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Trade in Services and the Multilateral Trade Negotiations

Jagdish N. Bhagwati

The dispute between developed and developing countries over the inclusion of services in the Uruguay Round of trade negotiations reflects critical differences in perspective on substantive issues. In particular, these substantive divisions arise from the differences between services and goods in matters such as regulation and the requirement in many instances of freedom to move productive factors across national boundaries—for example, the "right to establish" that would permit the provider of services to get to the user. In addition, developing countries see the developed countries as seeking concessions on service trade in exchange for removal of the latter's existing and potential barriers on trade in goods, rather than establishing quid pro quos within the service compact itself. Developing countries have possible export advantages in the service sector and have much to gain by joining actively in negotiating a services compact that permits them to exploit these advantages.

The question of inclusion of services in the Uruguay Round was a principal source of discord between the Group of Ten (G10), led by Brazil and India, and the developed countries, led by the United States in the negotiations prior to the Punta del Este meeting.[1] In between these two "hard-line" groups[2] were doubtless other developing countries who shared G10-type concerns. Nonetheless, they felt sufficiently pressured by the ballooning protectionist threat in the

1. The G10 was the group of developing countries consisting of Argentina, Brazil, Cuba, the Arabic Republic of Egypt, India, Nigeria, Peru, Tanzania, Vietnam and Yugoslavia.

2. It has become customary in some sections of the press to describe the G10 as "hard-line" developing countries and the G48 as being led by "moderate" developing countries and "medium-sized" developed countries, when equally accurately the latter could be described as the "medium-sized" developing countries and the "moderate" developed countries. The dialogue between the two sides with opposed viewpoints is hard enough to manage without the addition of such pejorative characterizations of the principals.

The author is a professor of economics and politics at Columbia University and currently consultant to the World Bank. Thanks are due to Brian Hindley, Ambassadors Shukla and Batista at the GATT, and Ambassador Muchkund Dubey for helpful conversations. The comments of Harvey Bale, Narongchai Akrasanee, David Lee, Tony Lane, Paul Leuten, Martin Wolf, and others at the Bangkok conference where the paper was presented, have also led to necessary revisions.

United States and the energetic and relentless diplomacy of its negotiators, to become with the European Community (EEC) the "moderate" brokers of a compromise solution at Punta del Este.

But the compromise merely clears the way for the trade talks to be launched despite the discordant views on services. The compromise relates to procedures on which the contending parties fought because, as I shall explain below, they symbolized substantive differences. These differences are serious and they raise both broad conceptual questions and narrow negotiating issues. This article seeks to address these issues and to define the possible agenda that the developing countries may seek in the service negotiations that are now to begin.

I. The Question of Tracks: Form and Substance

The procedural issues that divided the United States from the G10, if we may confine ourselves to the principals, related to two questions:

1. Would the General Agreement on Tariffs and Trade (GATT) be augmented to handle a service compact, or would there be a separate institution or agreement to oversee and regulate world commerce in services,

2. Would the negotiations for arriving at such a compact be conducted under GATT auspices or independently; by contracting parties or by a different group; and parallel to the next round of talks on goods or disjoint therefrom?

The U.S. position at the outset was to augment the GATT to include services, leaving the form of such an augmentation to the negotiations themselves. That shape may, as a witticism went, be simply to add to the GATT Articles the two words "and services" wherever the word "goods" appeared, or alternatively, taking the cue from the conventional Oxford English Dictionary where "man" embraces "woman," to declare that "goods" imply "services" in the Agreement. But, as often, good wit is bad economics; and services raise issues that go well beyond the scope of the GATT as it currently stands.

It followed equally that the United States wanted the new round of trade talks to include the negotiation of the services compact. The so-called single track was therefore the preferred U.S. option.

By contrast, Brazil and India, and the G10 as a whole, wished to delink the GATT from a potential services agreement and derive comfort rather than suffering embarrassment from the fact that the acronym for the General Agreement on Services would be GAS. In turn, therefore it was reasonable for them to seek a neat separation in the negotiating procedures for goods and for services: this was the dual-track procedure proposed by Brazil in June 1985.

The negotiations, according to this formula, would be distinct for services, would be undertaken by governments rather than GATT contracting parties, need not be parallel to those in goods, would not be under GATT auspices, and would lead to a services compact outside the GATT.

What transpired at Punta del Este was a compromise between these two

opposed procedural designs. The dual track was preserved in that the "contracting parties" would negotiate on goods but would change their hats to "governments" when they negotiated on services. But the G10 yielded to the extent that both groups would operate under the aegis of the Trade Negotiating Committee, to which they would take their recommendations; and the question of whether the GATT would be augmented or bypassed via a separate services compact was deliberately avoided.

Why all this fuss? Was it really a "farce," as U.S. ambassador Yeutter is reported to have remarked? As it happens, it was not. Underlying these procedural issues is a key, substantive source of discord. The United States, and lately the EC, have given the impression that they would trade concessions on their imports of goods, for concessions on their exports of services. Recent U.S. Section 301 actions (which are trade actions directed at what are deemed unfair practices affecting U.S. exports) have even explicitly followed this type of linkage with a degree of energy that leaves little doubt of U.S. earnestness in the matter. The linkage has been formulated not merely in terms of "rollbacks" of barriers against developing countries' exports of goods in exchange for access to developing-country markets in services. More seriously, the linkage has been made in terms of denying "standstills" and hence *added* protection being threatened, for developing-country exports of goods if they did not offer "reverse" market access on services.

Opposed to this approach has been the position of the G10 that most "rollbacks" and "standstills" on goods merely call for the contracting parties to conform to explicit GATT rules. The demands of the developed countries such as the United States that goods and services should be linked are seen as offering conformity to GATT rules on goods as an exchange for developing countries opening up new areas such as services to market access. This is considered to be unfair and wrong. In short, the U.S. position is construed as a demand for an *unrequited* concession by developing countries on services masquerading as a quid pro quo trade of concessions by developing and developed countries.

The single-track and dual-track modalities are therefore not superficial phenomena but reflect the desires of their respective proponents to choose bargaining procedures that reflect and hence enhance these substantive positions. Single-track negotiations do underline linkage; dual-track negotiations do not.

II. Services versus Goods: Concepts and Consequences

It is important, at the outset, to recall the conceptual advances that international economists, following as usual in the footsteps of activist policymakers, have now made in the matter of defining services. This conceptualization should provide the underpinnings for the positions that governments must consider in formulating the general principles of a services compact, just as the theory of trade and welfare provides the underpinnings for the general principles that

underlie GATT and for the impulse to trade liberalization that informs current World Bank conditionality.

How, then, are services to be defined? Or how are they different from goods? Adam Smith, John Stuart Mill, and many others raised these questions, but perhaps the earliest answer to them was attempted by T. P. Hill (1977) only recently. Hill focused on the fact that producers cannot accumulate a stock or inventory of services, stressing that services must be consumed as they are produced. This key element will not characterize all items which we customarily define as services: for example, "answering services" do store messages. But such exceptions do not detract from the usefulness of a definition of services that characterizes them as nonstorable because they require the simultaneity of provision and use.[3]

Services Requiring Physical Proximity versus "Long-Distance" Services

If services must be used as they are produced, then there must of necessity be *interaction* between the user and the provider of the service. A producer of goods, by contrast, can produce but store, and generally transact with users at any subsequent time. But this interaction, in turn, implies that we can contemplate two essential categories of services: first, those that necessarily require the physical proximity of the user and the provider; and second, those that do not, though such physical proximity may be useful. I noted this important distinction sharply in a recent article (1984):

> Basically one has to draw a distinction between services as embodied in the supplier of the services and requiring their physical presence where the user happens to be and services which can be disembodied from the supplier and provided without a physical presence being necessary."[4]

Physical proximity essential. The class of services where physical proximity is essential is usefully thought of as consisting of three categories based on the mobility of the provider and user of the services.

The first category is *mobile provider, immobile user.* This class of services *requires* that the provider go to the user, while the reverse mobility is physically

3. Another characteristic of services which is necessary is that services occur *between* different economic agents or otherwise all activities and value added would collapse into the service sector. An implication of this characteristic is that the definition of services reflects economic organization or "market structure." If Mr. Smith paints a car on the assembly line inside your auto plant as your worker, then his wages are part of goods production and value added. But if he does the same job from his own establishment, his wages or income are part of service production and value added. For a detailed discussion of this question, see Bhagwati (1987a, 1984).

4. In my 1984 paper, I focus on the latter class of services (which I now call "long-distance" services) discussing how the "disembodiment" effect can frustrate the intention of immigration restrictions on skilled labor. Conversely, Gary Sampson and Richard Snape (1985) have drawn on this twofold distinction in my 1984 article to explore further the *former* class of services, where physical proximity of the provider and the user is involved, with a valuable classification of such services which I use, with some simplification, below.

infeasible. If an Indian or Korean firm had won the bid for construction of the Connecticut Turnpike, unskilled Indian or Korean labor services could have been provided only by moving them to Connecticut. Supplies of brute, Ricardian-style labor services must be relocated to the user's locale, as we have seen in the Middle East since the 1970s.

The second category is *mobile user, immobile provider.* This is another important class of services in which the user must move to the provider. Open-heart surgery cannot currently be done in Zaire because, even though Dr. Cooley can go from Houston to Kinshasa, there is no way the necessary support services and hospital care can be duplicated there. In this class of services, some key elements are simply not transferable geographically to the user's location.

The third category is *mobile user, mobile provider.* For this range of services, mobility is symmetrically possible. Haircuts, tailored suits, and lectures are the type of services which are in principle transmittable between user and provider in either's location, the only difference being the cost of so doing.

The generic class of services, where the provider must move to the user, as a sheer physical necessity (as in the first category above) or because of overwhelming economic advantage in so doing relative to alternative means of effecting the service transaction at long distance (as discussed immediately below), I call "temporary-factor-relocation-requiring" services.

Physical proximity inessential: the "long-distance" services. In the second broad class, which I call "long-distance" services, physical proximity between providers and users may be useful, but it is not necessary. Live music concerts and data transmission "over the wire" are obvious examples. Traditional banking and insurance services fall into this category, in principle, since loans could be secured by mail or phone, and insurance policies are often so purchased. The scope for long-distance service transactions will increase with the advance of technology (see Bhagwati 1984). This has important implications for broader issues such as the trend effect of immigration restrictions on the relative wages of skilled and unskilled labor since skilled services may increasingly be transacted "long-distance" whereas the latter cannot.

Physical proximity between provider and user in many services (especially in banking) does involve substantially greater efficiency, however, and at times may allow a wider range of possible transactions even when long-distance or arm's length transaction is feasible. Technical change which has opened up product diversification in banking, for instance, has reinforced this aspect. In legal services, continuous interaction between local client and overseas lawyers is deemed essential for efficient service and has fueled lobbying efforts by multinational legal firms to secure ways of establishing physical proximity to their clients abroad.

The vast majority of service providers are likely to require and therefore press for physical proximity. The question of devising a service compact, whether as part of an augmented GATT or outside the GATT, is thus inextricably bound up with the question of provider-mobility across national borders.

The negotiations on services must therefore come to terms somehow with the implications of this essential connection, in many services, between international factor mobility and international trade. While we have accepted the distinction between these two phenomena since the founding of both economics and the GATT, it vanishes for these, indeed the preponderant class of, services. Factor mobility and trade are simply two integral aspects of the service transaction. For this reason, I prefer to talk of service *transactions* rather than service *trade,* so that we do not lose sight of this dual nature of the services that do not fall into the "long distance" mold.

This essential connection of services with international factor mobility has critical implications for government restrictions on service transactions. If services require factor mobility, then the ability of governments to exclude or impede service transactions does not depend altogether on restrictive border measures on trade. Restrictions on factor inflow can suffice for this purpose.

Hence arises the immediate and compelling need to go beyond the conventional focus on border trade measures such as tariffs or nontariff barriers (NTBs) for services. This fuels the demands for the "right to establish" domestic outlets.[5]

But the phrase "right to establish" conceals a continuum of factor-mobility phenomena which embrace both capital and labor mobility. It can cover the right of an American bank to establish a branch in Bombay, implying foreign investment, and the right to employ foreign personnel locally, implying skilled and semiskilled importation of labor. It can extend to a Korean firm's right to construct a road or a harbor by importing skilled and unskilled labor, *both* constituting (according to sound economic theory as spelled out above) an integral component of the service transaction in that sector.

Equally, it can extend to an English multinational legal firm setting up an office in Tokyo, with local personnel but with English barristers or American lawyers who fly in and out to work with multinational Tokyo-based and other local clients. It could include hospital management contracts with short-term inflows of managerial personnel.

In short, factor mobility can be complex, not fitting into any particular mold. What *is* certain however is that the concept of the "right to establish" cannot meaningfully or justifiably be circumscribed to exclude the inward mobility of foreign labor and its services. And the problem that this raises cannot be dismissed simply by saying, "Oh, we cannot dismantle immigration restrictions and have free mobility of labor across national borders." For, as I have argued earlier (Bhagwati 1987a), the concept that we can work with is that of "*temporary-factor-relocation-requiring*" services and hence of temporary residence by foreign labor to execute service transactions. For example, Korean construction

5. At the time of U.S. treasury secretary Connolly's efforts to "open up Japan," the "right to establish" question applied to *goods* trade. It was then believed that, unless Japan permitted U.S. goods exporters to set up their own retail outlets, market access to Japan could not be effective. The economic implications of this issue have been discussed and modeled in Bhagwati (1982a).

firms would bring in workers to build a turnpike; when the task was completed, the workers would return to Seoul. Or an Indian legal firm would have lawyers come from New Delhi for specific assignments or predetermined periods, the firm then rotating the personnel as necessary to avoid permanent residence (for example, immigration) of specific individuals.

Conceptual clarification of the nature of service transactions therefore has led to a keen awareness that freeing trade in services and the associated "right to establish" question, will raise serious questions relating to labor relocation as well. As long as the "right to establish" was regarded as simply a question of U.S. banks, insurance companies, and multinational professional firms setting up branches in Bangkok, Dar-es-Salaam, and Tokyo, there was at times a certain sense of patronizing disdain for the hesitations of the countries that found the factor-mobility aspects worrisome.

As Hindley (1987) shrewdly remarks, however, a certain ambivalence has apparently crept into the U.S. negotiating attitudes, now that the labor-mobility issue suggests that openness to foreign services may create immigration problems for the United States. On the one hand, the impression has been given by U.S. officials at times that the overall services compact should confine itself to long-distance and arm's-length transactions, ruling out "right-to-establish" questions and hence the corresponding enormous range of services that require such establishment.

On the other hand, since the powerful U.S. lobbies from the service sector continue to clamor for the "right to establish," some official spokesmen have instead tended to opt in favor of an emasculated (and conveniently self-serving) notion of the "right of presence" or "right of market access," euphemisms which are designed to ensure artfully that the labor-mobility aspects of the "right to establish" questions will be soft-pedaled.[6]

Exclusion of services that require significant temporary relocation of labor, however, would rule out of the compact a range of services in which some of the principal developing countries that have been skeptical about or opposed to negotiating services happen to have sufficient skills and endowments to consider developing exports of such services.[7] Except for a handful of developing countries such as Singapore and Hong Kong, which entertain offshore banking and insurance establishments without hesitation, "such a definition of 'services' . . . excludes any substantial *export* interest on the part of developing countries" (Hindley 1987, p. 4). It would also necessarily reinforce the position of those developed countries which seek concessions on services from developing countries in exchange for their (real or apparent) concessions on goods to the developing countries. The question therefore is pertinent to the issues that divide the G10 and the United States.

6. Compare with Hindley's (1986a) penetrating discussion of this issue.

7. This implication was noted earlier in Bhagwati (1987a, 1985a, 1985b) and has been further discussed by Hindley (1987), among others.

Regulation

Another aspect of the difference between services and goods is the much more pervasive application of regulation to services than to goods, and the rare harmonization of regulatory provisions across national boundaries.

The *critical* difference, however, arises from the fact that these regulations often apply to the *provider* of the services while their intent is to protect the *user* of the services, whereas with goods the regulations apply to the *product itself.* Thus, with trade in goods, it is possible for foreign suppliers to meet national regulations by manufacturing to necessary standards. While it is not uncommon to hear complaints about how different health, safety, and human rights traditions and standards result in "unfair" competition, it is conventional with goods not to be bothered by the behind-the-trade-scene regulations as they differentially affect rival *producers* in competing countries. With services, this detachment is often impossible. The regulations imposed on the provider can critically affect the service transaction, as for instance with reserve requirements that an insurance company has to meet before it is allowed to even begin to attract any customers.

This regulatory difference between services and goods implies that, while local establishment by a foreign provider to supply a service will permit the fulfillment of local regulatory criteria, sale of such services from a base abroad where the regulatory criteria are less strict, will not. This difficulty with regulation arises with "long-distance" or arm's-length transactions, whereas the difficulty (identified earlier) with service transactions requiring physical proximity between provider and user arose where such long-distance transactions were infeasible or significantly inefficient.

The nonharmonization of regulatory systems has led to major difficulties with service trade liberalization in the EEC (Hindley 1986a). The EEC does not lack for the "right to establish." But the incapacity to sell services from a base abroad, where the regulatory regimes are dissimilar, has been a major obstacle to liberalization and accounts for the miniscule progress observed to date.

A gung-ho reaction to this issue would be to permit regulatory systems to "compete through their outputs." A less demanding or restrictive system would then prosper at the expense of ones that restrict or regulate more. In their present deregulatory mood, U.S. officials may then see a triumph of the more efficient resulting over the less efficient. It is unlikely that others will see the matter this way, however, any more than the U.S. would if the shoe were on the other foot. Within the EEC freer service trade has not been permitted to transpire; and successful efforts have not been made to harmonize the service trade regimes. It is unlikely that the developing countries, where regulation sometimes tends to be stiffer, will be enthusiastic about these matters either.

Between the hesitations over the "right to establish" and the desire to emasculate it to developed-country advantage, on the one hand, and the hesitations over the indirect competition between unharmonized regulatory regimes that the

developing countries with greater attention to the role of the State must fear when services are transacted without the benefit of local establishment, on the other hand, it seems as if progress toward the general principles underlying a service compact is likely to be slow.

Infrastructure, National Security and Other Constraints on Liberalization

Overlaying these difficulties is the fact that some of the service sectors (for example, banking) are regarded by the hesitant developing countries to be part of their infrastructure which they feel they must control for political reasons much as, say, the U.S. restricts ownership by foreign nationals in its media (services) sector. Again, transborder data flows and the information sector are regarded as sensitive areas that raise issues bordering closely on "national security" for the "middle powers" such as Argentina, Brazil, and India.

In these areas it is therefore difficult to urge the developing countries to discard such notions altogether, especially when these types of asymmetrical views about some services and many goods are held by many influential citizens within the developed countries themselves. (As I argue later, however, their fears and concerns are greatly exaggerated and need to be carefully evaluated in their own interest.) Consider the following impassioned pronouncement:

> We ought to be exporting computers, not shares of IBM. We should seek to sell more, not sell out.
>
> To accept the de-industrialization of [our nation] while exulting in the growth of foreign ownership and influence in our domestic institutions could be an unwitting prescription for slowly becoming an economic colony again.

It came, not from Prime Minister Rajiv Gandhi or from President Alfonsin. The author was U.S. Representative Jim Wright, majority whip in the U.S. Congress, writing in the *Wall Street Journal* (October 3, 1985).

III. Comparative Advantage in Services, Cost of Protection, and Policy-Mix Solutions

The foregoing analysis highlights the difficulties that emerge for the impending service negotiations, especially as they reflect the special characteristics that serve to set services apart from goods. But before I turn to the prospects for different solutions to these difficulties, it is necessary to speculate on where the comparative advantage in service transactions may lie, especially between the developing and the developed countries. Several observations on that issue are in order.

First, while the trade data for services are extremely unreliable, Sapir's (1985) careful analysis of what is available underlines strongly what common sense would suggest: many traded services tend to be intensive in the use of technology

Table 1. *Trade between the Industrialized and Developing Countries, 1980*
(billions of dollars[a])

Category of merchandise and services	*Industrialized-country exports to developing countries*	*Developing-country exports to industrialized countries*
Merchandise trade, of which:	277	385
Fuels	6	258
Other primary products	44	67
Manufactures	227	60
Service trade, of which:	72	30
Transport	35	10
Travel	14	12
Other private services	23	8

a. Billion is 1,000 million.

Source: Sapir (1985, table 2); data for merchandise trade are based on GATT (1983); and for service trade, on own estimates.

and of capital, whether human or physical. This should give the developed countries the competitive edge since they are abundant in the endowment of human and physical capital. It is suggestive that, when Sapir (p. 37) looks at the balance of trade in services, it is the advanced newly industrializing economies such as the Republic of Korea, Singapore, and Taiwan that come out with small positive or negative balances rather than the large deficit of many developing countries.[8]

However, it would be totally wrong to infer that developing countries simply cannot find traded services that they can export successfully. Table 1, compiled by Sapir, gives an aggregated and very rough picture of service trade among the two groups of industrialized and developing countries for 1980. The data can be read two ways. On the one hand, they show that the service exports of developing countries are a substantially smaller fraction of their total exports than is the case with industrialized countries' share of service to total exports. On the other hand, the developing countries' service exports are by no means negligible, as recorded, and seem to reflect earnings not only from tourism and transport but also from "other private services" (which include professional, design, construction, and related services).

Second, detailed studies further underline the export possibilities that the energetic, outward-oriented newly industrializing economies have in services. Thus, for example, table 2 suggests that the earlier U.S. domination of the world market for international *construction* may have diminished with the medium-level developed countries and a newly industrializing economy such as Korea taking significant shares in the 1980s. A non-negligible share of the developing countries is evident from table 3. In the more complex field of international design contracts, again the data show a sizable share of contracts being awarded to firms from Brazil, India, Korea, Lebanon, and Taiwan (Sapir 1986, table 3).

8. In itself, however, the trade balance would be, of course, an inconclusive piece of evidence on the issue.

Table 2. *Market Share of International Construction Measured by New Contracts Awarded to the Top Two-hundred Fifty International Contractors, 1980–84*
(billions of dollars)

Country	*1980*	*1981*	*1982*	*1983*	*1984*
United States	48.3	48.8	44.9	29.4	30.1
	(45%)	(36%)	(36%)	(31%)	(38%)
France	8.1	12.1	11.4	10.0	5.4
	(7%)	(9%)	(9%)	(11%)	(7%)
Germany, Fed. Rep.	8.6	9.9	9.5	5.4	4.8
	(8%)	(7%)	(8%)	(6%)	(6%)
Italy	6.2	9.3	7.8	7.2	7.8
	(6%)	(7%)	(6%)	(8%)	(8%)
United Kingdom	4.9	8.7	7.5	6.4	5.7
	(5%)	(6%)	(6%)	(7%)	(7%)
Other European	9.2	12.6	10.3	9.1	7.2
	(8%)	(9%)	(8%)	(10%)	(9%)
Japan	4.1	8.6	9.3	8.7	7.3
	(4%)	(6%)	(8%)	(9%)	(9%)
Korea, Rep.	9.5	13.9	13.8	10.4	6.8
	(9%)	(10%)	(11%)	(11%)	(8%)
All other	9.4	10.5	8.6	7.0	5.9
	(9%)	(8%)	(7%)	(7%)	(7%)
Total	108.3	134.4	123.1	93.6	80.5

Source: Various issues of *Engineering News Record;* from ongoing studies by U.S. Office of Technology Assessment.

Third, there is little doubt that the broader group of newly industrializing economies, not just the super exporting economies like Korea but also the traditionally inward-looking ones like India, have the skills to develop export advantages, not merely in computer software (a good, not a service) and in an increasing range of "on-the-wire" services that new technologies make possible, but also in the services that imply temporary relocation of skilled labor. I would expect that legal and professional services, with right of establishment, exhibit a *mutual* rather than one-sided export advantage for developing and developed countries. The developing countries must not be misled into thinking otherwise simply because the initiative to include such trade in a services compact comes almost wholly from multinational firms in the developed countries. Why?

The reason is that such services are not homogeneous. It is necessary to think of "dualistic" structures here (Bhagwati 1986d). The advantage in tendering services at the multinational level is likely to inhere in developed countries: in fact, these multinationals are piggybacking on their multinational clients in other sectors that have operations abroad. Only as the developing countries expand their own multinationals in nonservice sectors, as is beginning to happen, will they begin to develop some "linked" advantage in professional services.

At the other end of the spectrum, however, the advantage must belong to lawyers, doctors, and accountants in the developing countries, because, while they are equally competent, they can work more cheaply and offer a range of

Table 3. *Cumulative Foreign Awards of Top International Contractors by Economy, 1978–83*
(billions of dollars)

Economy	*Awards*
All countries, of which:	566.6
All developing countries, of which:	99.2
Korea, Rep.	56.2
Turkey	10.0
Yugoslavia	7.4
Brazil	5.8
India	3.9
Taiwan	3.4
Philippines	3.2
Argentina	3.0
Lebanon	1.4
Pakistan	1.3
Kuwait	0.7
Singapore	0.6
Malaysia	0.5
Panama	0.4
Mexico	0.2
Thailand	0.2
United Arab Emirates	0.2
Colombia	0.1
Indonesia	0.1

Note: Countries are ranked according to the foreign contract values of their top firms. Until 1980, the top 200 firms were surveyed; since then, this number was raised to 250.

Source: Compiled by Sapir (1986, table 2) from *Engineering News*, various issues.

services where price competition is decisive.[9] If they are allowed to enter under "temporary-factor-relocation" visas to make service transactions possible, I see no reason why they cannot increasingly take a sizable fraction of the market at that level.[10]

Such a "dualistic" view is quite consonant with mutual trade in "similar products." A product is a vector of characteristics, and different countries can have advantage in some and not in others. In service transactions, physical proximity accentuates such differential elements and can lead to mutual comparative advantages within a sector for suppliers from different countries.

Fourth, the export possibilities become even more compelling for developing countries if the issue of unskilled labor mobility in the execution of specific short-term contracts (as in the Middle East), is resolved in favor of its inclusion in the "right to establish." It is already within the realm of probability, thanks to

9. The question of whether they would be allowed to indulge in price competition is critical. Attempts by professional associations to regulate minimum prices would then be in restraint of trade.

10. It is important not to confuse the "brain drain" question with the issue of temporary relocation of labor. I have discussed the contrasts in Bhagwati (1985c).

the widespread use of such unskilled labor, including that by U.S. international contracting firms, during the 1970s and 1980s. It also has legitimacy in the practice of Western Europe in its postwar "guestworker" systems and in the latest U.S. legislation which permits over 300,000 workers to be imported for specific types of short-term work (that is, in U.S. agriculture).[11]

Fifth, it is important for developing countries to recognize that a great number of traded services are intermediates. Protecting banking and insurance sectors for example, increases domestic prices of these services. As they are inputs into other goods, this can raise prices of export goods and undermine export prospects.

The effects of protecting intermediate services are similar to those that result from increasing the cost of intermediate goods such as steel.[12] But the adverse effects on exports of goods are more serious in the present instance because, in denying the domestic exporters of goods access to efficient banking services, the protective policies succeed in denying access to more than cheaper credit. More important, exporters are denied access to the entire vector of services that modern international banks can provide to facilitate international commerce. The protection of intermediate services, in the interest of goals such as political control, therefore has costs that are not negligible and have presumably not been properly assessed by the developing countries.

Finally, it is important to recognize that policies such as the protection of locally produced computer hardware in the telematics and information sectors may represent an unnecessarily expensive way of securing one's objectives. If the objective is to build up national technological know-how through "learning by doing" (rather than to develop the industry itself), then the cost of such a policy is to spread computer illiteracy in the population and high costs to producers who must make do without lower-cost access to modern information technology in the production process.[13]

A country such as India (and possibly Argentina and Brazil as well) has the possibility of using an alternative policy instrument to achieve the desired mastery of know-how without these costs. Remember that the know-how is embodied in one's citizens. If one then looks at the national-origin composition of scientists in only the artificial intelligence, robotics, and computer science labs

11. In the spirit of the U.S. service sectors' demands, the developing countries may well ask for equal access to these jobs instead of having them de facto assigned to applicants south of the Rio Grande.

12. The successful outward-oriented regimes have managed to ensure that internationally traded intermediate goods are available to domestic producers at world prices. Similar logic should apply to internationally traded intermediate services as well.

13. In India, import-substitution in computer hardware has led to higher costs, unavailability, and enormous lags in the use of computers in tourism, the judiciary and the schools. The import-substitution policy manages to distance greatly even a highly educated population and skills-endowed economy such as India from the modern world outside. It also inhibits the rapid adoption of modern information-technology-based processes that are essential to absorbing high-productivity economically-efficient advances in the manufacturing sector.

and institutes in the United States, it is possible to find numerous Indian mathematicians and scientists, even in leadership positions. These Indians embody know-how in these fields at the very cutting edge of technology.

Since the sociology of international migration of professional classes increasingly permits immigrants to retain ethnic ties to their countries of origin, and therefore the "diaspora" model has increasingly come into its own, the Indian government has the option of utilizing this U.S.-based resource any time it wishes to do so.[14] Going the protectionist route will yield a lower level of embodied technology in resident nationals (who may also leave anyway) *and* will sacrifice computer literacy and efficiency in production. Permitting cheap imports at world prices avoids these costs, and utilizing the superior know-how embodied in one's nationals abroad also secures know-how at its best and cheapest.[15]

To put it differently, the *two objectives* of (i) spreading computer literacy and encouraging adoption of efficient production processes, and (ii) building up technical know-how among one's nationals are impossible to achieve with one policy instrument, namely, protection. They are achievable, and are in effect Pareto-dominated in outcome, by the use of *two policy instruments:* (i) world-price imports of computers and related technology; and (ii) an open-door policy on emigration combined with a policy to utilize the know-how embodied in one's nationals abroad.

Such a policy mix breaks from the protectionist mold and requires an imaginative and simultaneous use of policies from what are generally considered to be unrelated areas of governmental intervention. But they do offer the prospect of a superior approach for those countries such as India which have the talents and the skills in the field of information to make such an approach feasible.

IV. Developing Countries: Bargaining Options and Strategies

What positive approaches emerge that the developing countries may take in the forthcoming negotiations on services?

Developing countries cannot be expected to opt en bloc for any one approach on services any more than we can expect them to have identical positions on agricultural liberalization or the developed countries to agree on the optimal redesign of safeguard procedures. Thus, Hong Kong and Singapore can be expected to be agreeable to the more "hard-line" developed-country positions on

14. When a people are geographically dispersed but ethnically linked, this new reality has several important implications for a variety of other policy issues such as the appropriate exercise of income tax jurisdiction on one's nationals when they are internationally mobile. See Bhagwati (1982a) and Bhagwati and Wilson (1987).

15. Although I talk of "nationals," there is little doubt that even those who change nationalities today often have attachment to their countries of origin. Nonetheless, this distinction in turn raises the issue whether developing countries ought not to consider permitting their nationals to hold dual nationality as part of the policy option that I advocate above.

services. Brazil and India can be expected to oppose them. They, and also the developing countries that initiated the Uruguay Round under the G48 umbrella, will have to decide what kind of game they want to play now that the players are coming onto the field.

The options that they must consider are best determined by the demands that the developed countries, especially the United States, have been making.[16] These options will have to be defined in terms of the *responses* that the developing countries make to these demands or negotiating positions, as they have been indicated so far. Let me begin with what are generally understood to be the broad outlines of the current U.S. positions, however negotiable they may turn out to be in the course of the Uruguay Round itself.

Generally Perceived U.S. Positions

Inclusion of services in the Uruguay Round, and indeed of other "new" sectors and areas such as intellectual property and trade-related investment rules, is considered to be part of a "grand tradeoff" where these new areas benefit the United States. *In return,* the United States is willing to consider rollbacks and standstills (consistent with the exercise of trade-affecting, GATT-compatible actions such as countervailing duties, antidumping, and Section 301 actions) on goods (see also, however, the discussion below).

The "grand tradeoff" is seen in terms of both cosmopolitan interest (that is, what international economists describe as "world welfare") as well as U.S. interest (that is, what international economists describe as "national welfare"). The former position emphasizes that an efficient world allocation of resources requires that "everything be put on the table": the outmoded GATT must be redesigned, augmented in scope, and brought up to date to embrace new realities. The latter position is developed in terms of U.S. comparative advantage having shifted to the new areas so that, if United States is to yield on goods, it is fair for it to ask others to yield on services and new issues. A brief tabular arrangement of United States–perceived losses and gains in relation to those of the developing countries in terms of the mercantilist logic of trade-barriers-bargaining is presented in table 4.

A third argument in the United States in favor of this grand tradeoff is that the current presidential administration is too beleaguered to hold protectionists at bay in Congress unless the advanced developing countries (and, of course, Japan and the EEC) open up their markets to U.S. exports of services as a quid pro quo.[17] These countries are faced with what could be construed as a rather

16. While the discussion below focuses on the United States, it is clear that, unlike in the 1982 GATT Ministerial meeting, the EEC also perceives export competitiveness for itself in services and hence is closer to the U.S. positions on it than before. See, for example, the recent statements of Willy de Clercq (1986) to this effect. Table 4 on the United States (below) therefore could be readily modified to one for the EEC, with agriculture being considered as a "loss" instead of a "gain." Japan, with its enormous surplus, also sees clear comparative advantage in the financial services area.

17. The U.S. government has encouraged such export-seeking lobbies as a political countervailing force to the trade-threatening protectionist lobbies.

Table 4. *Perceived U.S. Benefits and Losses in Relation to those of Developing Countries from the Prospective Liberalization of Trade in the Uruguay Round*

U.S. "Benefits"	*U.S. "Losses"*
1. Services	1. Rollback of the Multifibre Arrangement (MFA) and other voluntary export restraints (VER) and Organized Marketing Arrangements (OMA) on goods
2. Intellectual property	2. Standstill on VERS, OMAS on goods
3. Trade-related investments	3. More stringent use of safeguards and tighter rules to prevent abuse of countervailing-duty and antidumping actions
4. Reverse market access to developing countries	4. Improved structural adjustment
5. Agriculture[a]	

a. Agriculture is included as a benefit because agricultural liberalization in cereals is expected to favor U.S. exports, mostly at the expense of the EEC and Japan but, depending on the final package, even at the expense of some developing countries.

difficult situation: trade concessions appear to be demanded of them as a way of ensuring that market access for their exports is continued.

But this, in turn, reflects a substantial shift in U.S. positions in trade negotiations from what I have called GATT-style "first-difference" reciprocity to "full" reciprocity.[18] The United States has increasingly looked at, not the balance of advantages from *changes* in trade barriers, but the balance of advantages from the trading system in toto.

Doubtless this attitude stems from the macroeconomic difficulties that the overvalued U.S. dollar entails and the resulting substantial adjustments forced on the traded sector. It also stems from the "diminished giant syndrome" that has affected the United States as its effortless postwar hegemony in the world economy has been threatened by the relentless advent of the Pacific Century.[19] But overlaying these two factors has been the fundamental fact that the GATT's basic conception, and indeed that of the United States as its leading founder, was always based on contractual and (fully) reciprocal rights, with member states enjoying symmetrical rights and obligations. The United States, which emerged as the *force majeure* in the 1940s, permitted Western Europe effectively to get away with nonreciprocity while it worked through the 1950s to achieve current account convertibility, and agreed to special and differential treatment for developing countries until now.

The current U.S. insistence on full reciprocity can then be seen as an inevitable return to the original symmetrical conception of the world trading order. Hence,

18. I note with pleasure that Brian Hindley, in his article in this volume, has embraced this terminology. The use of the phrase "aggressive reciprocity" to denote full reciprocity is inappropriate: full reciprocity could equally be pursued in a tranquil way.

19. On this, see Bhagwati and Irwin (1986) on the parallels between late nineteenth-century Britain and the present-day United States in the rise of "fair trade" movements.

it is *not* a position that the developing countries (or Japan, which is alleged, rightly or wrongly, to offer less-than-symmetrical access to its own markets) are likely to be able to challenge with success, much as they consider it to be unfair from the perspective of first-difference reciprocity. My judgment therefore is that the developing countries must proceed from the unhappy premise that the United States, especially its Congress, cannot be expected to trade access to its markets any longer without significant elements of reciprocity from the developing countries, even if the balance-of-trade deficits are somehow eliminated.

The Developing-Country Options

From the viewpoint of the hesitant developing countries, the U.S. position presents one major difficulty even if they are prepared to accept the reality of full reciprocity and yield on their sense hitherto that the so-called bargain being offered to them simply is not one. It is unclear what the United States and the EEC, can offer by way of standstills and rollbacks on goods if these developing countries offer concessions on services. I quote one influential commentator, who was a member of the U.S. administration:

> The issue for the United States is whether a meaningful standstill and rollback commitment would apply to existing U.S. restrictions in sugar, meat imports, textiles, steel, automobiles, etc. as well as the use of future 301 actions in both goods and services trade. Ideally, the United States would like this commitment to apply only to new measures, not existing restrictions or extensions of existing programs (such as another VRA [voluntary restraint agreement] in steel or tightening sugar quotas under the existing programs). According to U.S. interests, it would not apply at all to trade legislation consistent with GATT (201, CVD [countervailing duty], and AD [anti-dumping] provisions and national security), and it would mean submitting 301 cases to GATT but only in goods. In new areas—services, etc.—the United States would remain free to retaliate under 301, including retaliation in goods areas, without submitting to GATT rules. [Nau 1986, pp. 22–23]

This has been the sense of the remarks reported in the U.S. press by Ambassador Yeutter on his return from Punta del Este. This is also consonant with the substances of Martin Wolf's "Europessimistic" argumentation on special and differential treatment presented in this volume: few meaningful concessions on rollbacks and standstills on goods can really be expected and the developing countries ought to yield on reverse market access largely because it is good for them to liberalize as suggested by the export-promoting strategy.[20] Doubtless, as I have already emphasized in section III, even unilateral trade liberalization in intermediate services should have big payoffs for the developing countries. But if only we could persuade trading nations to accept such compelling arguments,

20. On the merits of this strategy, see the extended review in Bhagwati (forthcoming).

we would not have to worry about rollbacks and standstills either. The developing countries cannot realistically be expected to be less mercantilist than those who preach free trade but practice mercantilism themselves. This is a pity, but a reality too.

This reinforces, in my judgment, a suggestion I had made earlier (Bhagwati 1985c), that the developing countries ought to participate actively in the service negotiations instead of rejecting them on grounds of first-difference-reciprocity unfairness. They should then seek quid pro quo (in terms of export possibilities) within the service sector itself.

Not merely is it risky to establish linkage between goods and services when the goods "benefit" is less likely than the services "loss." It is also silly to let the developed countries define the service compact all by themselves in a way that can then be fully expected to serve their own narrower, export interests rather than reflecting more fairly and adequately the general principles as set out in recent analyses and recapitulated in section II of this article.[21] The latter would also serve the interests of developing-country exporters.

As I argued in section III, quid pro quo within the service sector certainly exists for the skill-abundant, newly industrializing countries, and especially so if the temporary-factor-relocation-requiring labor- and skilled-labor-intensive services are not omitted in the formulation of a services agreement.[22]

The difficulties that I detailed in section II that plague rapid progress in service liberalization also imply that the Uruguay round is unlikely to yield anything more concrete than a code or an agreement of principles. It is improbable that actual service liberalization under the code will emerge during the course of the Round itself.

This prospect also underlines the wisdom of a strategy in which the developing countries offer to discuss services, thus assuaging the desire to begin bringing them under trade discipline and hence helping to head off protectionist pressures on goods trade. At the same time, they can use the opportunity to ensure that their export prospects are adequately reflected in the service code.

My suspicion is that, while this multilateral "constitution making" on the

21. It seems probable that the failure of the developing countries to be actively involved in the Tokyo Round negotiations on the subsidies code, for example, until fairly late may have caused the code to be written against their interests (for example, in the blanket restrictions on export subsidies) and hence have led to widespread refusal by the developing countries to sign it.

22. Feketekuty's (1986) extended analysis and documentation of U.S. visa practices in regard to domestic entry for *temporary* business purposes needs to be read by the skeptical among the developing countries. Evidently, there is far more room for active diplomacy and negotiations here than is commonly believed. Also, the reader should consult the entire issue of the *Chicago Legal Forum* (1986, vol. 1, no. 1), which deals with the question of trade in legal services across nation states and which contains the Feketekuty (1986) and Bhagwati (1986c) papers, especially the papers by Barton, Cone, Noyelle, and Rossi. Needless to say, the negotiators will have to address complex issues which get even worse in dealing with unskilled labor mobility. For example, while firms can bring in professionals of different nationalities under the temporary visas, could a U.S. firm bring in Bangladeshi construction labor to Düsseldorf?

principles of a services Agreement will go on, the United States will continue to use bilateral approaches with the aid of Section 301 to pry open selected service sectors in selected countries. This is probably unavoidable, given the immense Congressional and lobbying pressures to produce quick results.

To some extent, the U.S. Trade Representative (USTR) can be expected to ensure that these bilateral approaches are adopted to "set useful precedents" for the wider, multilateral code. At the same time, there is some cause for apprehension that the sectoral lobbying pressures to produce results may lead to "quantity" rather than "rule" outcomes (as strongly suggested in an insightful study by Cho [1986] of the United States–Korea 301 episode on the opening of the Korean insurance market).[23] This tendency to substitute "quantity" outcomes in favor of U.S. export sectors rather than to secure rule-oriented liberalization abroad is a peril that has not been easy to avoid. This was evident in the case of beef quotas in Japan in which the United States reportedly wanted a larger quota rather than genuine Japanese liberalization which would have allowed Australian beef to triumph over that both from the United States and Japan. Similarly, in negotiations on trade in semiconductor chips, an assured market share in Japan for U.S. *firms* was actively urged and, while not finally in the pact, is still the basis by which Japanese "performance" on the pact has been judged to be inadequate and hence to require the retaliatory tariffs imposed by President Reagan in April 1987. This is such an interesting innovation in trade policy that I have recently (Bhagwati 1987b) christened it as VIEs (voluntary import expansions).[24]

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 resort to multilateralism, which has been regarded as the only shield of the weak. Evidently, as such bilateral targeting and quantity targets multiply the wisdom of the developing countries joining in devising a multilateral compact will become increasingly evident.[25]

Yet another compelling reason for the developing countries to join in writing the multilateral rules is that rules written between "equals" will tend to underplay the problems that "unequals" face in service liberalization. One would have

23. Thus, one of Cho's central conclusions is that "both governments approached the case with the perception that the main issue of negotiation is the *sharing of profit* [rents] in Korea's insurance market. In the process of negotiation, both governments (especially U.S.) basically represented the interests of their insurance industries. The effect of the results of the negotiation on other sectors and efficiency of the economy as a whole has not been an important consideration." (1986, p. 17).

24. See also the discussion of this issue in Bhagwati and Irwin (1987) in the context of recent U.S. trade policy.

25. For those in the United States who believe therefore that such bilateralism, or "plurilateralism"—what a lovely euphemism for "regionalism" and other nonmultilateral arrangements—, is only a tactical device to get rapidly towards multilateralism, it would be wise to remember that such arrangements create vested interests *against* new entry, no matter what you write into the rules!

to be deranged to imagine the largest American banks taking over wholly from the largest five British banks in the United Kingdom if banking were fully liberalized. Yet such fears are routine in New Delhi and Dar-es-Salaam. The "political control" issues take an added significance in the context of such fears. I spend a fair amount of time arguing with the risk-averse that such scenarios do not make much sense for New Delhi either, that it would be an act of insanity for a large American bank to open branches in India's vast hinterland, that its clientele and operations would most likely be in international transactions.

But it is evident that the unequals have fear; and, as the Russian proverb goes, fear has big eyes. So, we will need to incorporate, at least for developing countries, some quantity-safeguards, just as we have GATT Article XIX as a safeguard on goods. These would have to be more generous for the developing countries, subject to eventual and negotiated erosion with "graduation," perhaps even slower-paced than as now discussed for goods. In essence, therefore, we should contemplate freer, not free, trade in services, and, contrary to the conventional rules of the strange English language where "freer" should mean more free than "free," the developing countries should remember that it is just the other way around. But these explicit safeguards to assuage their fears will not arrive like manna from heaven. The developing countries will have to argue for this; they cannot do it if they do not actively participate in the rulemaking.

Everything therefore points to one simple piece of advice for the hesitant developing countries: get into the negotiations on the code and exercise a voice; to exit is certainly the inferior alternative.

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