

**MULTILATERAL TRADE
NEGOTIATIONS
THE URUGUAY ROUND**

RESTRICTED

MTN.GNS/W/57
5 June 1989

Special Distribution

Group of Negotiations on Services

Original: Spanish

COMMUNICATION FROM MEXICO

Tests of the Applicability of Concepts to the Construction Sector

The following communication is circulated at the request of the delegation of Mexico to the members of the Group of Negotiations on Services.

According to the GATT secretariat's reference list, the construction sector comprises five activities:

- site preparation
- new constructions
 - buildings
 - civil engineering (bridges, roads, etc.)
- installation and assembly work
- building completion
- maintenance and repair of fixed structures

However, in the Central Product Classification - on which the secretariat list is based - the construction sector comprises ninety sub-activities whose features vary considerably in many cases. The following test of the applicability of concepts will concern a small number of construction sector activities, the selection of which is without prejudice to Mexico's negotiating interests. Unlike document MTN.GNS/W/53, professional services other than civil engineering are not taken into account.

The interpretations made concerning the elements contained in the Montreal document likewise do not represent the position of the delegation of Mexico on each element. On the contrary, an effort has been made to interpret the position of other participants on these elements, on the basis of past discussions in the GNS. Thus, the following remarks are as neutral as possible; Mexico's position has been clearly stated in various earlier GNS documents, particularly MTN.GNS/W/42.

1. Market access

According to the Montreal document, foreign services may be supplied according to the preferred mode of delivery, but consistent with the other provisions of the multilateral framework and with the definition of trade in services.

As far as the definition of trade in services is concerned, two basic hypotheses may be advanced for the construction sector:

- (i) cross-border movement of limited duration of production factors;
- (ii) cross-border movement of indefinite duration of production factors.

These two hypotheses would appear to be the only ones that can be adopted for this sector, since cross-border trade in services in the construction sector is limited to the sending of information in the form of plans and designs and perhaps processing of information concerning suppliers, inventories, financing and so forth. While these elements are highly important, they most probably represent a small fraction of the total value of a construction project.

In accordance with document MTN.GNS/W/53, the world construction market has stabilized in recent years at a value of between 75 and 80 billion dollars. If the world market follows the same trends as have been observed for United States construction firms, world trade defined according to hypothesis I would amount to between 45 and 48 billion dollars, while under hypothesis II it would be between 30 and 32 billion dollars. A large part of these markets is in developing countries.

Demolition work (CPC 51120)

Demolition work may be capital-intensive (demolition using explosives) or labour-intensive. Naturally, the mix of primary factors of production will depend on their relative price (including the "delivery time" for demolition).

For the first hypothesis, market access will be determined by the temporary establishment of a demolition firm in the market of the importing country. The firm may bring with it the gangs of workers and specialized personnel it needs from the country of its choice. Furthermore, this hypothesis also involves the temporary movement of foreign workers and technical and professional personnel even if the company recruiting them is a local one, in other words, the temporary establishment of a firm is not necessary for market access to exist for a production factor.

The second hypothesis would imply the indefinite establishment of a construction company and gangs of workers in the importing country. Here again, the demolition firm may be established with workers, technicians and professionals from its country of origin or from any other country it chooses. Furthermore, the workers and technical personnel may be recruited by a local company sine die, that is to say without a specific date for the termination of their contract. The technicians and professionals would have to be legally competent to exercise their profession or trade, which implies that the importing country must recognize their university degrees. Otherwise a foreign engineer would not be able, for example, to direct demolition work.

General construction work for buildings (CPC 512)

Unlike the previous case, general construction work for buildings (for housing, for industrial or commercial use, public recreation, hotels and restaurants, for educational or health purposes and other) is generally labour-intensive.

Under the first hypothesis, the foreign firm established temporarily, or a local firm, will presumably need a larger proportion of manual workers and technical personnel than in the case of demolition work. As in the latter case, market access would consist of the possibility of transferring workers, technicians and professionals from any country to the importing country for a finite period of time. It also implies the possibility of temporary establishment of a foreign firm.

In the case of the second hypothesis, market access implies that the foreign company can establish itself indefinitely, or for the period of its choice, in the importing country. But that foreign company, like any local construction company, must be able to hire foreign workers and technical and professional personnel, again for an indefinite length of time. The professional qualifications of the latter would also have to be recognised by the governmental authorities and civil bodies of the importing country.

Renting services related to equipment for construction or demolition of buildings or civil engineering works with operator (CPC 518)

In this case the service, and therefore market access, may be provided in various ways. Under hypothesis I, the equipment may be rented in at least nine different ways according to whether or not the equipment can be imported and whether or not foreign workers and technical and professional personnel are employed.

For the present exercise we are only interested in three of these, although those relating to the origin of the equipment (which are not studied here in the interests of simplicity) are also important. The three are: (a) temporary establishment of the firm without use of foreign operators, technicians and professionals; (b) temporary establishment of the firm with foreign operators, technicians and professionals (from its country of origin or other countries); (c) hiring of foreign operators, technicians and professionals for a specified length of time by a local firm. Market access would be defined in this case by the possibility of temporary establishment of a foreign firm, the possibility of (again temporary) international mobility of foreign personnel, and recognition of professional university degrees.

For hypothesis II the same cases also arise, but with the indefinite presence of the firm renting the equipment and permanent recruitment of the equipment operators, as well as of the firm's technicians and professionals.

Civil engineering works (CPC 513 and 522)

Civil engineering works comprise a wide range of sub-activities, including: work for highways, streets and roads, railways and airports; bridges, elevated highways, tunnels and underground transport constructions; canals, ports, dams and other hydraulic works; for long-distance pipelines and communication and electricity lines; for urban piping and cables; for industrial construction (including construction for chemical complexes for example); for sport and recreation constructions, etc.

In this case, there may be great differences between one sub-activity and another in terms of market access, particularly as regards the participation of national and foreign professionals. In other words, the fields of specialization are very different as may also be the forms of obtaining market access. For example, it may be the case that trade organizations (and the requirements for joining them) and the amount of the bonds for works may be different from one type of construction to another.

Nevertheless, the following market access requirements may be established under the first hypothesis:

- (a) Recognition of the professional degrees of foreign engineers so that they may work in the importing country during the duration of the project.
- (b) Possibility for a foreign firm to operate temporarily in the importing country.
- (c) Possibility for the foreign enterprise to bring into the importing country foreign workers, technicians and professionals.
- (d) Possibility for a local firm temporarily to bring into the importing country foreign workers, technicians and professionals.

In the case of the second hypothesis, the same conditions are necessary, but on a permanent basis.

Finally, market access in the construction sector implies that the professionals, technicians and operators brought into the country temporarily (hypothesis I) or indefinitely (hypothesis II) by, for example, a demolition firm may subsequently be rehired by a general building firm or civil engineering firm, and so on.

2. Progressive liberalization

From the above analysis of market access for four specific construction activities it may be seen that progressive liberalization must have different features for each of them. Nevertheless, in what follows we shall seek to summarize for all of them, once again on the basis of the two hypotheses for the definition of trade and services.

Under the first hypothesis, progressive liberalization would involve:

- (a) Progressive liberalization of the granting of temporary working visas both for engineers and for technicians and workers.
- (b) National, state or provincial, local or cantonal recognition of professional qualifications of engineers and other professionals so that they can work temporarily in the importing country.
- (c) Progressive liberalization of the regulations restricting or hindering temporary direct foreign investment in such activities in the importing country.
- (d) Progressive reduction in the amount of bonds for the value of the project, which in many cases implicitly discriminate against foreign enterprises.
- (e) Progressive elimination of other barriers to trade in this sector, as defined in accordance with hypothesis I, such as those set forth in paragraphs 18-23 of document W/53.

In the case of hypothesis II, in other words with permanent establishment of production factors in the importing country, the following would be the conditions for progressive liberalization:

- (a) Progressive elimination of measures contained in laws or regulations that limit or hinder the indefinite establishment of construction firms in the importing country.
- (b) Progressive elimination of measures contained in national, state or provincial, local or cantonal laws or regulations that limit or restrict the indefinite establishment in the importing country of foreign professionals and workers in the construction industry.
- (c) Recognition by governmental authorities and civil bodies of the university degrees of foreign professionals working in the construction industry at national, state or provincial and local or cantonal level.
- (d) Progressive elimination of other barriers such as those already mentioned, including the question of bonds, which restrict or hinder trade in services in this sector as defined under hypothesis II.

Of course, in accordance with the Montreal document, there must be due respect for national policy objectives including, for example, implementation of construction plans for subsidized housing, irrigation areas, etc.

Likewise, again in accordance with the Montreal document, appropriate flexibility must be provided for individual developing countries for opening fewer sectors or liberalizing fewer types of transactions or in progressively extending market access in line with their development situation. The practical significance of the above in the construction sector is that the elements of progressive liberalization mentioned under hypotheses I and II would be achieved over a longer period in developing countries than in developed countries, and that one or some of these elements would not have to be covered by the former.

3. National treatment

Although the effects of the granting of national treatment would be different for each of the four construction activities mentioned above, in the interest of brevity the following analysis will be conducted at the general level.

It would seem that national treatment is independent of the definition adopted for international trade in services, although under hypothesis I or hypothesis II national treatment would be either temporary or else permanent.

Nevertheless, in accordance with the Montreal document, there may be two interpretations of what national treatment is considered to be:

- A. The paragraph on progressive liberalization states "...the adverse effects of all laws, regulations and administrative guidelines should be reduced as part of the process to provide effective market access, including national treatment". This paragraph may be understood as meaning that national treatment is considered a long-term objective within the liberalization process.
- B. National treatment may also be understood as meaning that exports and/or exporters of services of any signatory will receive treatment "no less favourable" than that accorded to domestic services or services providers once market access has been obtained.

In case A, national treatment would be granted gradually, while in case B national treatment would be provided as soon as market access was granted. This would involve the following in both cases (but with a difference in the speed with which national treatment would be granted):

- (a) That construction firms established temporarily or indefinitely in the importing country would receive the same treatment as domestic firms as regards subsidies, employment requirements, foreign-exchange earning, tax incentives, domestic bank finance, use of national inputs, obligations with regard to social projects, government procurement, and so forth.

- (b) That construction workers established temporarily or indefinitely in the importing country would receive the same benefits as national workers as regards social security, unemployment insurance, education, etc. This would apply both at national and at the state or provincial and local or cantonal levels.
- (c) That foreign engineers and professionals would receive the same treatment as national engineers and professionals as regards possibilities and facilities for freely exercising their profession in the importing country. This would again apply both at the national and at the state or provincial and local or cantonal levels.

On the other hand, in accordance with what the Montreal document has to say with regard to developing countries in the section on progressive liberalization, developing countries under either of the hypotheses may implement national treatment less quickly, and may also reserve their position with regard to one or more elements of that treatment (for example, national financing for the establishment of foreign firms, government procurement etc).

4. Transparency

In the construction sector, transparency would mean publication of all laws, regulations and administrative guidelines of a national or federal, state or provincial and local or cantonal nature.

In this connection, the construction sector is one of the sectors in which regulations undergo the greatest changes. What is more, these changes in regulations exist not only at the national, state or provincial and cantonal or local level, but also at the level of every city. For example, there are cities situated in areas of intense telluric activity, or cities with a high concentration of vehicle traffic. Their building regulations are different from those of cities with no telluric activity or little vehicle traffic. This applies to the construction not only of buildings but also of bridges, dams etc, although each activity has its own specific regulations. The authorities responsible for regulations governing construction vary not only with the various levels of government but also within each level. A public works ministry will deal with regulations for the construction of bridges and highways, but another ministry may be responsible for the building of dams, and yet another for housing construction. Thus, the information is scattered among a large number of government agencies and various levels of government.

Consequently, implementation of a requirement of centralized dissemination of information on the many regulations that exist in the construction sector may be extremely difficult for countries which do not have the resources for doing so.

In addition, transparency also implies adequate provision of information concerning regulations on foreign investment and on the cross-border movement of labour, as well as on other elements that are not usually published such as explicit or implicit preferences for domestic suppliers under "buy national" schemes.

5. Most-favoured nation/non-discrimination

In the case of most-favoured nation/non-discrimination, three main hypotheses may be advanced:

- (i) Optional MFN
- (ii) Conditional MFN
- (iii) Unconditional MFN (at least for developing countries)

The two basic hypotheses for the definition of international trade must also be taken into account.

As mentioned above in the case of the temporary presence of foreign capital and labour in the importing country, it is considered that this form of international trade in construction is more important than trade through subsidiaries. Optional MFN would involve discrimination against the two production factors of countries which have not negotiated with the importing country, and so apparently the majority of countries currently taking part in the negotiations would not come under the MFN treatment.

With regard to conditional MFN, here again the number of countries involved might be very small, although greater than in the case of optional MFN. This is because the only countries that might benefit would be those that acceded to the corresponding sectoral agreement. From the experience of the Tokyo Round Codes of conduct, non-extension of MFN treatment to non-participants has by no means led to a major increase in the number of signatories of the Codes, in other words, it has not acted as a powerful incentive, as some had supposed, to encourage more countries to sign the Codes.

Finally, with extension of MFN treatment to all developing countries, the number of beneficiaries would be much greater, but what might be called the "marginal cost" of the extension would be very small.

As shown in the secretariat document, the developing countries' share of the world construction market was barely 7 per cent in 1987. Consequently, extension of MFN treatment to all developing countries would barely make a mark on a world market undergoing progressive liberalization.

In addition, the construction firms of developed countries are extremely internationalized, which is not the case for developing country firms. For example, in 1986, 75 per cent of the total invoicing of the major United Kingdom engineering firms was carried out abroad; in the case of France and Italy the figure is 70 per cent; 40 per cent for the main firms of Canada and Japan, and 31 per cent for United States firms. Consequently, progressive liberalization of the world construction market would be more beneficial for developed country firms.

The above remarks in the case of the first hypothesis on the various MFN treatment possibilities are also applicable for the second hypothesis, with the addition that if there are quotas per country of origin for the

entry of production factors, these will have to disappear in the case of the hypotheses of conditional MFN treatment (among signatories of the sectoral agreement) and unconditional MFN treatment (among signatories of the framework agreement). Optional MFN treatment could give other results according to its practical application.

6. Safeguards and exceptions

In the construction sector, a number of possible safeguard measures may be considered, including the following:

Temporary safeguards on the grounds of:

- (a) infant industry argument in the case of developing countries;
- (b) balance of payments;
- (c) temporary disruption of the construction market caused by a sudden increase in "imports".

In all three cases the safeguards may concern one or more of the following elements:

- (a) Market access. For example, temporarily suspending access to the importing country for foreign firms.
- (b) Progressive liberalization. For example, temporarily suspending the progressive liberalization process as of a given point.
- (c) National treatment. Temporarily suspending application of some of the elements of national treatment.

Specific measures could also be taken regarding MFN treatment, but this would not appear appropriate since the ensuing discrimination would not comply with a fundamental element of transparency. In any case, this is one of the most controversial elements in the Uruguay Round negotiations on goods.

Safeguards would have a different character in the case of hypothesis I for the definition of international trade in services than in the case of hypothesis II, since in the latter case it would be difficult to apply safeguards to production factors already indefinitely established in the importing country.

With regard to exceptions, it is very difficult to think of an exception concerning cultural policy objectives. Nevertheless, it is possible to point to regulations concerning the forms which certain types of construction must respect (for example, preservation of some specific form of architectural style for a given city). Nevertheless, in principle, this would not involve in any discrimination between domestic or foreign construction firms, and again there should be no discrimination between national or foreign workers, technicians and professionals.

As for security grounds, it is possible to think of a large number of cases in which national security calls for certain characteristics that a construction company must have for specific projects.

7. Increasing participation of developing countries

Strengthening the national capacity of developing countries in construction, by upgrading their efficiency and competitiveness, can be achieved in two fundamental, and not mutually exclusive, ways:

- (a) a larger number of projects in the domestic market for domestic firms and labour; and
- (b) a growing external market for them.

To begin with, it must be recognized that it is impossible to talk of the construction sector as such, just as it is impossible to discuss an industry in the case of goods. The four construction activities referred to above are only one example of this. Some developing countries may be competitive in, for example, road engineering, while others would be more so in bridge engineering and so forth. This is to enter the highly complicated domain of comparative or competitive advantage in services, for which there is no accepted theory.

Nevertheless, as far as negotiations are concerned it is possible to imagine certain measures to achieve increasing participation of developing countries in the world construction market (including, of course, their own market).

Firstly, with regard to the domestic market developing countries could, in accordance with what was said above about progressive liberalization in the case of these countries, liberalize a smaller number of transactions or open their markets less rapidly.

Secondly, developing countries could make reservations concerning the granting of certain elements of national treatment to foreign suppliers, as described above.

Thirdly, the trend observed in projects funded by regional and international finance agencies towards granting a growing number of such projects to domestic firms of such countries could be stepped up.

With regard to increasing participation of developing countries in world export markets, access to information channels is essential in the case of projects put out to international tender. Many such competitions are won by developed country firms because developing country firms, although competitive as regards prices and quality, do not have timely access to the necessary information on the competitions.

In addition, lack of access by developing country firms to world distribution networks for project contracts prevents them even from participating as sub-contractors in the activities in which they are competitive. The same may be said of labour and professional services (for example, architects and engineers): they cannot be contracted because they are not included in the distribution channels, the main obstacle being the system of visas applied by developed countries.

Furthermore, developed countries should cease to subsidize their construction service exports, so that developing countries may be in a position to compete with the financial packages offered by developed countries.

This is a typical sector where developed countries could autonomously grant preferences to developing countries. For example, some regional and international finance agencies grant preferential margins to domestic firms of developing countries in which a specific project is to be implemented. Developed countries could do the same for developing country firms in the case of public competitions, at least for certain activities.

Another way of granting preferences could be found in the amount of the bonds required for each project. For example, in a developed country a bond of 100 per cent or even more of the value of the project is required; however, if the firm which is to carry out the project is owned by members of an ethnic minority, the amount of the bond is reduced to 25 per cent. Developing country firms could receive the same preferential treatment.

It must be stressed that the delegation of Mexico is merely showing that there are possibilities of granting preferences in this field to developing countries.

Everything said so far could also apply to the least-developed countries, but granting them a greater degree of flexibility in all respects, as well as the possibility of receiving preferences for their exports of construction services.

8. Regulatory situation

Construction is an activity that needs to be regulated, both to protect consumers (building construction) and to ensure that it fulfils the purpose for which it was carried out (durability of a dam, strength of a bridge, etc.), as well as for environmental reasons. As mentioned above, construction is an activity whose regulations are continuously being modified in line with changing needs at the national, state or provincial and local or cantonal level. But these regulations are not in fact addressed by progressive liberalization or even by the Uruguay Round negotiations. In a word, liberalization is not identified with "deregulation", at least in the construction sector.

What the negotiations and possible progressive liberalization do address is market access for production factors, national treatment, MFN treatment and so forth. It is in this area, and particularly as regards regulations concerning the mobility of unskilled, semi-skilled and skilled labour, that developed countries have more regulations than developing countries as regards foreign investment and access to the country of foreign professionals in the construction field. It is here that the asymmetries exist with respect to the degree of development of services regulations in different countries, as mentioned in the Montreal document.

Conclusions

International trade in construction services is very slight if it does not include the cross-border movement, whether temporarily or for an indefinite period, of primary factors of production, although in addition to these there are others such as information, know-how and organization.

Under this hypothesis, all the concepts, principles and norms contained in the Montreal document would be applicable to the construction sector. However, some of them would have varying consequences according to the specific activity involved.

The concept of transparency could cause difficulties for countries which do not have the necessary resources to centralize in an information office or similar body all the laws and other regulations issued by the various levels of government. Even for developed countries this would be no easy undertaking.

The other concepts will have different effects if the international mobility of factors is temporary or indefinite, but in principle the Montreal concepts continue to apply, as we have attempted to show. Some concepts, such as national treatment, will have varying effects depending on the definition of them that is agreed. In fact, this applicability will depend on the willingness of countries participating in the GNS gradually to liberalize international trade in construction sector services, and in particular the willingness of developed countries gradually to liberalize the regulatory measures which have prevented the international competitiveness of developing countries from emerging in this sector.

As far as the delegation of Mexico is concerned, there can be no priority for one factor over another; there is not a primary and a secondary factor. In the negotiating process, both are inseparably linked.

Consequently, while the concepts are applicable in theory, the question is: are participating countries, especially the developed ones, prepared for them also to be applicable in practice at the end of the negotiations?