiveness. The more efficient and competitive the EC becomes though domestic deregulation, the more favorable it will be towards international liberalization of trade in services, and vice versa.

In the last section of this paper, an attempt is made to identify elements of the EC negotiating strategy. Naturally, an exercise of this type is highly speculative and should be treated with a dose of scepticism.

II. A Glance at Statistics

It is only natural to begin examining the EC position by recalling some basic facts and statistics. It should, however, be noted that data on trade in services, in developing and in developed countries alike, are of poor quality. There are therefore rather strict limits within which the question of comparative advantage can be examined.

Table 1 contains the basic statistics pertaining to individual EC members and the Community as a whole. The table considers the EC as a set of individual countries rather than one trading block. Thus, the trade flows do not separate intra-EC trade from external trade of the Community. The best source of data on international trade in services continues to be the

Table I. E C Trade in Services, 1985
(in millions of SDRs)

Country	Shipment	Other Transport	Travel	Other Private Services	Total Services
BELGIUM-LUXEMBOURG					
credit	2,029	1,269	1,647	5,841	10,786
debit	1,598	1,355	2,030	4,949	9,932
net	431	-86	-383	892	854
BRITAIN					
credit	2,685	5,952	7,024	13,026	28,687
debit	3,258	6,240	6,281	5,101	20,880
net	-573	-288	743	7,925	7,807
DENMARK					
credit	1,716	884	1,316	1,457	5,373
debit	862	1,294	1,398	1,197	4,751
net	854	-410	-82	260	622
FRANCE					
credit	5,443	5,440	7,861	16,064	34,808
debit	6,734	4,786	4,519	8,252	24,291
net	-1,291	654	3,342	7,812	10,517
WEST GERMANY					
credit	3,930	4,345	5,866	10,930	25,071
debit	4,806	4,713	14,476	11,980	35,975
net	-876	-36	-8,610	-1,050	-10,904
HOLLAND					
credit	2,616	5,384	1,480	4,574	14,054
debit	3,853	2,009	3,103	4,478	13,443
net	-1.237	3,375	-1,623	96	611
GREECE					
credit	62	197	1,396	921	2,576
debit	435	201	360	277	1,273
net	-373	-4	1,036	644	1,303
IRELAND*					
credit	- 17	394	466	152	1,029
debit	-357	258	400	262	1,277
net	-340	136	66	-110	-248

Table I. E C Trade in Services, 1985
(in millions of SDRs)

Country	Shipment	Other Transport	Travel	Other Private Services	Total Services
ITALY					
credit	2,919	2,048	8,625	5,972	19,564
debit	4,371	1,805	2,249	5,959	14,384
net	-1,452	243	6,376	13	5,180
TOTAL EC					
credit	21,417	25,913	35,681	58,937	141,948
debit	26,274	22,661	34,816	42,455	126,206
net	-4,857	3,252	865	16,482	15,742

Source: IMF Balance of Payments statistics, Volume 37, Yearbook, Part 1, 1986
* The Figures for Ireland are for 1983.

IMF Balance of Payments statistics. The IMF distinguishes four basic categories:

1. Shipment covers the freight, insurance, and other distributive services. Most shipping services are provided through the operations of carriers. This category is rather homogenous, although serious difficulties may be encountered in establishing the residence of an enterprise especially when its carriers operate in more than one country or sometimes only in third markets.

2. Other Transport comprises two main categories: passenger services and port services. Services covered by fares as well as transportation of excess baggage and of personal effects accompanying an individual traveller such as automobiles fall into the first category of Other Transport. Most service activities and foreign exchange earnings are generated on this account through the operation of airlines. Port services stem from shipping and airline activities and cover procurement, loading, storage, pilotage, maintenance and repair.

3. Travel refers to the goods and services purchased by a traveller in a country of which he is not a resident. Tourism is the major component of this category.

4. Other Private Services are a collection of very diverse and heterogeneous activities. They include: non-merchandise insurance, communications, advertising, brokerage, management, operational leasing (other than charters), processing and repair, and professional and technical services.

The IMF also uses a category called Other Goods,

<u>Services and Income</u>. The figures reported in Table 1 do not include labor income or prcperty income.

Table 1 gives trade flows for the Community of ten with Belgium and Luxembourg being aggregated into one entry. At the time of writing this paper, the most recent available statistics referred to 1985. For this reason neither Spain nor Portugal were included in Table I. Of the two new entrants to the EC, Spain is by far much more important. However, the Spanish strength is services stems almost entirely form one single type of service, namely travel (with credits and debits amounting in 1985 to 7,962 and 985 million SDRs, respectively).

It can be clearly seen that the members of the European Economic Community are major exporters and importers of services. Indeed, among the 12 largest exporters of services in the world, six come from the EC: U.K, France, West Germany, the Netherlands and Belgium. The Spanish entry into the Common Market will increase this number to seven.

The individual members of the European Community generated in 1985 a surplus on trade in services worth 15.7 billions of SDRs. This happened in spite of a very large deficit of almost 11 billion SDRs run by West Germany. The United Kingdom, France and Italy were the main contributors to the net surplus.

In comparing the EC with the United States it is worth pointing out that the ratio of service exports to merchandise export is, on average, about twice as high for the former than for the latter. Also, the sizeable EC surplus in services is to be contrasted with the U.S. deficit of 2.73 billion SDRs.

Looking at the individual categories of services, Table 1 reveals that as far as shipment is concerned the EC countries tend to be net importers. This also applies, perhaps somewhat surprisingly, to Greece. Only Belgium and Denmark recorded shipment surpluses in their balance of payments statistics for 1985.

The picture changes when one looks at other transport services. Italy, France, Ireland and especially the Netherlands emerge as net exporters. As already pointed out, Other Transport services are mainly dominated by airline activities. In fact almost all EC member states have strong national airlines or at least national airlines strongly supported by governments.

Turning to the travel category, the majority of the EC countries offer substantial tourist attractions for foreign visitors and, in addition, the necessary infrastructure to turn tourism into an important service industry. Only West Germany and Holland run a sizeable deficit on this account.

Without any question, the most important and interesting category are Other Private Services. Unfortunately, it is also the most heterogeneous group of services. It is in this area that the strength of the Community manifests itself most clearly. Belgium, the United Kingdom, France and Italy come out as very strong exporters. However, on the basis of IMF statistics it is not possible to establish a transparent picture of the EC's revealed comparative advantage in Other Private Services. For one thing, the grouping and the level of aggregation differs between the countries concerned. Yet it can be established that France's particular strength lies in construction activities and surveys and technical cooperation. As for the United Kingdom, one can only guess that insurance, communications and financial services contribute in a substantial way to the total export earnings.

So far the European Community has been treated as a collection of individual countries. It is of course also important to look at the EC as a single entity. Given geographic proximity, similar levels of income, much the same tastes and institutional factors, intra-EC trade in services is bound to be important. Yet for many policy issues it is the external trade of the Community that matters in shaping general perceptions and in developing negotiating positions.

Table 2 contains general information about extra-EC trade in services. The figures are in millions of ECUs and represent averages for 1979-82. It appears that the Community's exports approximately equal its imports. About two-thirds of the trade involved OECD countries, with the United States being the dominant partner. Trade with Japan, Canada, Australia, and New Zealand was relatively modest. It is worth pointing to significant trade flows - exports as well as imports - between the EC and non-OECD countries. In fact, these flows were even more important than trade with the United States.

Table 2. European Community External Trade in Services, 1979-1982 average.

(in millions of ECUs)

value	U.S.A.	Japan	Canada	Austr.NZ	Other OECD	Other Countries	Un-Allo-cated	Extra EUR 10
Credit	24260	3239	1722	2076	18151	36457	5229	91134
Debit	21773	1783	1377	1157	24118	34555	3771	88534
Net	2487	1456	345	919	- 5967	1902	1458	2600

Source : Study on International Trade in Services, European Communities, Brussels, 1985.

Looking at individual services items, transport (comprising shipping and other transport) amounted to about 30 percent of total extra-EC trade flows in services. Exports to and imports from the United States represented around 25 percent of the total value of the transactions in this category of services. The EC achieved a rough overall balance in transportation services, as well as a balance with major external partners.

As far as travel is concerned, the Community ran a deficit between 1978 and 1982. There was a surplus with the United States, Japan, Canada and Australia and a substantial deficit with other OECD countries.

Again, the most interesting category are other services which amounted to roughly 50 percent of extra-EC exports and imports. Here the EC was able to generate a surplus worth on average 4.2 billion ECUs. The existing statistical information points to the importance of non-merchandise insurance and construction/engineering services. In both areas the Community ran a surplus during the 1979-82 period (827 million ECUs for insurance and 6,320 million ECUs for construction and engineering services).

What is the relative importance of intra and extra-EC trade? Only crude estimates can be obtained, but they indicate that in transport and other services intra-EC trade amounts to about one third of total services traded by Community members. The importance of intra-EC trade in travel is even greater: the relevant figure approaches 50 percent.

The data presented above substantiate Willy de Clercq's claim that the European Community is indeed a "superpower" as far as trade in services are concerned. Extensive trade flows have developed among the member countries. These links are likely to continue and even further intensify independently of the ongoing international negotiations.

If one wanted to explain intra-EC trade in services, one would have to turn to so-called "new trade theories" which stress product differentiation, oligopolistic market structures and technological competition as a basis for trade and downplay the role of factor endowments. It is generally agreed that competition is limited in shipping, other transport and in major components of the other private services. Liberalization of various service sectors in the Community and harmonization of internal rules and policies will in all likelihood further stimulate intra-EC trade.

The external EC trade in services marks the Community as the major force in this field, both as an exporter and an importer. With balanced trade in transportation services and a relatively small deficit in tourism, the Community's comparative advantage appears to be in the <u>Other Services</u> category. This group contains many modern services such as banking, insurance, telecommunications, and construction/engineering. These services are often provided under non-competitive market conditions and tend to be human-capital intensive in production. In addition, long historical experience, reputation, technological excellence and extensive networking are key elements to a successful export strategy.

While the magnitude of the EC's trade in services makes the Community a key player in international trade negotiations, it does not necessarily follow that it will seek a very open and multilateral trading regime. The EC's position will depend, inter alia, on whether present export performance stems from real strength or is induced by policies - commercial and domestic - which favor domestic producers and exporters and impede foreign competition. To use a somewhat unfair comparison, the EC export performance in agriculture does not go hand-in-hand with high efficiency among European farm producers. At this point it remains still unclear whether the Community itself and the national governments have arrived at a clear assessment of the situation.

In concluding this section it bears stressing that only a partial analysis of trade in services has been provided. The statistical picture was limited to trade defined in a narrow, or traditional, sense. However, great deal of international transactions in services are done through activities of foreign affiliates located abroad rather than though traditional channels. This is so because services often require physical proximity of the provider and or the receiver. Unfortunately, statistical information about foreign affiliates of services firms is extremely limited and therefore not much can be said on this subject. Yet, in what follow I will talk about trade in services defined in broader terms. To limit the discussion to direct trade in services would mean missing the main point of the ongoing international negotiations and debates.

III. Community Legislation Regarding Trade in Services

The authors of the Treaty of Rome aimed high in their vision of bringing the economies of the member states closely together. Their objective was that, ultimately , the internal trade in goods and services, as well as in factors of production, would be free of any obstacles.

Trade in services is dealt with the Treaty of Rome in Articles 59-66; transport services are treated separately in Articles 74-84. It is pertinent to note that Articles 59-66 are in the section of the Treaty setting the rules for movement of labor, rights of establishment for business and capital movements. The legislation concerning services must therefore be seen in the larger context of the question of freedom of establishment by legal and physical persons within the Community. The key element of this policy is set out in Article 52 which reads as follows:

> "Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be abolished by progressive stages in the course of the transition period. Such progressive abolition shall also apply to restrictions on the setting up agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State ...." .

This general approach is upheld and amplified in Article 59 dealing specifically with services. It states in part that "... restrictions on freedom to provide services within the Community shall be progressively abolished during the transition period in respect of nationals of Member States ..." It could be argued that the provisions of Article 59 are even wider than those dealing with free movement of capital because they call for the elimination of all restrictions which prevent performance, limit the use of services, restrict the movement of services, or even restrict payments for services rendered.

Article 60 defines the range of services covered by the Treaty of Rome. Although they are determined by a negative definition, it is clear that the coverage includes : 1) all services where the supplier moves to the recipient; 2) all services where the recipient moves to the supplier ; and 3) all services which themselves cross national borders within the EC, with their suppliers and recipients remaining in their own countries.

Taken together Articles 59-66 should be seen as calling for the abolition of restrictions on trans-border trade in services occurring without any accompanying flow of factors as well as the elimination of restrictions on movements of factors of production for the purpose of providing services in another member state.

Naturally, the abolition of existing restrictions on services within the European Community was to be implemented gradually. The Treaty of Rome assigned the Council of Ministers the role of laying down a general program for the elimination of obstacles to the free provision of services, as well as the role of issuing directives for the implementation of the general plan. In principle, by the end of the transition period (i.e. by January 1, 1970) services were to be liberalized within the Community.

The envisaged liberalization has not been fully implemented. It is commonly agreed that the abolition of restrictions on establishment and on the freedom to provide services has been a very painful and slow-moving process whose end is still not in sight. The basic reason for the failure to establish freedom of services within the EC is the lack of harmonization of member states' legislation, regulations and administrative rules regarding services and the fundamental disagreement between the Commission and the member states on the interpretation of Articles 59-60.

The Commission - Member States conflict can be explained as follows. The Treaty of Rome requires the signatories to do two things : first, to abolish restrictions on the freedom of provision of services; second, to harmonize national legislation, regulations and administrative rules in the field of services. The question is what should come first. Member States argue that, given vast differences between national regulatory regimes, the harmonization of regulations is a precondition for freeing trade and factor movements in the field of services. The Commission holds the view that the Treaty of Rome called for an immediate (i.e. within the transition period) elimination of restrictions on the freedom to offer services. The purpose of the coordination of national legislation regarding services was to eliminate distortions to competition, quite a different matter. The lack of harmonization should, in the view of the Commission, have no limiting influence on the scope and applicability of Articles 59 and 60.

In recent years the Court of Justice of the Communities seems to have upheld the position taken by the Commission. In the Van Binsbergen case decided in 1974, the Court ruled that Articles 59 and 60 were self-executing as of January 1, 1970 with no need for additional Community legislation.

On a number of other occasions (in the Webb case decided in 1981, the Van Wesemael case of 1979 and the Transporoute case in 1982) the Court has further upheld the rights of the nationals of one member state to provide services in another. Of course, a supplier operating outside his own territory, is bound to abide by the regulations of the host country. But as one commentator has observed, the last provision "... does not mean, however, that the person providing the service is subject to all national provisions which apply to undertakings established in that state but only to those provisions which are justified by the general good, insofar as that interest is not already safeguarded by the provisions to which the provider of the service is subject in the Member State of his establishment" (Pool, (1984), p. 138).

It is quite likely that the EC Court of Justice will continue to be involved in the application and the upholding of the Treaty of Rome with regard to services. But the progress cannot be rapid in the face of the disagreement between the Commission and Member States and resulting litigations involving the Court.

All in all, the European Community has still a long way to go in establishing a common market for services. To accomplish this task it has first to achieve harmonization of domestic regulatory policies. It will then need to develop a common approach towards third countries.

So far, member states are free to pursue their own regulatory policies on a unilateral basis. The United Kingdom - with the deregulation of telecommunications, airlines and financial services - has gone further than other EC countries in introducing competition though domestic deregulation. But France has also been moving in the same direction, especially since the right-center coalition has formed the government under Premier Minister Jacques Chirac.

IV. Market Deregulation and International Competition

Many of the developed countries are today engaged in both domestic deregulation and at the same time at attempts to liberalize international trade in services. Domestic deregulation by and large concerns service sectors: airlines, railways, banking, insurance, public utilities. The two issues are often linked in the minds of policy makers, although they do not necessarily grasp the nature of the interrelationship. It would be fair to say that the willingness of governments to seek a liberal trading system in services would be enhanced if domestic deregulation resulted in more efficient service industries.

The usual argument employed by proponents of economic liberalism is that the more competition at home, the better the export performance, and an increase in domestic efficiency carries over to the international arena. But is it really true ?

This section will explore the relationship between domestic deregulation and the joint harmonization of policies within the EC. So vast a problem can be only dealt with effectively by referring to a particular industry. I propose to look at the problem of market deregulation and international competitiveness in the context of the air transport industry in the EC.

As already indicated transport is treated in the Treaty of Rome in a separate section, Articles 74-84. Article 74 called for the EC Council of Ministers to implement the common transport policy in the course of the transition period by "laying down common rules applicable to international transport from or to the territory of a Member State .." and "determining the conditions under which non-resident transport concerns many operate transport services within a Member State...". It was recognized from the outset that the forces of free competition were weaker and the market mechanism was less efficient in the transport sector than in other sectors of the economy. For this reason the Treaty of Rome did not seek to establish unrestricted free competition. Nevertheless, a common transportation policy was to be established in the course of integration. This policy was to be based on three fundamental objectives:

1) the elimination of obstacles to the establishment of a common market. With respect to transport services, this meant, among other things, the elimination of discrimination among member states with regard to transport rates.
2) the reduction of barriers of the free provision of transportation services within the Community. This goal was to be achieved though common rules applicable to international transportation services provided by nationals of one member state in the territory of another member state, as well as through the entry of non-resident carriers in to national transportation systems.
3) the establishment of a more competitive transport system.

The general rules described above were to guide the formulation of a common transport policy in various areas, among them passenger air travel. It has been clear for a long time that the Community badly needs a common transport policy. This need was reinforced by several rulings of the European Court which clearly stated that the general provisions contained in the Treaty of Rome also apply to air transport. Up until now, however, there has been virtually no tangible progress. A proposal made in 1975 in the so-called Spinelli Report to create a "European airspace" and set up single civil aviation authority empowered to negotiate with third countries did not gain the support of member states. Several rather modest suggestions made by the EC Council since the late 1970s have also met with rejection. As the EC authorities admit themselves in the study on international trade in services prepared for the GATT : "The Council Directive 41b/83 of July 25 1983 concerning the authorization of scheduled intra-regional air services for the transport of passengers, mail and cargo between Member States is the only (emphasis added) community legislation in this sector".

Thus, thirty years after the signing of the Treaty of Rome, a common Economic Community air transport policy still remains to be formulated and implemented. Absent such a policy, one is confronted by a jungle of bilateral arrangements and agreements. Pairs of individual countries negotiate conditions of entry and competition was well as rates. Community institutions are nowhere present in this process, and to the extent that common standards can be said to exist, they are not upheld.

The EC air transport industry has become very inefficient. Passenger costs per seat-kilometer on intra-EC flights are 60-80 percent higher than costs on domestic flights in the United States. Even when generous allowances are made for higher fuel prices in Europe, shorter average flights and other factors, a 20 percent differential in favor of American airlines still remains. Furthermore, recent deregulation in the United States has led to a dramatic increase in passenger traffic; the number of air passengers increased by more than 35 per cent between 1980-1985. European air passenger traffic rose by a mere 10 per cent during the same period. In the presence of economies of scale, different rates of growth of output are likely to accentuate cost differentials between the United States and the Common Market.

United States deregulation has, more than anything else, persuaded the European Community that it must establish a viable air transport industry. The United Kingdom and the Netherlands have become the chief proponents of liberalization. The two countries concluded a bilateral agreement in June 1984 which is notable for two outstanding features: (1), free entry by any British or Dutch airline is allowed on any route linking the two countries; and (2), airlines are free to set tariffs as well as the number of scheduled flights. Deregulation has also taken place on the Dublin-London route with spectacular results: new entries have increased competition, leading to a reduction of fares by 50 per cent and an increase in the number of passengers by over 30 per cent.

At this point it is not at all clear to what extent the Dutch-British and Irish-British examples of bilateral deregulation will be followed by other EC member. It is even less clear whether bilateral deregulation could be replaced in the near future by a liberal Common Market policy towards the air transport industry. Resistance to any change is considerable, as could be seen at the June 1987 meeting of the Community's transport ministers in Luxembourg. The ministers rejected a very modest package of deregulatory measures aimed at increasing price competition and limiting the size of the market reserved for a national airlines.

The question of domestic (or regional) deregulation and international liberalization of trade in services is of utmost importance. The two issues are very closely interrelated. This interdependence is brought out in a simple model developed in Kierzkowski (1987). The model deals specifically with the air transport industry and I will discuss its main features.

To begin, let us assume that there are only two regions in the world called the United States and the European Community. In the beginning each region has only two airlines; one serving only domestic or intra-regional routes and the other providing internal as well as international service. This assumption seems to describe the real world quite well, for only certain airlines are given the right to fly international routes and these airlines offer domestic flights as well. The demand functions for domestic flights within the United States and within the EC are given by equations (1) and (2) :

$$(1) \quad P_{EC} = a_1 - b_1 D_{EC}$$
$$(2) \quad P_{us} = a_2 - b_2 D_{us}$$

Note that the two demand functions are written in the inverted form, i.e. as the airfare on domestic flights within each region that the residents of that region are willing to pay for a given quantity of services, D_{EC} and D_{us}. Let us also assume that the demand functions for international flights, say from Brussels to New York, are like equations (1) and (2).

$$(3) \quad \overset{*}{P}_{EC} = a_3 - b_3 D_{EC}$$

$$(4)\ P^*_{us} = a_4 - b_4 D_{us}$$

To ease welfare analysis, the passengers are conveniently divided into two different categories: individuals who demand only domestic flights and have no use for international service, and individuals who take international flights but demand no domestic air transport services.

In modelling the supply side, I assume that the air transport industry is not only characterized by the existence of economies of scale but also by economies of scope. An airline with domestic and international services will produce any non-zero combination of output more cheaply than two separate airlines, one only with domestic flights and the other with only international routes. The existence of joint inputs (such as air terminals) is the usual reason given for the existence of economies of scope.

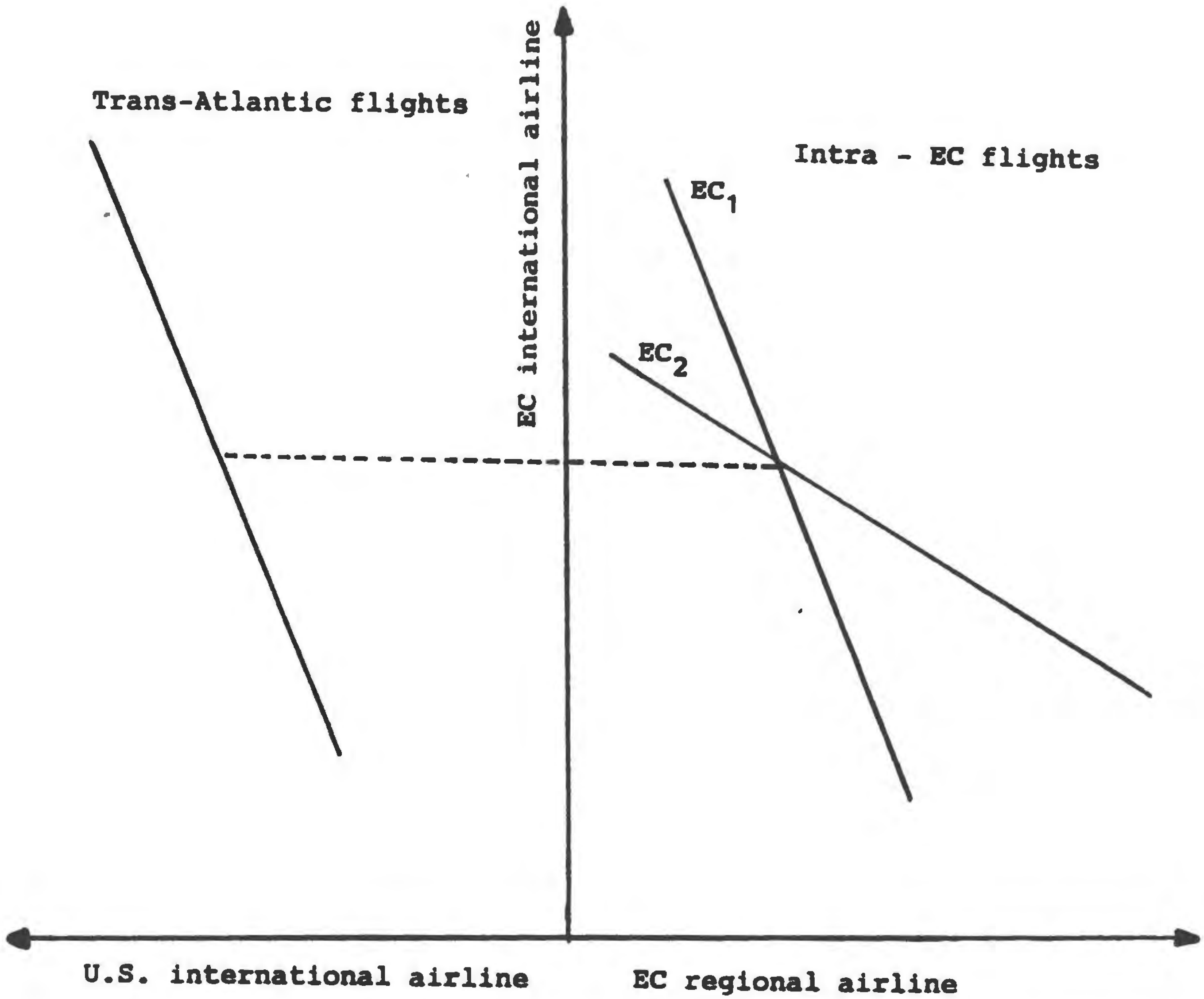
The model has been set up in such a way that there is a duopoly in each of the domestic markets as well as a duopoly in the international market. Every pair of duopolists plays a Cournot game in the relevant market.

It is relatively easy to solve the model and describe equilibrium for the industry as a whole, and in each market. This is done in Figure 1. The division of the EC internal market is shown in the right-hand panel. Intra-EC traffic is divided between the regional EC airline and the "global" EC airline with internal as well as international flights. The reaction functions of the two airlines are represented by EC_1 and EC_2. The solution for the intra-EC market shows that the global airline is the dominant producer. The reason for this is the existence of economies of scope. International operations allow this airline to be more competitive in the internal market.

The schedule contained in the left-hand panel of Figure 1 shows the relationship between intra-regional strength and international strength. The relationship is positive; the bigger an airline is in the domestic market, the more competitive it becomes internationally.

Consider now deregulation in the Economic Community which increases the number of airlines from two to three. The new entrant does not automatically gain rights to serve the trans-Atlantic market, it can only provide intra-EC flights. As a result, the EC_1 schedule shifts to the right. The global EC airline loses a part of the internal market. By being smaller, this airline becomes less competitive in the international market.

Figure 1


Trans-Atlantic flights
EC international airline
Intra - EC flights
EC_1
EC_2
U.S. international airline
EC regional airline

Welfare analysis of market deregulation in the EC is quite straightforward. More competition is a good thing for domestic passengers. Internal fares go down and the volume of traffic expands. However, international passengers need be better off. In fact their welfare will be reduced as a result of deregulation. As the global EC airline has its share of the market reduced, it becomes less competitive in the international market. Less competition means higher trans-Atlantic fares.

The model outlined above could be applied to other industries as well, such as banking or insurance. Whenever there are economics of scope, there is a genuine conflict between domestic deregulation and international competitiveness. Although the result of this model is not general, it does show at least a possibility that domestic deregulation may actually reduce international competitiveness. One could also set up a model where more domestic competition could enhance international efficiency. Since the results are ambiguous, policy makers are faced with a real dilemma. This is well captured in a recent report of the British Civil Aviation Authority: .." [The] Authority does not see competition as an end in itself or as one which should be pursued regardless of the impact upon the UK's international competitive strength ... The Authority favors competitive solutions ... The pursuit of multi-airline policy can, however, entail certain costs in terms of the UK's bilateral relationships with many other countries and possibly also in terms of the British industry's overall competitive strength when facing foreign airlines. These fundamental realities must shape and moderate the policies which the U.K. can adopt". (Quoted in Pelkmans (1986), p. 367).

V. Elements of the EC Negotiating Strategy

In the textbook world, international negotiations are conducted when the parties concerned have formed clear policy options, obtained the necessary information, formulated their objectives and detected an interest on the part of other countries in entering the negotiating process. In the real world, these conditions are not always fulfilled.

Certainly, as far as the negotiations on international trade in services are concerned, most of these conditions have not been satisfied by most of the countries. Even in the case of the United States, the initiator of the current MTN process, very serious doubts may be expressed as to whether complete rationality, abundance of information and clarity of policy goals were the main characteristics of the U.S. initiative. Be that as it many, this does not necessarily mean that a negotiating process which is not completely thought out by interested parties is doomed to fail. Negotiations can, and often do, force the participants to clarify their objectives, generate statistical information and see opportunities that otherwise would go unnoticed.

The above remarks should be kept in mind when discussing the Economic Community negotiating strategy for international negotiations on trade in services. A discussion of this strategy should begin with the November 1982 ministerial Meeting of the GATT. The Community - as much as other contracting parties - was surprised, if not astonished, to hear the U.S. proposal. It will be recalled that the American delegation pushed for liberalization of international trade in two priority areas : services and agricultural products. When the initial astonishment faded, doubts were created as to which of these two areas was the real goal of the U.S. initiative.

From the EC point of view, liberalization of trade in agriculture appeared to be much more threatening than services negotiations and hence to be more strongly resisted. It was conceivable that the U.S. was using the services threat as a means of opening talks on agriculture. But, of course, no one could be sure. In any case, the EC could not possibly say no twice to the United States.

When faced with a surprising initiative or with uncertainty about motives, stonewalling is the best negotiating strategy. This is indeed what happened. In the jargon of international commercial diplomacy, the GATT contracting parties agreed to study the problem of services. This was the main result of the November 1982 meeting.

The process of preparing national studies on services must have been a valuable learning experience for the Community. For one thing, countries were forced to start thinking about a new issue and they quickly realized the domestic importance of services as well as their future trade potential. Also, the extraordinary degree of ignorance regarding services - statistical information, policy analysis and the state of international trade theory - was revealed with great brutality. The EC became very conscious of this situation, perhaps more conscious than other partners.

In preparing its report on services for the GATT, the Community actively sought opinions not only from within its institutions, but also from outside, particularly the governments and the business community. At that stage a picture of the Community's strength in services and of its future potential began to emerge. Furthermore, spurred by the EC request for input, service industries in different EC countries, but particularly in the United Kingdom, started to lobby for a more open international trading system. To be sure, push for liberalization generates counter-forces pushing in the opposite direction. What was relevant, however, was that strong support for liberalization was manifested for the first time, in the Community.

The period between November 1982 and the September 1986 Punta del Este conference was a very preliminary, but necessary, stage in the process of policy formulation. The EC emerged from this stage much more confident of its comparative advantage in services, clearly aware of the strong support of service industries and therefore much more willing to talk business in the GATT, or elsewhere for that matter.

If one may speculate as to subsequent events, the European Community must have also realized at this point that its interests in the area of services basically coincided with those of the United States. Yet, the EC decided to be much less outspoken and partisan than the United States. Instead, the Community elected to assume the role of an intermediary between the United States and the developing countries. Essentially wanting the same thing, the Community did not want to be associated with this controversial initiative, lest the EC burn bridges and undermines its standing with the developing countries. It may well be that thanks to this constellation of forces and the lack of a common U.S. - E.C front that developing countries' fears and suspicious abated to some extent.

The Economic Community continued to play the role of an intermediary at Punta del Este. It supported the demand of developing countries to separate negotiations on goods from negotiations on services. As the result, a two-track negotiating procedure has been set in motion. It should be pointed out that while the Group of Negotiations on Goods works within the GATT and is therefore composed of contracting parties, the Group of Negotiations on Services involves governments and is outside the GATT. This distinction is by no means trivial; the existing arrangement leaves the question of whether services should be incorporated in the GATT entirely open. The outcome can not be foreseen at this point, but it is entirely possible that at the end of the day negotiations on services will be divided between several international organizations such as GATT, UNCTAD, ITU, WIPO and others.

The Group of Negotiations on Services met about ten times in the course of 1987. On december 4, 1987 the EC presented a discussion paper entitled "A possible conceptual structure for a Service Agreement". This short memorandum of six pages can be regarded as an opening shot on the part of the E.C. It is the view of the Economic Community that the first step on the road to a successful multilateral service agreement must be the development of a common conceptual framework with regard to services.

The EC discussion paper suggests the following key elements of the conceptual structure for a service agreement:

1. Progressive Liberalization of market access and respect for policy objectives. It is pointed out, quite correctly, that many service sectors are regulated for reasons having nothing to do with international trade. But it is, of course, possible that certain domestic regulations may represent a hidden

form of protection. The crucial question thus becomes: which regulations are appropriate. The EC proposes to establish a permanent regulations committee to deal with this issue.

2. Preservation of international competition. Liberalization of market access must not result in the monopolization of different service sectors by a small number of global firms.

3. Transparency. A liberal trading system requires transparency with regard to the existing domestic rules, regulations and the motives for their introduction.

4. Development compatibility. Liberalization of international trade in services must not hinder the development process.

It is quite possible that the suggestion made in the EC discussion paper will meet with general approval in the Group of Negotiations on Services. But some countries may see the document as being too general provide a solid starting point for the negotiations.

To date, the EC's position has not been fully articulated. There are three reasons for this :

1) The European Community is still in the process of developing a coherent policy of its own. This process takes a lot of time and often involves tensions between the member states and the Commission. In addition, statistical difficulties continue to impede the development of a rational policy.

2) The EC realizes that the U.S. position and attitude to the negotiations on services may change after President Reagan leaves office. The present U.S. policy stance has a strong imprint of the Reagan Administration; a different president,

especially a Democrat, could see things differently. Although no reversal of the U.S. policy can be anticipated, important shifts may occur and therefore the EC does not wish to reveal its negotiating position to the outgoing U.S. administration at this stage of the MTN.

3) The U.S.- Canada bilateral trade negotiations were very closely followed by the EC. The conclusion of these negotiations was awaited with great interest because the results could reveal what is possible in the MTN process. The EC may even expect that the United States will use the agreement with Canada as a prototype for an MTN accord. This scenario is certainly not far-fetched and its possibility would have discouraged the Community from revealing its hand.

The above arguments suggest that at least for the time being the European Community will continue to take a very low-key position in the GATT. At the same time, the EC attitude will crystalize. Already now several components of the negotiating strategy are becoming more and more visible. I will enumerate them in not necessarily the order of importance.

The division of the negotiating process into goods and services suggests that trading off benefits in one area against concessions in another will be more difficult. The fragmentation of the Punta del Este round favors in fact strong countries. It may be even argued that the EC should go for even further fragmentation - negotiations on a sectoral basis. This approach could allow it to refuse or limit negotiations in sensitive areas where the Community is weak.

As far as the EC is concerned, the process of international liberalization will be a function of domestic policy changes. The EC is still a long way from establishing internal free trade in services. It is even further away from establishing common regulatory policies for services. The Community would certainly not wish to proceed with international liberalization at a faster rate than internal liberalization.

The European Community is likely to be very concerned about factor movements - especially labor - as these would have to be permitted in a truly liberal trading regime. Without a doubt, the issue of right of establishment will be a key item on the agenda for services negotiations. To remove this obstacle means to allow for the international reallocation of factors of production employed in services sectors. In area such as banking, insurance and telecommunications, establishing a business abroad requires the displacement of physical and human capital with virtually no or very little movement of unskilled labor. However, in other industries such as construction, maintenance and repairs, mainly unskilled labor would be required to move internationally in great quantities. High unemployment in the EC, the strength of trade unions and the experience of the 1960s with migrant workers, suggest that the European Community will not favor total liberalization of services. Strict limits to factor movement will be imposed, especially labor. Sector-by-sector negotiations and insistence on reciprocity could make the imposition of such limits much easier.

The European Community has privileged relations with certain developing countries. It will try to protect its preferred supplier position and special historical links. The EC will therefore continue to play a bridging role between the North and the South.

Last but not least, the EC is certain to insist on its unlimited power to regulate service industries for other purposes than protection and on the need for foreign countries to meet EC standards. Certain elements of this position are already contained in the December discussion paper. I would venture to say that this point is non-negotiable and is very likely to create major conflicts in the future.

The above considerations suggest that the process of negotiations on trade in services will be protracted and very painful. We are only in the very beginning of it.

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