

Liberalization of Trade in Services

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Background

In the Uruguay Round negotiations (1986-1994), trade in services was discussed for the first time and a basic framework, the General Agreement of Trade in Services, was worked out for the liberalization of trade in services. It was also decided as a built-in agenda that further liberalization will take place in the next negotiations scheduled to begin in 2000.

As preparatory work for the next negotiation, WTO Members reported their own situation of liberalization, sector by sector, through the information exchange program at the Council for Trade in Services since June last year. From this year, the assessment of trade in services are to be carried out and negotiation guidelines and procedures for the next negotiations (scope and method of negotiations) are to be developed. By the third Ministerial Conference in Seattle this November, all the preparation process have to be finished.

This article will review the importance of trade in services. It will also introduce how major countries are preparing for the next negotiations, and will also discuss what Japan has to do toward the next negotiations.

Importance of Trade in Services

(1) Progress toward a Service Economy

As an economy matures, the share of tertiary (service) industry in economic activities increases, mainly in developed countries and the share of the service industry in GDP and the percentage of people engaged in the service industry range from 60% to 70%. The corresponding share in developing countries is as low as 40% to 50%, but it is believed that

progress toward a service economy will be seen as their economies mature.

As the share of the service industry grows, its links with manufacturing industry become stronger. According to an inter-industry relations analysis, the share of services in the production of manufacturing goods was 22.2% in 1980 and increased to 29.5% in 1995. This indicates that the importance of services industry to manufacturing industry has been growing. A similar trend is visible in the U.S. where service industry has a share of more than 30%.

Moreover, the importance of the service industry is obvious from the point of productivity increase in domestic economic activities. In view of the progress toward a service economy and its importance as input, the productivity increase in the service sector is beginning to have a greater effect on domestic industry as a whole. The productivity effect (the ratio of contribution that price falls make to the domestic economy through inter-industry relationships) was about 0.7% in the service industry, compared to 0.4% in other industries in 1995. Statistics from 1980 onwards show that while manufacturing industry's rate of contribution has declined, that of the service industry has been generally rising.

Turning to the world economy, the share of trade in services in world trade in 1997 stood at \$1,295 billion, or about 20%. In 1975-1985, the growth ratio of services (8.6% per year) fell below that of goods (9.5%), but in 1985-1995, the growth ratio of services reached 11.9%, outrunning that of goods (10.9%). However, since the above figures do not cover Mode 3 (establishment of commercial presence: direct

investment in services) out of the four modes of transactions covered under the GATS, the real importance of trade in services is much greater.

As stated above, the share of service industry and its role are increasing in domestic economic activity, and so is the importance of the service industry.

(2) Increasing Globalization

Among an integration of the world market through economic globalization, the service industry is becoming increasingly globalized. This means that the "economy of scale" is beginning to work in the field of services with the world market as its target. In other words, it has become possible for service suppliers to provide homogeneous services in various countries, adding to expectations of cost reductions. This can be easily presumed from the fact that the emergence of global companies is seen in the fields of accounting, telecommunication and banking services.

From the point of consumers, these movements have a great impact on the improvement of the business environment as they make possible the provision of homogeneous services throughout the world for global business deployment.

(3) Advance of Information Society

In recent years, trends such as the development of information and telecommunication technologies, especially the widespread use of the Internet, have brought about the swift digitalization of economies and societies. Especially, in the economic sector, a new mode of transactions through networks (electronic commerce) has been introduced, providing distribution, financial and other existing services

with new business opportunities. It is believed that the spread of information will have a major effect on the reform of Japan's industrial structure by creating new industries and new job opportunities

Approaches by Major Nations

(1) *The United States*

Backed by the competitive strength of its own service industry, the United States has involved itself and played a leading role not only in the Uruguay Round but in the subsequent basic telecommunication and financial service negotiations. Its approaches spread over government, industry and academia. Since the Uruguay Round is of special interest to industry, the CSI (Coalition of Service Industries) has sorted out industrial needs and informed the government about them. At present, the CSI is mapping a strategy with such think-tanks as the Brookings Institution, AEI, and the Harvard Kennedy School.

As revealed by President Bill Clinton and U.S. Trade Representative Charlene Barshefsky, the fields of interest to the United States include telecommunication, financial, audiovisual and professional services plus such new fields as environmental, energy and express delivery services. The United States is interested in the adoption of sector-horizontal approaches for securing transparency and the application to other industries of pro-competitive rules stipulated in the basic telecommunication services.

(2) *European Union*

The European Union is expected to assume a leading position in the next round of negotiations by learning from its experience in reducing trade barriers to its member countries in the process of integration of EU markets. It is highly possible that the European Commission will pursue a strategy to disseminate its own liberalization formula for such major services as telecommunication and financial services to other countries as it led other countries in the

process of EU liberalization.

The EU sponsored a symposium, titled "GATS Towards 2000" last June under the initiative of EC vice-president Sir Leon Brittan and with the participation of negotiating officials, industry and scholars. It marked a kickoff of preparations for the next round. In January this year, the European Service Network (ESN) was organized with membership consisting of CEOs in major service industries. The EU's preparations to deal with the forthcoming negotiations are steadily progressing.

Among the fields of interest to the EU are telecommunications, financial, transportation, distribution, courier, environmental and energy services. The EU, like the United States, is moving vigorously in making horizontal approaches and working out pro-competitive rules.

(3) *Developing Countries*

Those developing countries that have been concerned about opening their underdeveloped service sector are generally negative about the next round against the background of the financial crisis in Asia. However, they are interested in establishing rules to prevent their industries from being damaged by liberalization. They are relatively enthusiastic about working out safeguard rules by the June 1999 deadline.

Developing countries are positive about the movement of natural persons, supported by their cheap, abundant labor. India in particular is showing interest in the movement of skilled workers under project-based contracts.

Task for Japan

In Japan, a subcommittee was set up in the Industrial Structure Council, an advisory body to the Minister of International Trade and Industry, in August last year to discuss a basic strategy toward the new round of negotiations. The panel compiled an interim report for the minister in February this year.

The report reviewed the status quo

of the services industry and its importance to manufacturing. It evaluated the existing agreement (GATS), the problems involved and the significance of the next round, and studied a basic strategy for Japan to pursue toward the next round. Introduced below are the problems that confront Japan about the next round and its basic strategy.

The subcommittee conducted a questionnaire survey about services liberalization (mainly manufacturing) in view of the importance of the services industry and its heavy impact on manufacturing, as stated in the previous section.

Problems overseas are roughly divided into two categories — one concerning all fields (sector-horizontal problems) and those concerning individual fields. Problems in the horizontal category concern administrative procedures. Among them are the immaturity of rules concerning business activity, the difficulty of rule-based activity due to insufficient disclosure of information and the difficulty of market entry (legal and system). It was pointed out that rules once determined are altered in a short period of time and the interpretations of such rules vary with the officials in charge to the detriment of business activities (complicated legal and system changes).

As regards investment problems, the report referred to investment regulations, under which fields available for foreign capital investment are limited and the upper limit of such investment is less than 50%. Problems related to the establishment of local corporations included rules that obligate investing parties to set up joint ventures with indigenous companies (regulations concerning the forms of business) and regulations that require investing companies to locally procure parts and components in quantities above fixed levels (local content requirement).

Last, the report took up the movement of natural persons, pointing out that there were restrictions on the

acquisition of labor permits for resident representatives and the resident office was obligated to hire a number of local staff above a certain level.

As individual problems, the report pointed out that differences in qualifications, standards and rules in the fields concerned make it impossible to obtain services conforming to the standards common to various countries, and that services rendered are inconvenient to users because their quality levels and prices vary owing to conflicting rules and business practices. Individual countries' regulations on investment were listed as a problem.

Japan's Basic Strategy

Among the rapid economization and globalization of services and structural change in the information services industry, the next round of services negotiations will benefit the world economy since liberalization makes the provision of efficient services through intensified competition possible and helps to heighten the productivity of the manufacturing industry that uses such services. The need for further liberalization was stressed as an important element for promoting Japan's economic reform.

(1) Global Liberalization

It is important that efforts will be made in the next round to elevate the level of global liberalization, including developing countries. To that end, it is necessary to push comprehensive liberalization without setting exceptions in advance.

As seen from replies to the subcommittee questionnaire survey, there are sector-horizontal problems involved in liberalization. Under the circumstances, the horizontal approach, whereby liberalization is pushed on a sector-horizontal basis under certain standards (transparency in administrative procedures and relaxation of foreign investment rules) — and not the request-offer formula negotiated bilaterally — is effective in securing a certain level of liberalization. For

liberalization by country and field, however, the conventional request-offer system still stands.

(2) Harmonization of Domestic Regulations and Mutual Recognition

With regard to the fact that services that can meet user needs are not provided because of conflicting qualifications, standards, rules and systems between countries, the report said it is desirable that rules for major fields be harmonized or converge in a certain direction for each country. This goes beyond the obligation of the GATS, but the Reference Paper on Telecommunication Services agreed in February 1997 contains the idea of convergence in the regulatory system concerning conditions for competition.

The circumstances of individual countries lie behind the regulatory systems in various countries; it is therefore necessary that such matters as whether harmonization in the broad sense (convergence, best practice) is possible and in what fields it is practicable should be discussed with the peculiarities of various fields taken into account. It is further necessary that attention should be paid to the possibility that conditions for competition will be distorted through arbitrary interpretations in the name of liberalization.

(3) Rule-Making in Response to the Information Society

It is necessary that there be discussions on the making of rules in the WTO with the basic recognition that such rules will contribute to the development of electronic commerce as the use of information progresses.

(4) Development of GATS Rules

GATS merely set a basic framework for services transactions (most-favored-nation treatment, national treatment), which still requires rules to be prepared about safeguards, government procurement and subsidies.

(5) Structuring of Safety Nets

Liberalization is expected to bring about economic and social costs in its wake. It is important, therefore, that there be discussions about the drafting of international competition rules and that adequate care be taken about problems that should be tackled from such broader social viewpoints as universal services, maintenance of regional communities and systemic risks.

(6) Working with Other International Institutions

In structuring international frameworks for services transactions in the 21st century, it is necessary to take into consideration a tie-up with the WTO and other international agencies specializing in various fields.

(7) Participation of Developing Countries

The participation of developing nations is necessary in the next round of liberalization. It is necessary that efforts will be made through APEC and ASEM to persuade developing countries to participate.

(8) Participation of Industrial Circles

In Japan, it is necessary that the government and private sector work closely together to set the stage for industry to participate in the round.

Future Approaches

The work of drafting guidelines for the next round of negotiations has started this spring. Japan intends to participate in the discussions from the eight viewpoints outlined above, so that its views may be fully reflected in the guidelines expected to be determined at the November ministerial conference. 