Observations on the Role of Services in International Trade

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Most international economists recognize the large and increasingly important role of services in international trade, but they often fail to account for services in international models of trade. In this article Susan Livingston analyzes the difficulties encountered in defining "invisible" goods in international trade. She first examines practical and theoretical attempts by economists and political authorities to define services. She then explores international trade in services and the barriers nations have erected to inhibit it. As an example of trade in services, she discusses the insurance industry and the problems it has experienced as a representative service-offering agent in the international market. The article concludes with suggestions for the use of several international policy forums to discuss service industry problems and to liberalize trade.

Although goods and services are often discussed and analyzed in international trade, the role that services play in the international economy is frequently neglected. Services comprise the tertiary, "invisible" sector of an economy in which agriculture and manufacturing have traditionally represented the primary and secondary sectors. Because services represent a wide spectrum of economic transactions — from those performed in beauty parlors to the activities of an insurance agency — and because of the difficulty in measuring the contribution of services to an economy, economic analysis and balance of payments accounting have predominantly focused upon the movement of tangible goods. The existence of a group of activities that can be classified in a "service sector" is hardly new; some of the world's oldest occupations were in the field of services, such as early money-lending. Services are "new" primarily in that until recently little attention was paid them in economic theory, national accounting methods, or in international trade forums. One economist writes that "[t]he eco-

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nomics of tertiary industry remains to be written. Many as yet feel uncomfortable about even admitting their existence."[1]

The phenomenon of increasing growth in the sector was evident in the US even prior to World War II; in the period from 1870 to 1930, the service sector grew more rapidly than the goods sector. Since the mid-1950s, more than half the labor force in the US has been employed in the provision of services, and today approximately 70 percent of US economic output and employment is in services. Virtually all net growth in the postwar-US economy has been reflected in services (*Note the spurt in services growth in Figure* 1), and growth in this sector has continued throughout the 1970s and into the 1980s, relatively unaffected by business cycles and recessionary periods. While the US has the most service-oriented economy, similar trends of growth in the sector are characteristic of other OECD countries. As evidenced in *Figure 2*, which shows the percentage of service sector participation in the economies of nineteen OECD countries, services comprise over 50 percent of Gross National Product (GNP) in a large number of these countries, and this proportion has increased since 1972.

While services fall well behind goods in their importance in international trade — representing about 30 percent of all US trade, for instance — the role of services is becoming more important. Most developed countries, for example, traditionally sustain a surplus in their service accounts; since this is the large growth sector of their economies (or what they have to offer overseas that is of increasing value), new policy interest in this area will be vital. As more focus is put on this sector, the gaps in the literature and economic theory will be filled.

WHAT ARE SERVICES? PRACTICAL CONSIDERATIONS

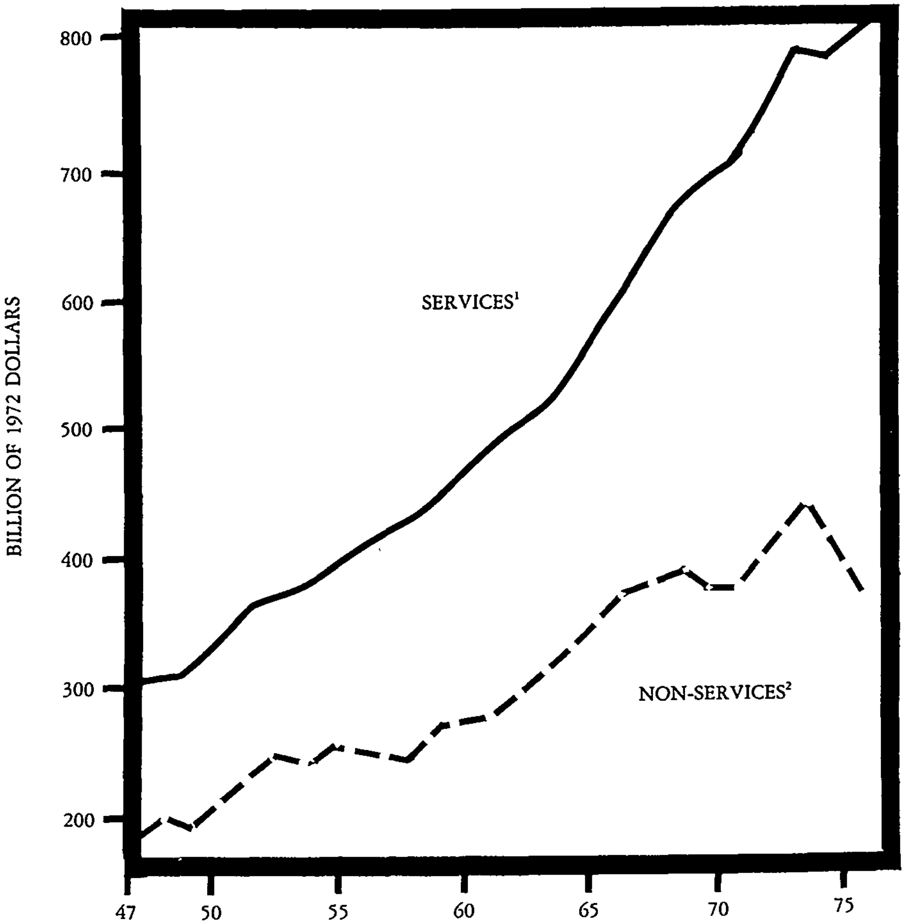
The service sector covers a very heterogeneous amalgam of industries whose common characteristic is the intangibility of their output. Practical working definitions of services vary greatly between and within countries. The US Standard Industrial Classification defines services as:

> hotels and other lodging places; establishments providing personal, business, repair and amusement services; health, legal, engineering and other professional services; educational institutions; membership organizations; and other miscellaneous services.[2]

1. Colin Clark, *Conditions of Economic Progress*, cited in V.R. Fuchs, *The Growing Importance of Service Industries* (New York: Columbia University Press, 1965), p. 1.
2. US Department of Commerce, *US Service Industries in World Markets* (Washington D.C.: USDOC, December 1976), p. 8.

Figure 1

US REAL GNP: SERVICES AND
NON-SERVICES COMPONENTS
(1947-1975)



[1] Value added in transportation, communications, utilities, wholesale trade, retail trade, finance, insurance, real estate, miscellaneous services, government.

[2] Value added in agriculture, forestry, fisheries, mining, construction, manufacturing, and "rest of world" sectors.

SOURCE: National Income Accounts Data, BEA

Figure 2

SERVICE SECTOR PROPORTION OF GROSS DOMESTIC PRODUCT, SELECTED OECD COUNTRIES, 1972[1]

	Total Proportion	Proportion Excluding Government Services
United States	64.3%	48.7%
Australia	60.8	49.5
Norway	60.3	47.2
Japan	54.8	51.4
Belgium	54.0	42.4
Canada	53.7	39.3
Netherlands[2]	53.7	40.9
Denmark	52.7	35.3
Sweden	51.8	34.8
United Kingdom	51.4	39.9
France (est.)[3]	51.0	39.5
Spain[2]	50.3	43.8
Italy	49.6	38.4
Austria	47.0	36.7
Germany	46.1	35.9
Greece	44.6	37.4
Turkey	43.7	33.0
Finland	41.3	29.0
Portugal	38.1	29.7

Source: OECD National Accounts Data

[1] Data represent percentage of GDP accounted for by gross product originating in services sectors as defined in this paper.
[2] 1971 data.
[3] Estimated on basis of other EEC countries.

The US national income accounts define services more broadly, including all of the above plus finance, insurance and real estate, wholesale and retail trade, general government, transportation, communication and public utilities. A recent World Bank study analyzed what are called "non-factor services," which include shipping, other transportation, travel, other private services and other government services. These definitions are by no means accepted internationally, and one of the major problems in analyzing the service sector is the lack of a consistent data base. It is clear that the service industries do not share common production processes, customers, suppliers, markets or even common trade problems.

Measuring the level and value of service activity has proved very difficult in the past, both for balance-of-payments and national income accounting purposes. Much service income escapes balance of payments under the present system. The output of a lawyer working for a manufacturing enterprise is placed under income in the manufacturing sector, whereas identical services performed in a private law firm are counted within the service sector income. The leakages in the balance of payments accounts, and general problems in measuring service outputs, lead to the conclusion that services play an even larger role in the economy than present measurement indicates. There has been a recent tendency to criticize GNP calculations on the grounds that they are unsuitable for measuring income in developing countries. It is now apparent that the traditional yardstick used for GNP may be unsuitable for recording real output in "post-industrial" states as well. The arbitrariness of the definition and of the measurement of services shows that drawing lines between goods industries and service industries is difficult. International agreement should be reached as to definitional and measurement standards so that a useful data base can be created for further analysis.

Now that a general framework for determining which industries are included in the service sector has been established, some characteristics of the sector can be discerned. First, higher per capita GNP countries tend to produce proportionately more services, especially of a tradable nature. *Figure 3* points out the correlation between per capita income level and percentage of employment in service industries. Higher per capita income levels are clearly associated with more services. Because of their extensive trade in services, most developed countries have a surplus on their invisible account. Developed countries are most successful in exporting services such as insurance and banking, construction and engineering services, or fees and royalties from affiliated foreign companies.

Rapid growth in services is not a characteristic unique to the most developed countries, for the service sector in many developing countries has been growing very rapidly as well. Examples of such countries are India, Korea, and Singapore, which export construction, engineering, and consulting services.[3] Most developing country economies are growing more rapidly in the industrial/manufacturing sector than in services, but on the average, services growth in these countries outpaces that of agriculture. The labor force in services is on the whole growing more quickly than that in industry or agriculture in developing countries, and some developing countries — Kuwait, Israel and Malta, for example — already have a majority employed in services. These countries are exceptions, however, as they have an unusually large tourist trade, an important entrepôt sector, and are small, highly-urbanized countries.[4] The rapid growth in services

3. World Bank, *Trade in Non-Factor Services: Past Trends and Current Issues*, Staff Working Paper No. 10 (Washington D.C.: World Bank Staff Working Papers, August 1980), p. 10.
4. For more discussion on service industries in developing countries, see Derek W. Blades, et al., *Services Activities in Developing Countries*, OECD, 1974.

Figure 3

PER CAPITA INCOME LEVEL AND PERCENTAGE OF SERVICE INDUSTRY, 1970
PER CAPITA INCOME (US DOLLAR)

Percentage of Employment in Service Industries	Less than 100	100-200	200-300	300-500	500-1000	1000-2000	2000-3000	3000
50								Canada, U.S.A., Kuwait
45-49					Lebanon, Singapore	Puerto Rico, Israel	Australia	Sweden
40-44					Jamaica	Argentina, U.K.	Belgium, Denmark, Luxembourg, Norway, New Zealand	
35-39					Chile, Uruguay, Venezuela	Japan, Austria, Finland, Ireland	France, Germany (F.R.), Switzerland	
30-34				Brazil, Nicaragua	South Africa, Panama Hongkong, Spain, Costa Rica	Italy		
25-29			Egypt, Tunisia, Honduras, Peru, Korea	Colombia	Mexico, Portugal			
20-24		Indonesia	El Salvador, Paraguay, Philippines, Syria	Dominica, Malaysia		Greece		
15-19		Pakistan, Sri Lanka		Tunisia, Guatemala				
10-14	Burma, India	Mozambique, Thailand						
0-9	Tanzania, Nepal	Sierra Leone						

Source: ILO, *op. cit.*, and U.N., *Yearbook of National Accounts Statistics*, 1975.

is not found on a wide scale in the centrally-planned economies (CPEs). In spite of the large bureaucratic structure of a state-run system, most CPEs have an underdeveloped service sector. Part of this is due to the lower level of "consumerism" vis-à-vis the Western countries. Services have in the past been totally ignored in socialist planning, and some consider services per se to be anti-Marxist.[5] An emphasis on industrial growth has characterized both socialist and developing countries' development strategies, and there is a bias against encouraging domestic services as essential to a country's development. Many developing countries have erected high barriers to imports of services from developed countries, and complain that developed countries dominate services trade in world markets.

Another characteristic of the service sector is that it is less sensitive to business cycles and has a different employment structure than the other sectors of the economy, in that demand for some services, such as health and education, remains relatively constant in spite of general economic fluctuations. (The tourist industry is an important exception to this phenomenon). Employment and output in services are considered more stable than in other sectors. The industrial organization in services tends to be much smaller than in the manufacturing sector. It is basically small and non-corporate, and about one third of the sector in the US is actually nonprofit. The service sector is generally considered to be more labor-intensive than the manufacturing sector, and there is often less demand for physical strength in service occupations, as many of the positions are white collar. The service sector is also a source of employment to older people and women. In the US, for instance, more than one-half of those employed in the service sector are women, while the goods sector employs only 20 percent women. In general, jobs in the service sector afford a greater opportunity for those who seek part-time employment. Women constitute a majority in all service occupations except for the most prestigious professions. There is a strong correlation in the US between the growth in the service sector and the increased employment of women.

The high labor intensity of service industries has been identified by some as the culprit responsible for the purported low-productivity, inflationary nature of the service industries. In Ernest Mandel's work, *Spätkapitalismus*, for example, an economy oriented toward the production of services is described as a society going through a technical revolution, characterized by economic planning, permanent armaments, international concentration and centralization of capital, neocolonialism, vast expansion

5. See Gur Ofer, *Service Sector in Soviet Economic Growth* (Cambridge: Harvard University Press, 1973).

of services industries and chronic inflation.[6] It is evident that inflation in services is a reflection of rising wages. From 1963 to 1973, the Consumer Price Index in the US rose 25 percent while the price of services in the same period rose 57 percent.[7] Prices of services rose 40 percent more than those of goods from 1947 to 1972 in the US.[8] Wages and employment vary greatly within the sector, but productivity overall is very low, manifesting itself in an above-average inflation rate. There has hence been some connection made between the increasing importance of the service sector in industrialized countries and the rampant inflation of the past decade.

The service sector has traditionally been characterized as less technologically sophisticated than other sectors, perhaps by virtue of its high labor intensity. Technology, however, is rapidly being integrated further into the services sector and exerting a profound influence: the self-service movement is a result of automation; television has caused a decline in the demand for other traditional entertainment such as movies and theater; and the telecommunications revolution has transformed the nature of banking, insurance and other service industries. An overall decline in productivity in the service sector may be attributed in part to an increase in the size of bureaucracy, primarily in the public sector. Technology has affected the public service sector, but output and productivity are very difficult (if not impossible) to quantify in the public sector because of the nature of public services. Government has been growing rapidly in many countries, and is thought to exert downward pressure on productivity figures for the sector and ultimately for the whole economy. In Figure 1, one can see that about 25 percent of US services are performed by government. Public sector enterprises do not operate under profit-maximization or efficiency motives, and this may account for the low labor productivity figures of the service sector as a whole. Data development for services lags behind that of goods, and the effect of services on macroeconomic indicators such as inflation, employment and productivity is still not fully understood.

WHAT ARE SERVICES? ECONOMIC THEORY

The primary sector of an economy encompasses agriculture and forestry, the secondary sector is the goods-producing or manufacturing sector, and the tertiary sector includes non-goods-producing industries, or services.

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6. Ernst Mandel, *Spätkapitalismus*, Frankfurt A.M., 1978.
7. US Department of Commerce, *Service Industries: Trends and Prospects* (Washington D.C.: US Department of Commerce, 1974).
8. *US Service Industries in World Markets*, p. 8.

Services have been neglected by the materialistic foundation of production theory. Services have traditionally been considered "unproductive production." Adam Smith considered only the production of material goods to be productive,[9] and observed that "services perish in the very instant of their performance."[10] T.R. Malthus made the same distinction when he stated that services had productive economic value only when they led to the production of material goods.[11] J.B. Say distinguished between "material" and "immaterial" production. Service industries were not considered productive or economically relevant.[12] Karl Marx shared the same "materialistic" basis of production concept. Services were generally not treated as a special sector in socialist writings.

Recently, this neglect of services in economic theory has been partially redressed. Several modern economists portray the service sector as the wave of the future. Fisher, in his classic work, "Production: Primary, Secondary and Tertiary,"[13] characterizes economic development as typified by the shift from primary to secondary, and then to tertiary sector-dominated economies. He considers an agricultural or traditional economy as the first stage of development, where there is a low average income and the demand structure is limited to essentials such as housing and food. The second stage of development is attained when the industrial secondary structure grows and becomes predominant in the economy. The predominance of the manufacturing sector brings with it a middle-average income and a demand structure for products which are non-essential alongside the basic essentials. These non-essential goods are manufactures, such as automobiles and washing machines. The next logical step, according to Fisher, is the shift of resources out of the secondary and into the tertiary sector. The tertiary sector is marked by a relatively high average income, with ever greater portions of this income spent on high-cost goods and services. Increased productivity in the secondary sector leads to lower labor intensity in production, and results in a surplus of workers. The tertiary sector attracts these roaming laborers because it is very labor-intensive. Fisher points out the varying elasticities of demand for goods, and finds that the income elasticity of demand for services is higher than that for goods.

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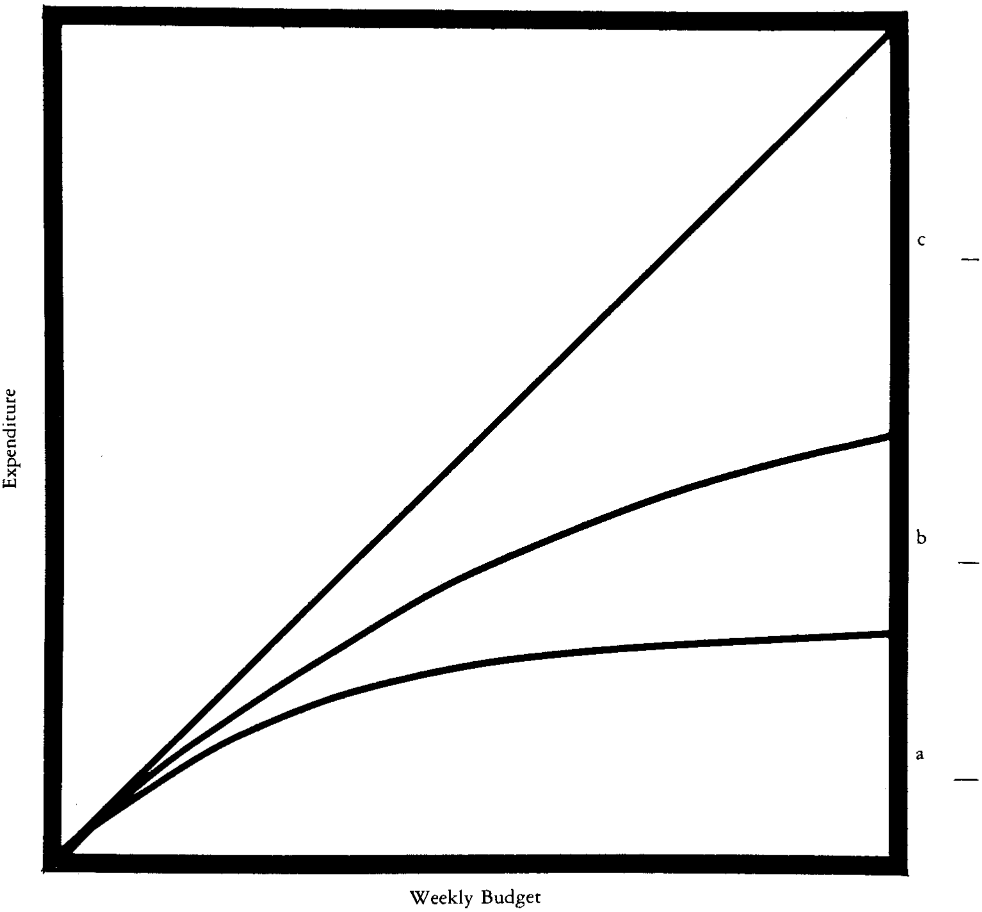
9. Adam Smith, *Wealth of Nations*, cited in Gerhard Voss, *Trend zur Dienstliestungsgesellschaft?* (Koln: Deutscher Instituts Verlag, 1976).
10. Jonathan Gershuny, *After Industrial Society? The Emerging Self-Service Economy* (New York: Macmillan Press Ltd., 1975), p. 92.
11. T.R. Malthus, *The Basis of Political Economy*, 1910, cited in Gerhard Voss, *op cit.*, p. 6.
12. Voss, *op. cit.*, p. 8.
13. A.G.B. Fisher, "Production: Primary, Secondary and Tertiary," in *The Economic Record*, volume 15, 1939.

With the current low rate of growth in the manufacturing sector in many industrialized nations, such theories are beginning to gain more acceptance. Walt Rostow's five steps of development lead to a services economy as well.[14] He contends that the drop in the growth rate in a sector signals its optimal development. This optimal level has already been reached in most industrialized countries, and the next step is that of a society of mass consumption. This "post-industrial" stage has been given many names, such as "the welfare state," "state-monopoly capitalism," "self-service economy" and, in Alvin Toffler's terminology, the "third wave." Most of these theories are based on an observed transition into a services economy based on Engel's law. This interpretation of Engel's Law states that there is a diminishing marginal expenditure on food and necessities with increased income. The consumption of services thus has a higher income elasticity. This is represented in *Figure 4*, where expenditure categories a, b and c are ranked according to their level of necessity. As marginal expenditures on necessities decrease with increased income, more income is available for expenditures that are less pressing. In *Figure 4* we see that as the size of the weekly budget increases, the proportion of it spent on "a" decreases, the proportion spent on "b" first increases and then decreases, and that spent on "c" continually increases. More income becomes available for personal services such as restaurants, hotels, sports, health and education.

Most of these ideas are limited to simple descriptions of structural changes observed in the development process and based on the experience of western industrial countries. V.R. Fuchs has disputed this application of Engel's Law, finding no statistically significant higher income elasticity for services than for goods. Perhaps the consumption of both goods and services should increase equally with an increase in income, depending still on the necessity/luxury of the good or service.[15] Fuchs credits socialization and urbanization effects as much as income elasticity for the increased importance of the service sector. This supply-side socialization thesis is cited by Sidney Pollard in "The Rise of Service Industries and White-Collar Employment."[16] Pollard explains the increase in labor participation in services not merely through an increased demand for services, but claims, "The types of employment have expanded in large part because that is where people prefer to work."[17] White-collar professions are more

14. W.W. Rostow, *Stadien Wirtschaftliches Wachstums: eine Alternative zur Marxistischen Entwicklungstheorie* (Gottingen: 1960), ". . . dass eine sinkende Wachstumsrate die normale optimale Entwicklung eines Sektors darstelle", p. 29.
15. Fuchs, *op. cit.*
16. Sidney Pollard, "The Rise of Service Industries and White Collar Employment," in Bo Gustafson, ed., *Post-Industrial Society* (Groom Helm, Ltd., 1979), p. 17.
17. *Ibid.*, p. 29.

Figure 4



ENGEL'S LAW

accessible and desirable, he says, in a society of high average income, high urbanization and high educational standards. Pollard cites the prestige and job security of service professions as elements in their growing desirability. He claims much of the growth is based on Parkinson's Law of the cancerous growth of bureaucracy, where labor participation grows independently of the demand for its output. More economic work needs to be done on the actual causes and effects of the increase in the service sector, but it is most likely a combination of these demand and supply forces in industrialized countries that accounts for service sector expansion.

INTERNATIONAL TRADE IN SERVICES

With that general background in the role of services in modern economies, we can now examine the trade implications of this important sector. Service sector participation in international markets, though still smaller than that of the goods sector, is large and growing quickly. As previously noted, service sector industries produce about half of all US invisible trade and represent about 30 percent of all US trade in goods and services.[18] As more countries become service-oriented, it seems that trade and exchange of these services will be greatly expanded.

As mentioned above, the nature of services is such that they cannot be easily shipped or stored, so much service sector participation in international markets is investment-oriented. About 85 percent of estimated US service sector sales is in the form of investment in foreign affiliates.[19] Banking, insurance, hotel and restaurant services are "traded" in the form of setting up foreign branches and offices, since most services have to be "consumed" on location.

The services sector may well be the setting for a large portion of future economic growth and job creation in the industrial world, and more economic policy attention is of the essence. In the US Trade Act of 1974, the President was given authority for the first time to negotiate reductions in trade barriers to both goods and services. In spite of the 1974 mandate in the US, services were not negotiated in any substantive way in the Tokyo Round of trade negotiations. Many governments have not acknowledged the need to reduce trade barriers to services. It was primarily at US instigation that services were introduced at a late stage in the multilateral trade negotiations (MTN). Services incidental to the supply of products were included in the provisions of the Government Procurement Code, and there was an agreement to expand the Code's coverage to service contracts within three years.[20] The US initiative was received positively by some countries, and bilateral discussion of some service trade barriers was put on the agenda. There was an effort to expand the Subsidies Code to include more services as well. A wider legislative interpretation of the word "trade" in the US now includes trade in services, and a trade policy infrastructure for services is blossoming in the US government commercial policy offices. Such developments will probably be furthered in other countries as well.

Given the heterogeneous nature of the service sector, a unified private

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18. International Service Industry Committee, *Report 1978-1980* (Washington D.C.: Chamber of Commerce of the United States, April 1980), p. 37.
19. *US Service Industries in World Markets*, p. 2.
20. International Service Industry Committee, *Report 1978-1980*, p. 18.

sector constituency has been slow in forming. The 1979 Trade Act in the US provided for the formation of a Services Policy Advisory Committee, to be composed of leaders of service industries and related labor groups, to make recommendations to the United States Trade Representative's Office.[21] An International Service Industry Committee was formed in 1978 in the US to bring together representatives of American service industry firms and service trade associations in order to foster a freer flow of trade in services in world markets. Some of the industries in the service sector, usually by virtue of their close relation to goods industries, have already received wide government attention and have organized industry representation. There are several other service industries that have not yet reached this stage of development, such as movies, accounting firms, insurance companies, banks and telecommunications. Many of these industries have special problems of their own in trade, and a service industry lobby per se is difficult to form since the industries themselves do not perceive common goals.

Obstacles to Trade in Services

Obstacles to trade in services are very extensive and primarily non-tariff in character. In the past, the lack of services and "invisibles" trade coverage under the General Agreement on Tariffs and Trade (GATT) has made this sector a likely candidate for restrictions. Since much of the flow in services is investment-oriented, discriminatory measures limiting capital movements are of great concern in this sector. These problems are hence similar to those of investment in goods-producing industries — exchange controls, barriers to establishment and operation of foreign affiliates and branches, and repatriation of earnings. The US Department of Commerce, in its 1976 study *US Service Industries in World Markets*, came up with a list of problems in international services trade, distinguishing between investment/ownership problems and trade/investment problems:

Investment/Ownership Problems

—Restrictions on remittances and repatriation of profits, fees and royalties.
—Ownership restrictions that require full or partial local ownership or control of establishments, and that may completely prevent market access by a foreign firm.
—Personnel restrictions, such as local labor requirements, licensing of professionals, visas, and work permits.

21. *Ibid.*, p. 20.

—Discriminatory taxes, i.e., taxes placed solely or inequitably on foreign business income, profits or royalties.
—Inadequate protection of intellectual property, trademarks, copyrights, and theft of technology.

Trade/Investment Problems

—Government subsidies to locally-owned firms to aid their competition in the home market or in third-country markets.
—Government-controlled facilities, frequently having objectives other than earning a profit.
—Difficult or discriminatory licensing regulations, licensing fees, and taxes.
—Excessively high duties on imports of necessary materials, or outright quantitative restrictions or prohibitions of imports.
—Absence of international standards and procedures for services.
—Restrictive or discriminatory government procurement regulations.[22]

Figure 5 shows the incidence of these service industry problems as seen by the industries themselves.[23] The US Department of Commerce study concluded that no such thing as a "service industries" problem existed, but rather that barriers were found to be unique to a particular service industry or affected both goods and services industries.

There is a traditionally close relationship between national governments and some services industries. Many countries actually prohibit the establishment of foreign companies in certain sectors. Banking and insurance are often closely regulated domestically, and imports or the establishment of foreign affiliates is virtually impossible. Peru, for example, prohibits foreign insurance companies, while foreign banks are prohibited in Algeria, Australia, Canada, Tanzania, Turkey and in certain states of the US.[24] Several other services industries fall into areas where government-owned operations may dominate, such as transportation or educational and health services. A large proportion of these government barriers arise in developing countries with less free markets in general investment. Investment and exchange restrictions are especially cumbersome in developing countries.

Services sector exports remain modest compared with merchandise exports, and further efforts to remove barriers to trade of concern to service

22. *US Service Industries in World Markets*, pp. 30-31.
23. *Ibid.*, p. 32.
24. Brian Griffiths, *Invisible Barriers to Invisible Trade* (New York: Macmillan Press, Ltd., 1975), p. 34.

Figure 5

INCIDENCE OF SERVICE INDUSTRIES PROBLEMS

	Investment					Trade/Investment					
	Remittance and Repatriation Restrictions	Ownership Requirements	Personnel and Employment Restrictions	Taxes	Intellectual Property	Government Subsidies	Government-Controlled Facilities	Licensing	Duties and Quotas	Standards	Restrictive Government Procurement
Accounting	X		X		X					X	
Advertising	X	X	X	X			X	X	X		
Auto/Truck Leasing		X		X	X			X			
Banking	X	X	X	X				X		X	
Communications		X	X			X				X	
Computer Services	X					X	X			X	X
Construction/Engineering		X	X	X	X	X		X		X	X
Education Services					X				X		
Employment Services							X				
Equipment Leasing	X	X									
Franchising	X	X	X	X	X			X	X		
Health Services	X	X	X			X			X		
Hotels/Motels	X		X		X	X			X		
Insurance	X	X		X		X		X			X
Legal			X					X		X	
Motion Pictures	X	X		X	X	X	X		X		
Transportation-Air				X		X	X				X
Transportation-Ocean				X		X	X		X		X

U.S. Services Industries in World Markets, U.S. Dept. of Commerce 1976, p. 32.

industries are clearly needed. Services industry affiliates are growing rapidly overseas despite trade obstacles, and the additional trade potential of these industries merits further study. This aggregate overview of trade problems for services reflects primary investment impediments and in no way can illustrate the unique problems of any one service industry. Of the eighteen service industries considered in the US Department of Commerce study, five stated that present international barriers and obstacles to trade were "significantly restricting their international business and its growth."[25] These industries were transportation, maritime transportation, insurance, motion pictures and construction/engineering services. A focus on one of these industries, insurance, should help illustrate the kinds of problems confronting service industries at the micro level.

THE INSURANCE INDUSTRY IN INTERNATIONAL TRADE

> Private enterprise insurance is a transaction between a policy-holder and an insurer whereby the former pays a premium to the latter in return for which the insurer undertakes to pay the policy-holder or some third party a sum of money, depending on the materialization of a specific risk or the occurrence of a particular event, at or during a specified time.[26]

One of the functions of governments is to protect their citizens against loss through operations of unscrupulous or insolvent firms. In the case of insurance firms, insurance regulatory legislation is a fact of life, and can range from being a constraint to a deterrent depending upon its "reasonableness." The insurance industry covers fire, marine and casualty insurance, and title insurance. Reinsurance is also quite common and comprises insurance which insurance firms buy from other insurance companies to underwrite a greater amount of insurance than their capital assets would ordinarily permit. (A single firm in the US cannot commit more than 10 percent of its capital surplus for a single risk.) Life insurance, accident and health insurance, and hospital and medical services constitute another category of insurance, but are currently of less importance to trade than the general insurance categories mentioned above.

There has been a major increase in insurance business overseas in recent years, but the industry is plagued by foreign government regulations restricting expansion into foreign markets. The major international problems as seen by the industry itself include:

—Expropriation of US capital investments by a foreign nation.
—Forced divestment, whereby US companies are compelled to sell out to host governments or private organizations fostered by host governments.
—Virtual impossibility for US companies to underwrite insurance or

25. *US Service Industries in World Markets*, p. 35.
26. Griffiths, *op. cit.*, p. 45.

reinsurance for commodity shipments to the USSR or East European countries or to underwrite life insurance in these markets.
—Government procurement of insurance and/or reinsurance coverage in various nations, wherein such governments require (a) all coverage be underwritten by a government-owned insurance facility or (b) that the vast proportion of coverage be underwritten by "nationals."
—Licensing restrictions against US insurance carriers, to include a government's arbitrary denial of a license to do business, or granting a license but specifying limits on the kinds of underwriting, insurance, etc., in which a carrier may engage.
—Restrictions on insurance placement, such as reserving the transport insurance related to imports to the domestic market or limiting the availability of foreign exchange for insurance purchases.
—Regulations designed to promote the growth of domestic companies by imposing additional costs on foreign competitors, such as discriminatory income taxes, premium taxes, or capital deposit requirements.
—Regulations deferring return of US earned funds, adversely affecting the international insurer's cash flow requirements and ability to meet obligations in other countries.[27]

Insurance companies sell abroad through the appointment of general agents in foreign countries, overseas branches or affiliated companies. Affiliated companies can be set up via minority- or majority-shareholding participation in a national insurance company to insure risks in the host country, or via appointment of a national insurance company to serve as the local insuring vehicle without equity shareholding. The nature of the international insurance business makes it very vulnerable to trade obstacles. The three major barriers are 1) the expropriation of capital investments by a foreign nation, 2) forced divestment, whereby US companies are forced to sell out to the host government or to private organizations fostered by the host government, and 3) the total inability of US companies to underwrite insurance and reinsurance for commodity shipments to the USSR or Eastern Europe. Most of these restrictions place the industry at a competitive disadvantage in foreign markets. The consequences of restricted competition are higher insurance rates for the insured and narrowed profit-making opportunities for the insurers. These increased costs apply to the foreign operations of US manufacturing corporations as well and thus contribute to higher expenses. These barriers to trade in insurance plague not only US companies but all companies in international markets.

27. *US Service Industries in World Markets*, p. 180-181.

There is an OECD Insurance Committee assigned with the task of attempting to resolve some of the industry's international problems. The insurance industry is a typical service industry in that data on the industry's international business are quite limited and difficult to measure. The impact of barriers to trade in insurance is likewise unquantifiable. Insurance is plagued by obstacles closely related to government restrictions and basic investment problems such as domestication, exchange control, localization of funds and government procurement policies. A list of obstacles to insurance trade at the national level, taken from Brian Griffith's *Invisible Barriers to Invisible Trade*, (1975), shows the proliferation of restraints on insurance, especially in developing countries. A majority of the nationalizations were never compensated.

POLICY FORUMS FOR FUTURE DISCUSSION OF SERVICE INDUSTRY PROBLEMS

OECD — The Organization for Economic Cooperation and Development is one of the most important multilateral forums for dealing with issues and problems of the service industries. The Codes of Liberalization of Capital Movements and of Current Invisible Operations are of great importance to the service industries, where so many of the trade problems are directly investment related. The Declaration on International Investment and Multinational Enterprise adopted 21 June 1976 also deals with the national treatment of foreign-owned affiliates. The twenty-four OECD countries have not all adhered enthusiastically to the principles of the Codes, and the fact that the developing nations are not a party to them limits their significance somewhat. The bulk of trade and investment barriers to services is found in developing countries. The "Rey Report" of the OECD singles out services, and particularly the insurance industry, for special efforts in liberalizing trade.

UN — The United Nations has several specialized forums for various specific service industries, such as the International Maritime Consultative Organization and the International Civil Aviation Organization. UNCTAD deals with specific service sectors as well, including insurance, maritime shipping and broader transfer-of-technology questions. The UN forums have brought out the diverging views of developing and developed nations on direct investment issues. The UN Commission on Transnational Corporations also deals with many of the services investment issues, and shows the disparity in approach to investment issues between the two camps.

GATT — The General Agreement on Tariffs and Trade's treatment of services trade barriers has been limited and selective in the past, but attention to this sector is growing. The motion picture industry was covered in Article IV of the GATT, which provides for screen quotas, but otherwise no specific service industries are treated. Observers hope that the post-MTN period will usher in a new GATT treatment of services. The GATT's aims and objectives of lowering restrictions on trade make it an important forum for discussing a new emphasis on services industry trade problems.

WIPO — The World Intellectual Property Organization overseas a number of conventions and treaties which deal with industrial property and copyrights covering services and goods-producing industries alike. This organization could be important in achieving international standards for transfer of technology and know-how in international trade.

Bilateral Forums — Treaties between nations on a bilateral basis can also be essential to freeing up trade in services. Friendship, Commerce and Navigation Treaties as well as bilateral Tax Treaties can help facilitate a smoother flow of trade.

Sectoral Organizations — Responsibility for solving trade problems in services will have to be taken on by industry leaders themselves at the sectoral level. Industry organizations such as the Maritime Shipping Organizations and the newly formed International Service Industry Committee can play an increasing role in the pursuit of free trade in services. Further organization is needed not only at the industry level, but between the various industries in the sector, to sort out common problems and goals within the sector.

Others — Many other forums exist for discussing services problems, and it is expected that many more will spring up as international attention becomes focused on this "new" sector. The International Monetary Fund, the World Bank, the World Tourism Organization and the Customs Cooperation Council, to name a few, are already open to discussion in services.

SUMMARY

The service or tertiary sector now accounts for over half the employment and output in several countries of the world, now characterized as "post-industrial" or "service" economies. Services seems to be the sector for future growth, and their growth has been most phenomenal in developed countries, although services growth is an international occurrence.

Services cover a wide range of economic activity having in common the intangibility of their output. Little is understood about how the rapid growth in services affects employment, productivity, inflation, or patterns of investment and trade. Services are not easily shipped or stored, and trade in services is usually investment-oriented, involving the establishment of foreign affiliates or branches. Most trade problems in this sector are therefore related to investment problems and are most prohibitive in the developing countries.

Service industries are now covered in parts of the MTN and the GATT, and new policy attention is being paid this sector. Development of a data base for empirical analysis is desperately needed, as is further development in economic theory. True international recognition of the importance of the service sector is still lacking. Whatever its cause — whether demand-stimulated by increased income, or supply-stimulated through urbanization and socialization affects — the service sector is the fastest growing sector in the (post-) industrialized world and is bound to have a radical impact on social and economic life in the future.