A REGIME FOR TRADE IN SERVICES

MARK E. DOW

Services are a vital and lucrative part of the world economy, yet despite their growing importance, no multilateral agreement exists to govern their trade. The breakdown of the Uruguay Round of trade negotiations in December 1990 diminished the prospects of concluding an agreement in the near future. Mark E. Dow examines the prerequisites necessary to produce an effective regime for trade in services. He maintains that existing service agreements incorporated into the European Community and the 1988 US-Canada Free Trade Agreement provide important principles and points of departure from which to pursue a General Agreement on Trade in Services.

Services are the international links that have led the world economy to its present level of integration. Industrial countries view trade in services as a promising way to enhance exports. Developing countries stand to gain valuable technological expertise, strengthen domestic economic infrastructures, develop new exports, and promote traditional ones. Although trade in services is becoming more important, more pervasive, and more lucrative, there are virtually no multilateral international rules to govern and promote the array of business transactions referred to as services. The recent Uruguay Round of the General Agreement on Tariffs and Trade (GATT) incorporated negotiations on services, but the round concluded in December 1990 without a services agreement. Although the negotiations produced some progress, several barriers to an accord remain.

One reason is political. Service industries such as banking, government procurement, and insurance are some of the most sensitive and zealously guarded sectors of national economic activity because the provision of services generally requires the mobility of factors of production. For example, banking hinges on the mobility of capital, construction on the mobility of labor. Unrestricted capital mobility can impinge upon a government's ability to conduct effective monetary and exchange rate policies, particularly for those smaller countries which have less developed capital markets and/or hard currency shortages. Furthermore, national economic policy is often motivated by objectives other than maximizing the quality, quantity, and variety of services available to the consumer. Consumer protection, self-sufficiency in strategically sensitive sectors, equitable income distribution, and the rectification of market failures are all valid reasons for less than complete liberalization. In short, the implications of liberalization touch the raw nerve of economic autonomy: the

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sense that a multilateral service agreement will impinge upon sovereignty gives some governments pause.

The second reason is economic. In order to justify a political commitment to a multilateral service regime, respective national governments must be convinced that the economic benefits from service liberalization will be balanced—in other words, that benefits do not accrue disproportionately to the more service-oriented nations.

The third reason is one of legal precedence. Obstacles to a multilateral agreement take the form of a complex web of economic, political, and legal arguments whose resolution finds little precedent in existing international agreements. Legal solutions have been found in only a few cases with limited signatories, in part because the boom in the service industry is a relatively recent phenomenon, and in part because the benefits that could be derived from liberalization are not yet universally perceived.

The lack of legal precedence does not mean that examining existing bilateral and regional service agreements is not useful in developing a broader, multilateral compact. The twelve nation European Community (EC), in its Project 1992, has been a pioneer in some of the areas that a General Agreement on Trade in Services (GATS) will sooner or later cover in its quest for a worldwide regime. Similarly, the 1988 US-Canada Free Trade Agreement (FTA) has elaborated to an unprecedented degree contractual rights and obligations in the area of service trade. These "microcosmic" agreements can be drawn upon to help steer the current service negotiations toward the issues where accommodation might be reached.

Insofar as existing agreements regarding trade in services are characterized by the special political, cultural, and geographic ties of the signatories, they do not represent readily generalizable models applicable to a wider, more diverse group of countries such as the signatories of the GATT. However, these previous agreements can be of concrete use because they identify negotiable elements and enhance the conceptualization and the definition of the salient points of contention. The negotiating experience of the GATT can also be useful, particularly in an institutional sense. Even though its mandate covers only trade in goods, the GATT is a recognized forum with established procedures in the area of international trade. As such, it can provide a familiar superstructure in which new ideas regarding services can be fused with existing GATT principles to forge a General Agreement on Trade in Services.

This article attempts to preview the principles which would in part constitute an international regime in services and which would enable such a regime to surmount the political and economic obstacles in its path. By taking into account past agreements and present negotiations, an attempt will be made to identify and develop a framework for the future of the dynamic service industry. To do so, it will be necessary to examine a series of issues: the relationship between such a regime and its unofficial sponsor, the GATT; the definition of trade in services; and the development of concepts, principles, and rules that such a regime would embody.

The GATT

The GATT is a multilateral agreement, in force since January 1, 1948, designed to reinvigorate the postwar international economy and to generate sustained growth and prosperity.[1] Founded on the traditional notions of liberal trade theory, the GATT enshrines the belief that the best trading system is a free one in which a country trades that which it produces most effectively according to its comparative advantage. The result maximizes consumer welfare and ensures the best possible allocation of resources.

To achieve an international trading system in which the theory of comparative advantage works most efficiently, two conditions must be met: the supply and demand of the trading countries must be determined by market forces, and prices charged by producers must reflect the product's cost to society.[2] The GATT has attempted to create a system that minimizes, and where possible, eliminates, impediments to meeting these two conditions.

The GATT is founded on the principle of non-discrimination, which is embodied in its Most Favored Nation (MFN) clause. This clause states that no country is to give advantages to or discriminate against one country to the exclusion of all others. Thus, all countries share the benefits of any step toward lower trade barriers.[3] Other core principles include reciprocity and national treatment. Reciprocity in the context of the GATT dictates that tariff cuts by one country involved in negotiations must be matched by the other negotiating countries without explicit regard for the parity or disparity of their respective economic conditions. National treatment states that all signatories must treat foreign enterprises the same as national enterprises, with a caveat for reasons of economic development and strategic national interest.[4]

By and large the GATT has been successful. So far it has survived the test of time, and has contributed to lower tariffs and increased trade worldwide. This raises a fundamental question: is the GATT system for goods, with its tradition of principles, broad participation, and accomplishments, an appropriate model for a framework for trade in services?

The GATT has never had competence in service trade. The United States views this as a defect and has been urging negotiations on trade in services since the end of the Tokyo Round. In 1982 the United States tabled the first proposal to institute a working party on services within the GATT.[5] However,

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1. The GATT has been modified and supplemented since 1948. The current version is contained in General Agreement of Tariffs and Trade, *Basic Instruments and Selected Documents* (Geneva: GATT, 1969). Currently, 108 nations participate in the GATT negotiations.
2. Geza Feketekuty, *International Trade in Services: An Overview and Blueprint for Negotiations* (Cambridge, Mass.: Ballinger, 1988), 96.
3. *The GATT Handbook* (Geneva: GATT Information Service, 1984), 2.
4. Sidney Golt, *The GATT Negotiations 1986–90: Origins, Issues, and Prospects* (London: British-North American Committee, 1988), 3–4.
5. Christopher Bail, "Conceptual Problems and Possible Elements of a Multilateral Framework for International Trade in Services" (Bergamo, Italy: Istituto Universitario di Bergamo, 1989), 2. (Paper from the Conference

this proposal met with direct opposition from developing countries and less than resounding support from many developed countries, including the EC. The objectors felt that service negotiations should not be linked to negotiations on goods. Developing countries, in particular, feared that the progressive liberalization of trade in goods, an area in which they often enjoy a comparative advantage, would be held hostage by the industrialized countries in order to extract concessions on services.[6] The EC, caught up in the rejuvenation of its internal market, preferred to keep its efforts at service liberalization focused inward.

The implications of service liberalization touch the raw nerve of a nation's economic autonomy; the sense that a multilateral service agreement will impinge upon sovereignty gives some governments pause.

At the launching of the Uruguay Round in September 1986, this initial obstacle was overcome. Services were included for discussion without either settling the question of GATT competence in services or undermining any government's position on the substantive issues. A Trade Negotiations Committee was established for the round in order to extend a unifying superstructure over the fourteen negotiating subgroups for goods and the one subgroup for services, the Group Negotiating Services (GNS).[7] The first phase of negotiations in services, beginning in January 1987, focused on five elements of a potential agreement: definition and statistics; principles and norms for an overall framework; scope of coverage; relationship with existing arrangements; and the difference between legitimate regulation and discrimination. These discussions, while helpful in defining conceptual questions, were abstract in nature and, therefore, inadequate for establishing a general framework for specific liberalizing commitments.

To rectify the situation, the Mid-Term Review of December 1988 focused on specific service issues on which there could be agreement. The text that emerged categorized some of the more prevalent types of services traded, and advanced the process of identifying barriers to trade in services.[8] Specifically, the text sketched some concepts for possible inclusion in a general framework.

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on the Uruguay Round of the GATT and the Improvement of the Legal Framework of Trade in Services presented at the Institute, September 21–23, 1989.)

6. Jagdish N. Bhagwati, "Trade in Services and Multilateral Trade Negotiations," *The World Bank Economic Review* Vol. 1, No. 4 (1987): 550–51.
7. Bhagwati, 550–51; Bail, 3.
8. "Mid-Term Review Agreements," *News of the Uruguay Round,* 24 April 1989, 40.

These included transparency, progressive liberalization, national treatment, MFN/non-discrimination, market access, and safeguards and exceptions.

In spite of this progress, the Uruguay Round could not be concluded by the December 1990 deadline. The entire talks stalled on the issue of agriculture, with the EC bearing the brunt of responsibility for the breakdown.[9] Service negotiations faced obstacles as well, and the GNS adjourned without reaching a consensus.[10]

From the preliminary discussions to date, the step-by-step process toward a service compact has been long on rhetoric and short on substance. Aided by the Uruguay Round, the negotiating parties have finally entered into serious discussion of more tangible concepts. However, the negotiations so far have only identified and clarified the principal issues; they have not resolved the institutional and substantive problems at the heart of an agreement on trade in services. A working definition of services is vital to this effort.

Defining Services

While it is extremely difficult to establish a static definition for services, one can grasp the fundamental conceptual differences between trade in goods and trade in services, and make use of those distinctions in the development of a viable framework. As a consequence, the approach to trade liberalization enshrined in the GATT, matching concessions of equal magnitude, would not be directly applicable to trade in services.

Defining Services in Theory

The definitional issue is composed of two parts: the accurate definition of trade in services and the possibility of establishing a regime of trade in services without such a definition. Initial attempts to define services in their different contexts took the approach of differentiating them from goods. For example, from an economic point of view, a service can be seen as a deed, a performance, or an effort, whereas a good can be seen as an object, a device, or a thing. Under contract law a good can be the object of property rights, whereas a service consists of an obligation.[11] In terms of attributes, a good is often thought of as something visible, tangible, permanent, and storable. On the other hand, a service is invisible, intangible, transient, and non-storable.[12] Making these conceptual distinctions is intuitively straightforward and systematic; applying them to a service regime is not. Many exceptions and

9. Peter Truell, "U.S. Seeks to Break Farm-Aid Impasse, Warns Trade Talks Won't Be Extended," *The Wall Street Journal,* 4 December 1990, A8.

10. *News from the Uruguay Round,* 9 October 1990, 11.

11. Giorgio Sacerdoti, "The International Regulation of Services: Basic Concepts and Standards of Treatment," (Bergamo, Italy: Istituto Universitario di Bergamo, 1989), 4. (Paper from the Conference on the Uruguay Round of GATT and the Improvement of the Legal Framework of Trade in Services presented at the Institute, September 21–23, 1989.)

12. Phedon Nicolaides, *Liberalizing Trade in Services: Strategies for Success* (New York: Council on Foreign Relations Press, 1989), 9.

counterexamples abound.[13] For this reason, later definitions have concentrated on the output, or the degree of change effected by a service. Outputs are easier to identify for the practical purposes of negotiation, and more convenient because trade in goods has traditionally been handled in this way. However, this approach is also incomplete. Many services, such as life insurance or, in some cases, consulting, make no effort to effect change. And how would one measure the output of a bank? Would it be by the number of customers served or by the cumulative value of their transactions?

To be of any use, a definition must go further than presenting a static comparison of services and goods. It must illuminate the essence of services: the interaction between service producers and users. Recent definitions have focused on the process or performance aspect of services rather than on their effects.[14] As defined by Phedon Nicolaides, a service is "an agreement or undertaking by the service-provider to perform now or in the future a series of tasks over a specified period of time toward a particular objective."[15]

Defining Services in Practice

What would be the consequences of adopting a precise, systematic definition of trade in services? First, it would help potential signatories identify and calculate the net benefits from entering into a binding process of liberalization. The drawback is that in order to calculate the net effects of liberalization, extensive regulation would be required to define the extent and nature of permissible activities by foreign agents. Second, an accepted definition would ease transparency by facilitating the identification of trade barriers. Consequently, determining whether a given barrier was discriminatory or legitimate would be easier. Once a service regime is in place, monitoring signatory compliance would be enhanced as well. Third, small countries would feel more secure if a definition were "etched in stone" because they often have relatively more power in determining the structure of an agreement than they do over its implementation.[16]

The argument against a definition is more persuasive: attempting to categorize types of service trade within a precise definition would hamper progress in liberalization and could possibly lead to further trade restrictions. To begin with, once a definition sets the parameters for legitimate trade in services,

13. For example, life insurance is intangible, but often permanent. A haircut, the classic example of a service, is certainly tangible.
14. See Nicolaides and Feketekuty.
15. Nicolaides, 9–10.
16. Specifically this is a question of structural power versus process power, i.e., the ability to influence the rules of the game versus the ability to use these rules to one's own advantages. See Robert Keohane and Joseph Nye, *Power and Interdependence* (Cambridge, Mass.: Harvard University Press, 1988), 21; Gardner Patterson, "The GATT and the Negotiation of International Trade Rules," in *Negotiating World Order: The Artisanship and Architecture of Global Diplomacy,* ed. Alan K. Henrikson (Wilmington, Del.: Scholarly Resources Inc., 1986), 185; and Murray Gibbs and Nina Mashayekhi, "Elements of a Multilateral Framework of the Principles and Rules for Trade in Services," in *Uruguay Round: Papers on Selected Issues,* ed. United Nations Conference on Trade and Development (New York: United Nations, 1989), 106.

governments might feel free to implement new discriminatory policies that fall outside these established parameters. This issue has been a serious problem for trade in goods within the GATT. For example, as rules regarding tariffs and quotas have become more strictly defined, the international trading system has experienced a proliferation of voluntary export restraints, orderly market arrangements, and other non-tariff barriers. None of these arrangements is covered by the GATT. Given that definitional problems make barriers to service trade more difficult to identify than barriers to trade in goods, it is quite possible that similar subterfuge in service trade would be even more pervasive.

The importance of the technological component to trade in services also argues against a static definition. Since services are processes, the final output or effect can often be delivered in a variety of ways. Consider, for instance, the substitution of a business conference with a conference telephone call. As technology improves so does the most efficient means of service provision. This fact makes it virtually impossible to regulate the services of the future with a static definition.

Defining Services in Negotiations

In the context of the definitional debate in the GNS, the practical questions parallel the theoretical ones. The negotiating parties, split along North-South lines, differ over the proper breadth of a definition as well as the need for one. Looking at some of the types of service transactions that are being considered provides insight into the substance of the debate.

Service activities can be separated into two principal categories: those that require the physical proximity of the service provider and the service user, and those where physical proximity is not essential.[17] The first category can be thought of in terms of the mobility of the providers and users. There are three possibilities: a) the movement of the provider to the user, such as a South Korean construction team building a soccer stadium in Bologna, Italy; b) the movement of the user to the provider, such as the late president José Napoleon Duarte of El Salvador seeking medical treatment at an American clinic; and c) the movement of both the provider and the user, such as in the case of lectures, concert performances, etc.[18] These types of services are referred to as "non-traded" services.

In the second category, where no movement of provider or user is necessary, the end result or output can be either embodied in a good which can then be traded separately, or can be encoded and transmitted electronically or by some other means. These are often referred to as "traded" services.[19] These service activities are less controversial because the barriers to transactions are more easily identified and many of the embodied goods are already covered by the

17. Bhagwati, 552.
18. Nicolaides, 28.
19. Ibid., 29.

GATT. For primarily these reasons, the growth in traded services is likely to be linked to the pace of technological advance, rather than to the pace of service deregulation.

Non-traded services pose the biggest difficulties in the negotiations. Non-traded services involve the movement of factors of production such as capital and labor. These are very sensitive areas of national economic autonomy, usually subject to extensive government regulation. By convention, the movement of capital has traditionally been classified as foreign investment while the movement of labor has been treated as an immigration issue since no fixed international definition of a resident worker exists.[20]

Developed countries possess a comparative advantage in the capital intensive services industries. Consequently, they argue for greater overall liberalization in traded as well as non-traded services, whereas developing countries initially suggested that the negotiations be limited to traded services.[21] Developing countries also argue that if an agreement is to be reached in the areas in which they are comparatively disadvantaged, they would have to be compensated by including a broader definition of mobility of labor to include their comparative advantage—cheap labor.[22]

On these points there has been a slow, but progressive convergence of views. Developing countries have recognized that a meaningful agreement must include the issue of foreign investment and commercial presence, often referred to as the right of establishment.[23] On the other hand, it has also been recognized that a *carte blanche* cannot be given in this regard.[24]

The GNS has also narrowed in scope the definition of the movement of labor. While developing countries suggested that the movement of labor and other factors of production be viewed as equally important, the negotiators considered it futile to seek major changes in the immigration laws of participating countries. Ultimately, the GNS determined that a working definition should subject movement of all factors of production to the following criteria: specificity of purpose and duration.[25]

The Need for a Definition

Many developing countries believe that detailed negotiations should not take place until a precise definition of trade in services is agreed upon, for fear that their ability to negotiate effectively would otherwise be substantially diminished.[26] The industrialized countries counter that illustrative definitions of certain service transactions are sufficient as points of departure in that they

20. Feketekuty, 81.
21. Nicolaides, 29.
22. *News from the Uruguay Round,* 19 April 1990, 20.
23. Bail, 7.
24. Ibid.
25. Bail, 7; *News from the Uruguay Round,* 19 April 1990, 21.
26. Developing countries are most concerned with the exchange of concessions, the binding of concessions, or the operation of a "standstill" freeze. *News from the Uruguay Round,* 19 April 1990, 22.

can clarify at least what is *not* a service.[27] Such a conceptual categorization would serve to identify the impediments to service transactions. This categorization will ultimately be more effective than a detailed codification of services which over time are likely to be transformed by technological advancement.

The reasons for the North-South division are clear. Less Developed Countries (LDCs) feel that illustrative definitions and guiding principles would leave too much room for interpretations, leading to exploitation by the industrialized countries. The LDCs also argue that they need to know exactly what sectors will be affected and to what degree; therefore the definition of services must be precise. Only then will they be able to assess the costs and benefits of liberalization. The industrialized countries argue that a detailed definition of services would not be able to evolve at the same pace as services. This lack of adjustment mechanism would lead to the discrimination of new types of services under the guise of approved regulation, thereby stunting innovation and mitigating their comparative advantage.

The Definitional Issue in Existing Agreements

In the US-Canada FTA the definitional issue was side-stepped. Rather than setting out general terms or principles which automatically covered everything falling within their purview, the FTA took a more pragmatic approach, negotiating sector-specific agreements.[28] In the case of the financial services sector, a special negotiating process, separate from the general negotiations on services, was held.[29] The inability to agree on even minimal levels of liberalization in some sectors (such as the maritime sector) and the emphasis on redoing regulation in each of the individual services covered by the FTA, cast doubt on the prospect of multilateralizing this "solution" to the definitional question.

The EC also side-stepped the definitional issue, instead opting for general principles of conduct such as mutual recognition, effective access, common minimum standards, and home country control. These principles foster competitive deregulation rather than detailed sector by sector negotiations. The EC's adoption of a conceptual definition of trade in services has yielded some very positive results. However, as a model for GATT usage, it has a major limitation. The efficacy of this system is based on the accepted role of the European Court of Justice as a final arbiter. It is unlikely that the EC system centered on the concept of mutual recognition could survive the efforts of national pressure groups without the established supremacy of Community law. A similar mandate for an authoritative arbiter of the more numerous and diversified nations of a GATS would be a tall order indeed.

27. Gibbs and Mashayekhi, 106.

28. Jeffery J. Schott, "Implications for the Uruguay Round," in *The Canada-United States Free Trade Agreement: The Global Impact*, ed. Jeffery J. Schott and Murray G. Smith (Washington: Institute for International Economics, 1988), 166.

29. Ibid.

Before the suspension of the Uruguay Round last year, the negotiators found themselves in a difficult situation. In the absence of a final arbiter, they could not make enough progress on the definitional question to establish the scope of an agreement. On the other hand, the multitude of diverse actors involved in the sector specific negotiations made it difficult to avoid the definitional issue. So far, the GNS has concentrated on sectoral work by developing annexes for certain industries, emulating the approach of the US-Canada FTA.[30]

The Body of an Agreement

Part of the problem of including services in the GATT is the lack of clarity as to whether existing rules could accommodate services, or whether new rules would have to be appended to the established procedures. The objective of the liberalizing rules would be to provide standards of treatment applicable to the conduct of trade in services. The issues which have figured most prominently in negotiations are MFN/non-discrimination, national treatment, and reciprocity.

MFN and Non-Discrimination: The Question of Market Access

While the exact definitions of these two concepts differ slightly, their general thrust—progressively establishing non-discriminatory standards of treatment for service transactions—is at the heart of any multilateral approach. As stated above, the GATT principle of unconditional MFN status ensures non-discrimination among trading partners in the application and administration of import and export duties. However, a country can have very significant barriers to trade and still treat all of its trading partners equally. Thus, it can conform to the letter of the MFN clause while violating the spirit of trade liberalization.[31]

In the context of trade in services, these two standards would have a different scope: they would cover the mechanics of service industry interaction rather than the treatment of tangible goods. For MFN/non-discriminatory principles, this amounts to standards regarding market access and the right of establishment.

Conceptually, market access and the right of establishment imply the right to be on foreign soil to conduct business. Technically, though, an important distinction exists. In the current GNS negotiations, the term "market access" has been used ambiguously to refer to service transactions in general.[32] Strictly speaking, market access connotes the freedom of people, services, and goods

30. *News of the Uruguay Round,* 9 October 1990, 11.

31. The ambiguity can be read in the words of the GATT agreement: "No country is to give special trading advantages to another (country) or discriminate against it." The subtle, yet important difference between the principle of the MFN and that of non-discrimination is often overlooked in the context of the GATT. See *The GATT Handbook,* 2.

32. Sacerdoti, 7.

to cross national frontiers. For the purposes of service transactions, this strict interpretation would only apply to tradable services in which there is no need for provider and user proximity. On the other hand, the right of establishment grants provider mobility across national borders and into the local market. Logically, this concept deals with the category of non-tradable services, in turn bringing up the sensitive issues of labor and capital mobility.

The negotiators' initial views on these points of contention reflected the North-South split. The developing countries wanted to exclude the right of establishment and factor mobility from a service accord while the developed countries pressed for inclusion. In order to overcome the deadlock and to arrive at a common position for the Mid-term Review of the Uruguay Round, a definitive resolution of the issue was postponed. The watered-down statement on "market access" in the Mid-term Review's Montreal Declaration satisfied both camps.[33] The application of both MFN and non-discrimination now deals primarily with the issue of granting market access "according to the preferred mode of delivery of the service provider."[34] In pursuit of this goal, the fundamental problem the GNS faces is the conflict between the automatic multilateralization of the MFN approach and the need to strike a balance between rights and obligations. Moreover, any principle securing such a balance must link effective market access to the objectives of progressive liberalization and consideration of different levels of development.[35]

The difficulty of arriving at such a balance lies in the "free rider" problem, the nemesis of collective action.[36] Allowing greater access into one's home market on a multilateral basis entails costly economic and political obligations. Under the GATT, a country concedes obligations in exchange for reciprocal rights from the country with which it is negotiating. No new obligations are assumed by countries not party to the mutual concessions of the negotiations. However, through the automatic multilateralization in the MFN clause, other countries are fully entitled to the same new rights acquired by the negotiating parties.

In essence, the non-negotiating countries are getting something for doing nothing. Rectifying this free-rider problem, however, could reduce the liberalization of services to the (s)lowest common denominator. Waiting for concrete commitments from all parties would leave the process vulnerable to one or two holdout countries. Furthermore, attempts by small groups of like-minded countries to develop more far-reaching rules could be inhibited if they knew they had to offer the benefits of the new rules to all member countries.

Addressing the free-rider problem has become central to the development of standards of treatment for market access in service transactions. One of the most frequent suggestions to counter this is to introduce conditional MFN status. In such a solution, a country not sufficiently contributing to the

33. See "Mid-Term Review Agreements," 40.
34. Ibid.; see also Bail, 9.
35. Bail, 9–10.
36. Mancur Olson, *The Logic of Collective Action* (Cambridge, Mass.: Harvard University Press, 1965).

liberalization process would be excluded from sharing the benefits achieved by liberalization.

The United States has been the most vocal proponent of this kind of solution. The American proposal "allows a signatory not to extend the benefits of its market liberalization to any signatory that has assumed an inadequate level of overall obligations under the Agreement (e.g., taken reservations in an excessive number of sectors)."[37] In fact, American insistence on some type of conditionality has been the biggest obstacle to formulating a service agreement.[38] The rationale is clear: Washington does not want an unconditional MFN principle because it would limit the United States' right to rescind its relatively liberal trade policies against countries that refuse to open their markets to American service industries. This ability to withhold selectively access to its lucrative market is the United States' strongest trade weapon.

By contrast, many of the negotiating parties feel that anything less than an unconditional MFN clause would undermine the multilateral liberalization process.[39] An unconditional MFN clause protects economically vulnerable countries against the more dominant countries of the international trading system.[40] In the words of Jagdish Bhagwati,

> there is little that the developing countries targeted for bilateral negotiations will be able to do since it is evidently a case where the strong prevail over the weak. This is the oldest argument in the book for resorting to multilateralism, which has been regarded as the only shield of the weak.[41]

This fundamental disagreement between the industrial countries and the developing countries brought the four years of service negotiations to a deadlock at the December conclusion of the Uruguay Round. After extensive discussions at the December meeting, a compromise of sorts was reached. The United States restated its position, expressing the desire for "progressive" rather than conditional MFN. Progressive MFN means that the inclusion of an unconditional MFN clause would be among the general principles of an agreement, provided that a "critical mass" of liberalizing commitments was achieved. Other countries recognized the inherent justification of the American stance.[42] Whether this compromise is enough to obtain a definitive breakthrough in the future remains to be seen.

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37. Office of the United States Trade Representative, *Fact Sheet: United States Uruguay Round Services Proposal* (Washington, 24 October 1989), 3.
38. William Dullforce, "EC Commits Itself to Liberalizing Trade in Services," *The Financial Times*, 5 December 1990, 7.
39. Bail, 10.
40. "Centre Stage for Services?," *The Economist*, 5 May 1990, 88–89.
41. Bhagwati, 567.
42. Margaret Wigglesworth, executive director of the Coalition of Service Industries, in an interview with the author, 13 February 1991; See also William Dullforce, "U.S. U-Turn on Services Removes Crucial Blockage," *The Financial Times*, 7 December 1990, 2.

The European Precedent

The EC bases its internal market on the free circulation of goods, people, capital, and services. With this overarching objective in mind, the Community goes further than GATT's MFN clause in its commitment to the liberalization of services. Article 7 of the Treaty of Rome states that "no discrimination based on nationality is permissible as to the freedom of services and the right of establishment in the EEC."[43] This approach guarantees market access and the right of establishment for both tradable and non-tradable services.

The greater degree of mutual commitment is possible in the EC because standards of treatment among EC members differ very little. The greater the difference in standards of treatment among a group of countries, the greater the potential impact of liberalization on their domestic economies and political systems. Thus, the consequences of the EC adhering to more far-reaching and binding standards are less dramatic than they would be among a more dissimilar group of nations. Furthermore, even if the EC policy of non-discrimination could be extended to a GATS, it would not adequately address the free rider problem.

Treatment in the US-Canada Free Trade Agreement

The US-Canada FTA made significant headway in the elaboration of rights and obligations along the lines of an MFN-like principle. Article 1402 of the FTA carefully sets out a commitment to create regulatory policies at the national and sub-national levels. Specifically, paragraph 1 of that article states that "each Party shall accord to persons of the other Party treatment no less favorable than that accorded in like circumstances to its persons." Paragraph 2 applies the same treatment to the sub-national level by codifying that "with respect to a province or state, treatment no less favorable than the most favorable accorded by such province or state in like circumstances to persons of the Party of which it forms a part." These obligations are strengthened by paragraph 4, which states that any party proposing or according treatment differing from that of the other paragraphs of the agreement shall have the burden of establishing that such treatment is somehow consistent with the agreement.[44] The essence of these provisions could serve as the nucleus of an MFN principle for a multilateral agreement on services.

As a model, though, Article 1402 is incomplete. Because of the bilateral context in which the FTA was crafted, the central dilemma of the GNS—free riding versus non-application of rights—is not considered. In any bilateral agreement, a perceived balance between contractual rights and obligations is implicit, otherwise there would be no agreement. Moreover, this critical issue would resurface in any attempt at multilateral replication of the FTA standards for service provider access.[45]

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43. As quoted in Sacerdoti, 11.
44. Canada-United States Free Trade Agreement, 2 January 1988; published in *International Legal Materials* Vol. XXVII, No. 2 (March 1988): 360–61.
45. Schott, 164.

National Treatment

National treatment differs from MFN/non-discrimination in that it guarantees equal treatment within national borders, once market access has been permitted. As stated in the GATT Mid-term Review's Montreal Declaration,

> National treatment means that the service exports and/or exporters of any signatory are accorded in the market of any other signatory, in respect of all laws, regulations and administrative practices, treatment "no less favorable" than that accorded domestic services or service providers to the same market.[46]

In spite of their differences, the line between national treatment and MFN/non-discrimination is not immutable. For some types of services, the granting of national treatment goes beyond the issue of equal treatment within national borders. It also raises questions of market access and the right of establishment, obscuring the distinction between the two.

For example, the cross-border sale of insurance is legally constrained in almost every country, even though the cross-border movement of a piece of paper (e.g., the insurance document) is not. Thus, with these tradable services there are two levels of protection. The principle of national treatment addresses the internal protection, and the principle of MFN/non-discrimination focuses on the protection at the border. By contrast, tradable services not embodied in goods (e.g., electronic data transmissions) have no real border; the only real level of protection they face is market access. Similarly, the nature of non-traded services prevents any effective distinction between internal and external protection since the treatment of these services deals with the subsets of the right of establishment. These subsets include provider-mobility, foreign direct investment, and the operation of foreign service firms in the market of the purchasing countries. Consequently, in these cases national treatment becomes indivisible from non-discrimination.[47]

Even though the distinction between the two is not always clear, most nations are more willing to negotiate an MFN/non-discrimination principle than a principle of national treatment. Since treating foreigners as nationals is generally more permissive than treating all foreigners equally, a national treatment obligation would be harder to impose than a non-discriminatory market access obligation. After all, fully implementing a national treatment principle would eliminate protectionism entirely. National leaders would obviously be reluctant to enter into such a blank check agreement.[48] Insistence on the inclusion of such a provision might, therefore, discourage broad participation in an agreement.

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46. "Mid-Term Review Agreements," *News of the Uruguay Round,* 24 April 1989.
47. See John H. Jackson, "Constructing a Constitution for Trade in Services," *The World Economy* Vol.11, No. 2 (June 1988): 197; and Nicolaides, 30.
48. Jackson, 197.

One way to avoid massive defection from an agreement would be to view national treatment as a long-term objective and not as an immediate obligation.[49] Another suggestion would similarly cite national treatment as an objective, but would require countries to pursue this goal only to the fullest extent possible. This could then be combined with transparency requirements which could facilitate identification and settlement of inconsistencies.[50] Hence, in the view of the LDCs, national treatment would not need to be included in the multilateral framework but could be used as a criterion by which to judge whether particular perceived obstacles to trade in services are legitimately regulatory or unfairly discriminatory.[51] For the industrialized countries, national treatment is an essential principle to ensure equal and fair opportunities for competition in and expansion of trade in services. Establishing clearly and applying uniformly the principle of national treatment, with exceptions granted only on the basis of international agreement, is a major objective of the developed countries, and the United States in particular.[52]

The US-Canada FTA heavily influences the American view on the multilateral application of national treatment. The FTA takes a broad interpretation of national treatment encompassing the barrier-to-entry issues of market access and the right of establishment. Any service industry specifically covered in the agreement is accorded the full range of binding rights and obligations that correspond to the FTA's interpretation of national treatment for trade in services, as detailed in Articles 1402 and 1403. The apparent success of the service sector provisions in the FTA stems from the unprecedented degree of explicit commitment therein. However, the most important achievement of the chapter on services imposes a standstill on service trade restrictions. This, in effect, forestalls future attempts to establish protection in the service sector and permits further consultations to limit and reduce the existing differences in treatment.[53]

Exceptions to these commitments exist. Most often, they consist of the non-application of national treatment to existing laws or regulations. Derogations may also include future amendments to existing national legislation, provided they do not increase the level of protection as defined by the mechanisms and institutional provisions set out in the agreement.[54] These dero-

49. India suggested this alternative at the January meeting of the GNS. *News of the Uruguay Round,* 23 February 1990, 13; see also Gibbs and Mashayekhi, 111–13.

50. Potential transparency requirements include obligated reports of situations where foreign service providers are not treated as favorably as domestic service providers; mandated responses to requests for information on comparative treatment; and formal statements of goals of meaningful market access when national treatment might not in itself ensure such access. See Jackson, 197.

51. Gibbs and Mashayekhi, 112.

52. Harald B. Malmgren, "Negotiating International Rules for Trade in Services," *The World Economy* Vol. 8, No.1 (March 1985), 20; see also Gibbs and Mashayekhi, 112.

53. The ongoing US-Canada consultations are doing just that. See House Committee on Small Business, *Hearing Before the Committee on Small Business of the House of Representatives,* 109th Cong., 2d sess., 4 October 1989, 45.

54. Article 1402, paragraph 4, of the Canada-United States Free Trade Agreement.

gations notwithstanding, national treatment is the norm in the US-Canada FTA.

The EC, in its quest for a barrier-free internal market, opted not to embrace the concept of national treatment, preferring instead the more dynamic approach of "equivalent access."[55] The American banking sector in particular reacted sharply to the prospect of institutionalizing equivalent access in the EC by pressing the European Commission to consider national treatment.[56] Those in the Commission who resisted the American view believed that implementation of pure national treatment would result in the codification of existing national protective practices, retarding rather than advancing liberalization.

After extensive discussion, the Commission modified its stance on equivalent access in favor of "national treatment that gives effective access."[57] In practice, this would mean that more restrictive nations would offer national treatment in exchange for market entry into less restrictive markets. While this outcome represents a compromise, it applies some pressure on regulatory systems to liberalize. An idea along these lines, recognizing the needs of the developing economies, could be workable within a GATS framework. In fact, the Montreal Declaration pledged that such a provision would be discussed as "part of the process to provide effective market access, including national treatment."[58]

Reciprocity

Reciprocity is a vogue word in the language of international trade. Traditionally, it has been the negotiating tool by which nations can obtain matching liberalization concessions, as well as the principal objective of the GATT negotiators. However, so many variants of reciprocity have developed that the term needs to be qualified. As was noted earlier, derogations and accommodations designed to hold the GATT together have thrown the contractual symmetry between obligations and mutual benefits off balance.[59] Consequently, negotiators have lost sight of full reciprocity as an approximate measure of commitment. Instead they have resorted to threatening to withhold reciprocity in order to achieve parochial objectives.

This danger is particularly germane to a GATS, given that any agreement must include some industry-specific negotiations. Nevertheless, the importance of services to the infrastructure of domestic economies and the track record of trade in goods would lead one to believe that unless a GATS

55. "A Survey of Europe's Internal Market," *The Economist,* 9 July 1989, 35.
56. Ibid.
57. Ibid.
58. "Mid-Term Review Agreements," 39.
59. For example, Article XXXVI of the GATT and the enabling clause of the Tokyo Round Framework Agreement exempt developing countries from rigorous application of reciprocity in their negotiations with developed countries.

framework includes some mechanism to ensure a symmetry of benefits, there can be no basis for an agreement.

Relative reciprocity appears to be a good starting point. It suggests that countries are not expected to make market access concessions inconsistent with their individual economic situation, yet it would allow broad participation and active commitment to progressive liberalization in a service agreement. Relative reciprocity on the basis of good faith would allow the LDCs to engage in obligations consistent with their developmental needs. At the same time, should they abuse that good faith, the rights that accompany those obligations could be rescinded. It is worth remembering that reciprocity, as a means of guiding proper behavior, is only as effective as it is credibly enforceable.

Conclusion

The process of developing a General Agreement on Trade in Services has come a long way since preliminary discussions began in the early 1970s. However, whatever progress has been achieved has been put on hold by recent events. Along with the events in the Persian Gulf, the suspension of the Uruguay Round in December has distracted governmental representatives from actual service negotiations.

Formally at least, the negotiations are trying to move on three tracks—with minimal results. The first track is to complete the negotiation of the framework. This track has been effectively stopped by the United States' refusal to discuss multilateral issues until the entire Uruguay Round reconvenes, and this will happen only when the Europeans demonstrate change in their negotiating stance on agricultural policy. The second track is composed of the individual sector specific negotiations. These, too, are handicapped. They are difficult to prosecute without the guiding principles of a framework, and they require to some extent a multilateral forum. The third track is what is called the request/offer negotiations. These are bilateral exercises in which national commitments to liberalization are defined. The limited participation and absence of direct GATT sponsorship is likely to impair progress on this track.

These obstacles notwithstanding, it is highly probable that multilateral talks will in some form be extended. In the aftermath of the December debacle of the Uruguay Round, most observers felt that the window of opportunity to secure a commitment to such an extension would close on March 3, 1991. At that time the fast-track negotiating authority granted to President Bush had to be renewed.[60] An extension of fast-track negotiating authority was requested at the eleventh hour. Congress now has ninety days in which to approve or reject the Bush Administration's request. To a large degree, their

60. The fast-track negotiating authority is an arrangement by which the US Congress delegates to the president its constitutional power to negotiate trade agreements. The results of negotiations are then subject to a single vote on Capitol Hill—no amendments are allowed. Clearly, if the fast-track authority is not renewed, any agreement produced would have to be tailored to the 535 opinions of the Congress.

decision will depend upon their perception of the EC's commitment to agricultural reform. Therefore, the future of all GATT talks will depend on two factors difficult to deal with: the American Congress and the European Common Agricultural Policy.[61]

The present uncertainty, however, cannot negate the real progress that has been achieved in the GNS over the course of the past four years. The extent of the GNS's progress can be attributed to the new ideas and experiences of the EC and the US-Canada FTA. Neither the EC nor the FTA represents a model that can be used in its entirety for a GATS, but their lessons should not be lost on the future negotiations of the GNS. The GATT can also be instructive in pointing out the problems that might arise from applying the lessons of these regional agreements to a multilateral forum.

International agreements among governments can take years to become fully operational. Therefore, it is prudent to develop a regulatory approach that envisages future problems, instead of one merely appropriate for resolving the problems of the past. Given that progress in technology continually changes the nature of services, GATS principles must be able to accommodate new services. In addition to accommodating the dynamic nature of services, principles based on agreed objectives must ensure broad participation. Such an agreement can still accommodate legitimate national goals without inhibiting liberalization or discouraging innovation.

Nonetheless, broad principles such as progressive multilateralism and overall reciprocity cannot stand alone, because they do not display the kind of tangible results that politicians can readily present to their constituents. For this reason, states frequently attempt to modify the agreed-upon principles. To prevent modification, a mechanism for regulating reinterpretation could be established. Such a mechanism would have to promise swift and compelling issue resolution in order to curb domestic pressures.

By sustaining the momentum of the GATT, the GATS signatories can help create a truly impressive regime: a worldwide free trade and service area. To achieve these objectives, the GNS should look to the experiences of the FTA and the EC in order to better understand the prospect for global growth and development and to avoid repetition of past errors.

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61. "Guilty on Trade," *The Economist,* 15 December 1990, 15.