

# GENERAL AGREEMENT ON TARIFFS AND TRADE

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## Services

### ISSUES AND CONCEPTS RELATED TO REGULATIONS AFFECTING INTERNATIONAL TRANSACTIONS IN SERVICES

#### Note by the Secretariat

1. The meeting on services held on 6-7 February 1986 requested the secretariat:

- "to prepare a note analyzing issues and concepts related to national and international regulations affecting international transactions in services, with specific reference to their tradeability, drawing on the information available to the meeting and the discussions that have taken place so far; and,
- to formulate questions regarding these issues and concepts."

The present note was prepared in response to this request.

2. The note is divided into four parts. Part I analyses the concept of international transactions in services. Part II looks at the various types of regulations which are relevant to such transactions and discusses issues related to these regulations. Part III discusses certain concepts related to the effects of regulations on international transactions in services. Part IV raises a number of questions based on the preceding analysis. No attempt is made in this note to define services, except insofar as it is necessary to refer to some of their common characteristics in order to understand the concepts.

#### I. International transactions in services

3. An international transaction can be defined in terms of movements of goods or services across borders or in terms of payments for goods or services sold by a resident of one country to a resident of another country. If the movement criterion is applied, an international transaction is synonymous with "trade", as this word is commonly understood. If the payment criterion is applied, then, according to IMF balance-of-payments definitions, an international transaction is a sale involving a change of ownership of a good or service between a resident of one country (the seller) and a resident of another (the buyer). Such a transaction can take place across borders or in the country where the sale occurs. For example, it can consist in processing data stored in a European university data bank on the M.I.T. computer in Boston, or in serving meals to a foreign tourist. There is a difference, however, between the sale of goods and the sale of services abroad, in that goods can normally be stored and transported at a distance, hence also across borders, whereas in many cases services cannot. The classical example of the latter is a haircut.

4. The selling abroad of services which cannot be transported requires that the seller stay temporarily in the foreign country during the time necessary to deliver the service or, if he wishes to maintain continuous access to that market, that he establish himself there, invest in a service enterprise already established there, or create a commercial link with an established service enterprise which would either act as his agent or whose facilities he could use to deliver the service (e.g. an insurance broker or an advertising consultancy firm). A sale made by a resident of one country staying temporarily in another country is the mirror image of a sale by a resident of a country to a foreign tourist, and is therefore an international transaction according to the IMF payment criterion. This is the case, for example, of an engineer working on the construction of a dam under a foreign aid programme. However, a sale taking place between a foreign national or a foreign-owned enterprise established in the country of sale and a resident of that country is not an international transaction between residents of different countries. The question which arises, then, is whether or not the fact that in many cases services cannot be stored and transported calls for an extension of the concept of international transaction to such sales among residents.

5. This question can be approached from a theoretical and from a practical point of view. Up to now, the theory of international trade has paid little attention to services. Since goods are storable and transportable, trade could easily be defined in terms of movements of goods, and all transactions taking place between residents of the same country have been excluded from the concept of international trade. In the case of services, trade is not always, as in the case of goods, an alternative to production abroad. Some services can be sold over the telephone wire ("disembodied" services, as Jagdish Bhagwati<sup>1</sup> calls them), others cannot be physically separated from the agent producing them, e.g. surgery. A foreign sale does not involve the presence of the producer in the case of goods, but it may do so, or it must do so, in the case of some services, whether these are attached to the sale of goods or are sold independently. Therefore, the movement criterion does not provide a theoretically consistent basis to define trade in services. Moreover, the borderline between the services that can and those that cannot be sold across borders is rapidly changing with the advent of new information and telecommunication technologies. Hence, the movement criterion does not provide a consistent basis to distinguish among tradeable and non-tradeable services.

6. The IMF payments criterion does not have the same theoretical drawbacks, since it covers direct delivery of services in foreign markets or to foreign buyers in the domestic market. However, in practice it may lead to inconsistent results, because the possibility of conducting international transactions in services as defined by that criterion depends on the regulatory environment within which sales take place. For example, some countries reserve the right to sell certain services (e.g. life insurance) to locally established firms, including foreign-owned firms, or only allow firms fully or in majority owned by nationals to bid for certain projects. In other countries, non-resident foreign firms or individuals may sell services across borders or through temporary local employment, but establishment of foreign firms or individuals is severely restricted. Tradeability as defined according to the IMF payments criterion therefore includes some services in some countries and not in others.

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<sup>1</sup>J. Bhagwati, "Splintering and Disembodiment of Services and Developing Nations", The World Economy, June 1984.

7. It could therefore be envisaged, for the sake of achieving maximum theoretical and practical consistency, to use a yet broader, or "IMF plus", definition of international transactions in services, which includes all forms of sales involving a change of ownership between nationals of one country (or firms controlled by them) and nationals of another (or firms controlled by them). This would of course be a break with tradition, but it is true that traditional tools of economic analysis have not been conceived to deal with products which cannot be sold without being produced at the same time and vice-versa.

8. In analysing regulations, this paper bases itself on the "IMF plus" definition of international transactions in services. This does not indicate a choice among the three definitions discussed above. Rather, it is a means of embracing the widest possible range of issues and related concepts, in order to facilitate a systematic examination of the subject matter.

## II. Regulations affecting international transactions in services

9. There are three ways of looking at regulations. First, a distinction can be made between national and international regulations both as to their coverage and as to their purpose. Secondly, within each of these two categories various classes of regulations can be distinguished. Thirdly, different types of regulations within each class can be related to the different concepts of international transactions in services discussed above. For purposes of this paper, the term "regulations" is understood to mean all laws, rules, provisions and measures applied by central or local governments to regulate the exercise of economic or other activities by individuals, corporate entities or government agencies. Figure 1 at Annex provides a bird's eye view of the categorization of regulations used in this paper.

### A. National regulations

10. National regulations which have a direct or indirect bearing on international transactions in services cover a very wide range of activities and fulfill an equally wide variety of purposes. For the purposes of this paper, they can be classified under three broad headings: (a) general regulations of an economic character applying across-the-board to all forms of economic activity; (b) regulations of an economic character applying specifically to certain services activities; (c) regulations of a non-economic character which affect the conduct of certain services activities. Examples of class (a) regulations are immigration laws, company laws, foreign exchange regulations, etc. Class (b) regulations include such measures as the prohibition of "universal" banking, the nationalization of railways, and the obligation to buy automobile insurance in the local market. Class (c) regulations cover matters such as language requirements in advertizing, protection of public morals, and defence of the seaboard.

11. Under each class of regulations there may exist (1) some which intentionally restrict certain types of international service transactions and (2) some which, so to speak, only do so incidentally. Examples of case 1 include restrictions on the takeover of local banks by foreigners, restrictive visa and work permit regulations, limitations or restrictions of

access to national airline reservation systems. Examples of case 2 include cabotage legislation reserving part or all of coasting trade to national flag ships, maximum speed limits on certain roads, and film censorship. In case 1 (on the assumption that the protective intent is established), the two issues raised by the existence of a regulation are whether or not there are grounds for seeking the reduction or elimination of the protection, and how this can be achieved. Case 2 is more complex. In the first instance, it involves the same issue as the preceding case, and if it is found that there are no grounds for seeking a reduction of protection, there is no point in discussing it further. On the assumption that such grounds exist, case 2 raises the issue of whether the main purpose of a regulation takes precedence over its incidental effects on international service transactions, and in whose judgement.

12. This second issue can be dealt with in a variety of ways: (i) the country maintaining the measure has the sovereign right to do so and it is sole judge of its appropriateness and desirability; (ii) the country has the sovereign right to maintain the measure provided it conforms to certain criteria and its alleged conformity can be challenged by countries affected by the measure; (iii) the country has the right to maintain the measure subject to explaining the reasons for it on request and the reasons given can be challenged by countries affected by the measure. The criteria in (ii) would serve to define the concept of "reasonable regulation", to which reference has been made by some delegations. In (iii), there are no a priori criteria, so that a country challenging the reasons for a regulation can only do so on the basis of other normative concepts whose applicability to international transactions in services are recognized by both parties.

13. Each class of regulations (see paragraph 10) also covers different types of measures which affect either cross-border sales of services, or sales on a temporary presence or on an establishment basis. Any measure in classes (a) and (c) may affect various services activities differently depending on the type of international transactions to which these activities give rise.

#### B. International regulations

14. These regulations are narrower in scope and less varied in purpose than national regulations for the simple reason that the field of international cooperation is limited compared to the domestic regulatory powers of states. International regulations of a multilateral character affecting international transactions in services are generally sector-specific, and are implemented by specialized agencies. Examples of such regulations can be found in document MDF/17 and Addenda. There are also regulations which apply on a bilateral basis or among groups of states, and which may cover a wide range of services activities; most such regulations also deal with international transactions in services on a sector-by-sector basis. The main purpose of international regulations is to define by mutual consent, the measures which states may or should apply on a national basis in respect of such transactions.

15. Generally speaking, international regulations may be classified according to: (a) the limitations they impose, by mutual consent, on the sovereignty of individual states, (b) the sectors of activity which they regulate, or (c) the aspects of sectoral activities which they address.

Class (a) covers treaties, agreements, conventions, arrangements, declarations, resolutions, etc. Class (b) ranges from regulations which encompass several services sectors, such as the OECD Code of Liberalization of Capital Movements, to those which cover specific areas such as international road transport. Class (c) covers, for example, agreements on the transport of dangerous substances, on the allocation of radio frequencies, etc.

16. International transactions in services as such do not fall under any consistent set of international regulations. For this reason, these transactions have been said to take place in a "legal vacuum". There are, however, regulations dealing piecemeal with certain aspects of services transactions, such as the Chicago Convention, which regulates first and second "freedoms" in air transport, or the UNCTAD Code of Conduct on Liner Conferences, which regulates liner shipping trade. In addition, there are agencies mandated to deal with various aspects of activities in specific sectors, but which have only drawn up regulations for some of these aspects, e.g. ITU technical standards.

17. Most international regulations of a multilateral character only affect cross-border movements of services, although sometimes they touch on other matters, e.g. the OECD Code of Liberalization of Capital Movements contains provisions relating to direct investment. Bilateral and regional treaties or agreements more frequently contain general provisions on investment and national treatment (as defined in these treaties) which affect bilateral or regional transactions in services and are specifically directed to these.

### III. Effects of regulations on international transactions in services

18. Regulations on services maintained by any one country are often viewed as restrictions to the exercise of their activities by suppliers of services from other countries. Irrespective of the grounds for maintaining regulations, such perceptions may be analyzed in terms of the transactions for which access may or may not be granted, or may only be granted in a limited way, in foreign markets. Thus, to each type of transaction corresponds a different concept of market access.

19. Market access for cross-border services transactions may be limited, for example, by legislation restricting the use of computer facilities located abroad, or by policies which discourage nationals from purchasing insurance or reinsurance from foreign entities. Market access for on-site transactions between non-residents and residents may be limited, for example, by restrictions on the granting of temporary work permits to foreign nationals, or by exit or travel taxes imposed on residents travelling abroad. Market access for transactions conducted by foreign nationals residing in the country of sale may be limited, for example, by restrictions on foreign direct investment either in new (first establishment) or in existing banking enterprises, or by prohibition of foreign-owned consulting firms from bidding on government-sponsored projects.

20. The effects of regulations on these three basic forms of market access may be further complicated by specific rules governing the transactions in question. Thus, in some cases access for services transactions originating in other countries may only be granted on the basis of bilateral reciprocity;

in some activities, foreign-owned enterprises are taxed more heavily than competing domestic enterprises, etc. There is no consistent approach among countries as to regulation of access, either across services sectors or within each service sector. This lack of consistency has sometimes been referred to as an issue in itself, inasmuch as it may hamper the development of international transactions in services by raising the cost of operating simultaneously in several countries.

21. For the sake of clarity, concepts which relate to the treatment of foreign enterprises or nationals in the conduct of services activities on the domestic market should be defined in terms of the type of market access issue to which they refer. Thus national treatment, an important concept in this category, has different meanings if it refers to market access for cross-border transactions than to market access for on-site transactions between non-residents and residents or market access for transactions conducted by foreign-owned enterprises established in the domestic market.

22. Another issue related to the effects of regulations is that in certain circumstances, equality of treatment of foreign and domestic services enterprises is not synonymous with equality of opportunity to sell services. For example, foreign exchange regulations applying equally to all banks may affect foreign banks more because they often fund operations from their parent institution and rely heavily on borrowing in the interbank market. This is a difficult issue to consider within the framework of a technical analysis of the effects of regulations, as it involves judgements regarding concrete results to be expected from engaging in international services transactions. Generally speaking, however, the question of expected results is central to different perceptions of what concrete problems different services industries may face in the international market, and of what could be done to deal with these problems. It may be noted in this connection that the coherence of any action to deal with perceived problems and opportunities is very much dependent on such action having sound theoretical underpinnings.

#### V. Questions

23. The following questions relate to various aspects of the preceding analysis, taking into account the purposes it may serve:

- (1) How important is it to discuss various types of international transactions in services for purposes of considering the appropriateness and desirability of multilateral action in these matters?
- (2) Is the sheer complexity and diversity of existing national regulations the central problem facing services industries internationally, or is it the current level of protection which these regulations afford against various forms of market access?
- (3) Are there reasons for maintaining regulations governing the domestic sale of services which are fundamentally different from the reasons for maintaining regulations governing the domestic sale of goods? Are such reasons generic or sector-specific?

- (4) Are there reasons for maintaining regulations governing international transactions in services which are fundamentally different from the reasons for maintaining regulations governing international trade in goods? Are such reasons generic, transaction-specific, or sector-specific?
- (5) Would it be feasible to devise a priori criteria covering a sufficiently wide range of reasons for maintaining regulations affecting international transactions in services, without ending-up with an agenda for inaction?
- (6) Is there scope at this stage for discussing possible normative concepts on the basis of which national regulations affecting international transactions in services could be challenged?
- (7) Is the fact that there is no consistent set of international regulations governing transactions in services a source of difficulty for services industries, and if so, why?
- (8) Are the effects of regulations limiting market access for services measurable? If so, is it possible to devise a standard unit of measurement applicable to all services?
- (9) If the effects of regulations limiting market access cannot be quantified, how else can they be evaluated?
- (10) What are the theoretical grounds for expecting or not expecting that improvements in market access for various types of international transactions in services will lead to increased trading opportunities in this sector? Does this reasoning differ according to the type of international transaction under consideration?

FIGURE 1

A bird's eye view of regulations

National regulations				International regulations			
Class (a) general economic		Class (b) specific economic		Class (c) non-economic	Class (a) legal character	Class (b) sectoral coverage	Class (c) activity coverage
(1) restrictive intent	(2) maintained for other reasons	(1) restrictive intent	(2) maintained for other reasons	(1) restrictive intent	(2) maintained for other reasons		