

Services Trade and Services  
Regulation in the United States

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THE ECONOMICS AND POLITICS OF TRADE IN SERVICES:  
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I. Introduction

Although for quite some time economists have treated transactions in "goods and services" under a unified analysis of market transactions, government policymakers whose focus is international trade have disaggregated the goods-and-services bundle. Acting in accord with the inclinations of much older economic teachings,2/ policymakers have concentrated on international trade in goods, but traditionally have paid little attention to trade in services.

With changing world economies, however, numerous "service industries" have assumed increased prominence, especially in more advanced economies.3/ These industries include banking, finance, and insurance, construction, engineering, transportation, travel, retailing and wholesaling, real estate rental,

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1/ We are grateful to several friends and colleagues for their advice and assistance: Peter Kahn, Seth Kaplan, Richard Boltuck, Joseph Francois, Stephen Narkin, and Howard Gruenspecht. These individuals deserve the usual exculpation from responsibility for errors. The views offered here also should not be taken as necessarily representing the views of the government of the United States, of the State of New York, the United States International Trade Commission, or the New York Public Service Commission. Additional disclaimers will be added as necessary.

2/ Writers as diverse as Adam Smith and Karl Marx treated services as a category of economic activity distinct from and inferior to production of goods.

3/ See Gibbs, Continuing the International Debate on Services, J. World Trade Law 199, 203 (1985).

medicine, law, accounting, consulting, advertising and information, communications, data processing, management, food preparation, recreation, personal care, and education.<sup>4/</sup>

The growth of services in the United States, and of their contribution to the United States' economy, is illustrative. The precise figures are subject to argument, but the same picture emerges from any method of accounting for various sectors' contributions to the national economy. In 1948, services accounted for about \$140 billion (or 54%) of the United States' Gross National Product.<sup>5/</sup> In 1981, this figure had grown to \$1.95 trillion in a \$3 trillion economy.<sup>6/</sup> By 1987, the total contribution of services exceeded \$3 trillion of the roughly \$4.5 trillion United States' GNP.<sup>7/</sup>

Even more marked changes in employment have accompanied this growth in service-related activities. From 1960 to 1984, the share of service activities in non-agricultural employment in the United States has grown from 62 to 72 percent, and in the past two decades about 86 percent of employment growth occurred in service industries. In 1983, some 53 million persons were employed in service industries in the United States; 9.5 percent of these in transportation; 10.1 percent

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<sup>4/</sup> Id.

<sup>5/</sup> J. Aronson & P. Cowhey, Trade in Services (1984).

<sup>6/</sup> Id.

<sup>7/</sup> Economic Report of the President 320 (1989) (calculated by standard industrial classification as GNP less all manufacturing, agricultural production, and mining).



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in wholesaling; 10.4 percent in finance, insurance, and real estate; 30.8 percent in retail services; and 37.6 percent in a general category, which accounts for a large share of the overall growth in services employment.<sup>8/</sup>

Much of this growth in services has been concentrated in what are referred to as "information services." A survey of employment trends in the United States over the past century for agriculture, general industry, information services, and other services found a sharp decline in agricultural employment and a steep rise in employment related to provision of information services, while employment in the other sectors showed relatively little change (the proportion of workers employed in provision of other services modestly increased, and industrial employment's share of the labor market modestly declined).<sup>9/</sup> Similar changes in employment for provision of services in general and of information services in particular have occurred in other countries as well.<sup>10/</sup>

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<sup>8/</sup> Feketekuty & Hauser, The Impact of Information Technology on Trade in Services, in G. Faulhaber, E. Noam, & R. Tasley, eds., Services in Transition: The Impact of Information Technology on the Service Sector 81-97 (1986).

<sup>9/</sup> \_\_. Marchand & \_\_. Horton, Infotrends (19 ). Figures from a broad array of developed and developing countries show substantial variation in the contribution of services to GDP (ranging from one-quarter to nearly two-thirds) and general stability in the proportion of each economy accounted for by services. See, id.; R. Summers & A. Heston, The International Demand for Services, Discussion Paper#32, Fishman-Davidson Center for the Study of the Service Sector, The Wharton School, U. of Penn., Philadelphia, Penn. (January 1988).

<sup>10/</sup> [Eli-source?]

As service industries have grown, international flows of people and products associated with services also have grown. The official balance of payments figures of the International Monetary Fund indicate that between 1970 and 1982 world trade in services grew at an annual rate of about 15 percent, just about the same as the increase in international trade in goods.<sup>11/</sup> While trade in services thus is not increasing in relative importance, the volume of such trade is clearly increasing substantially. For 1985, global trade in services was estimated at \$600 billion.<sup>12/</sup>

These changing economic realities have caused policy-makers (and others as well) to focus greatly increased attention on international trade in services. Any effort to discuss, and especially to devise rules for, international trade in services must confront several difficulties which can be separated into categories of theoretical, practical, and political problems. We address these three categories below in Parts II, III, and IV of this paper. The issues in these categories are closely related and hold considerable significance for the probable course to be taken in concluding any international agreement on services trade. Information

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<sup>11/</sup> The rate for services was 14.7% per annum over this period, compared to an annual growth rate of world trade in goods of 15.4%.

<sup>12/</sup> Feketekuty & Hauser, *supra*. The IMF's estimate of \$370 billion is considerably lower. Although this discrepancy may appear striking, it appears to follow from difficulties in measuring trade in services. Some of the reasons for these difficulties are suggested *infra*.

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respecting current rules on trade in services specific to the  
United States is presented in Part V.

## II. Defining Services

### Services vs. Goods

The first step in discussing trade in services is defining that category of trade. If a generic set of rules for such trade is contemplated, the generic definition of the subjects of such trade and of the instances for such trade will be essential to discussion. Unfortunately, this is not by any means a simple task.

We begin by considering what constitutes a "service." Two competing uses of that term are common. One common sense definition is that services are commercial activities that do not result in production of tangible goods.<sup>13/</sup> Haircutting or -styling produces attractive hair (one hopes); medical services produce healthier patients. None of these services actually produces goods, even though some services are performed on goods. Laundering or drycleaning, for instance, produces clean clothes; but neither produces the clothes themselves.

This negative definition of services -- as activity that is not the production of goods -- certainly was what Adam Smith had in mind when he opined that services were nonproduc-

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<sup>13/</sup> See, e.g., Hill, On Goods and Services, Review of Income and Wealth (Dec. 1977).

tive. He did not elaborate the basis for this belief, other than to note that, as defined, services do not produce goods. Smith assumed that all productive labor yielded material outputs. This proposition has been characterized as declaring that "the person who built the violin that Heifetz uses was a productive worker, but when Heifetz plays before an audience of several thousand people he is not productive."<sup>14/</sup> As he contemplated trade only in the articles that were more efficiently produced in the exporting nation, this distinction of services from productive labor led Smith to exclude services from the ambit of activities he thought suitable for trade.<sup>15/</sup>

Plainly, the distinction of goods from services on this basis does not, as Smith thought, separate valuable from valueless activity, and little attention today is paid to Smith's comment. The source of Smith's mistake, however, suggests a difficulty with the first suggested distinction of services from other activities. The sense of this initial common-sense definition is the importance of distinguishing things from actions, or put differently stocks from flows. These concepts are distinguishable, but the value of the good itself (the stock) is widely understood to be the value of its use over time (its flow), so that at bottom the concepts are

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<sup>14/</sup> Ginzberg, Informatics and the Emerging Service Economy, in J. Ruggie, ed., The Management of Transborder Data Flows: U.S.-Canada and Beyond (1984).

<sup>15/</sup> A. Smith, The Wealth of Nations (1776).

not readily disentangled. Moreover, as arguments in terms of "labor value" have stressed and as the first common-sense definition recognizes, the good itself is the product of an activity, so that the distinction in practice becomes less the separation of goods from actions but of some actions from other actions.

A second common sense definition of services does not categorize explicitly on the basis of this distinction, recognizing that the term "services" as commonly used includes much activity that is embodied in tangible goods. Although the waiter's services are quite plainly evanescent, for example, the chef's actions are less so. A pastry chef may work for a restaurant or for a bakery and produce quite tangible goods (goodies) for either. Restaurants, however, generally are thought of as providing services, while bakeries produce goods. Similarly, the lawyer's services can include advice rendered verbally or information embodied in documents that can be sold to clients; construction services can be incorporated in movable, or in immovable, goods; the architect can produce a saleable blueprint, and so on.<sup>16/</sup>

The second common sense approach attempts to avoid the difficulty among activities and instead categorizes certain lines of business -- communications, food preparation and delivery, transportation, and so on -- performance of ser-

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<sup>16/</sup> See G. Feketekuty, International Trade in Services: An Overview and Blueprint for Negotiations (1988).

vices, irrespective of the role played by the tangible goods in that business. This definition, too, is problematic. First, one must ask why the various businesses are joined in the generic "services" category. The answer surely is that they do not consist principally of activities that produce goods, or at least not goods that are common objects of trade. Second, none of the lines of business is self-delineating; where, for example, is the line to be drawn between the production of telecommunications equipment and its use to transmit messages?

Given this melding of activities that produce goods and activities that produce services, commentators have questioned the utility of separating goods from services. Some have stated that the distinction between goods and services may involve nothing more than the distinction between services performed internally to a firm in the production of goods and the same services performed outside the firm on a "for hire" basis.<sup>17/</sup> Other commentators have found no sound basis for distinguishing between goods and services at all.<sup>18/</sup>

The difficulty of distinguishing between goods and services is of more than semantic importance. The confluence

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<sup>17/</sup> See J. Bhagwati, Trade in Services and Developing Countries, Xth Annual Geneva Lecture at the London School of Economics (1987), at 7.

<sup>18/</sup> See, e.g., S. Hirsch, Services and Service Intensity in International Trade, Trade Policy Research Centre, mimeo (1987) (for international trade purposes, at least, the distinction between goods and services is without merit).



of those categories suggests that the actual business arrangements being described can, at least within limits, be organized to shift activities from "goods" to "services" or vice versa. Increased attention to trade in services, indeed, may in some measure reflect such shifts in response to changing economies of production. More to the point for our purposes, the rules governing trade in services should be crafted in such a way that they do not promote wasteful reorganizations of underlying business activity designed solely to allow such a recharacterization between these categories.

This last consideration underscores the need to appreciate the purpose for which a distinction between these not-so-readily-distinguished classes of economic activity is offered. Our concern is with trade, and especially with the rules that govern trade. If services are distinctive, their differentiating feature should relate to trade or have implications for trade. As an initial proposition, we suggest that, at least for discussion, a qualifier to the first definition of services discussed above may make the distinction of services from other commercial activities somewhat more useful. We begin with the observation that widely accepted rules exist to govern international treatment of goods that move in international commerce (tradeable goods) but not, in general, for other commercial actors and activities. A plausible separation of activities that should be of special interest now for purposes of international trade

would separately define as "services" those commercial activities that are not embodied fairly directly in tradeable, tangible products.

This revised definition still does not provide a thick and impenetrable line between services and goods, but it does comport better with the common sense distinction. If we return to the pastry chef, although his activities in the restaurant produce goods, they do not produce tradeable goods, goods that can readily be resold to others. For quite sound economic reasons, as well as social ones, patrons seldom leave a restaurant with pastries in their pockets and then endeavor to resell them. In contrast, the chef's activities for the bakery do produce tradeable (if perishable) products. This distinction also separates the lawyer's advice to a client on a particular problem bounded by specific facts -- whether rendered verbally or in writing -- from books giving general advice on legal issues.

Having hypothesized a distinctive category of commercial activity that can be denominated as services, the salient question is whether such activity is meaningfully distinguished only by the fact that it has, for whatever reason, escaped the current framework generally governing international trade. If services are meaningfully different, what rules should govern trade in them? Of course, there is both much that distinguishes one service from another that has important implications for international trade and many similarities



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between trade in goods and trade in services. Indeed, much trade in services may move in tandem with trade in industrial products. But is the service component of such trade properly governed by the same rules as trade in goods?

Parts III and IV below explore, respectively, the economic and political characteristics of services, as distinguished from goods. We find that the economic forces that govern decisions respecting the purchase and supply of services are essentially the same as those that govern decisions on supply and demand for goods. The differences between these categories are not in the essential nature of their economic determinants, but in the particulars of their application and, to a greater degree, in political responses to them.

#### Trade in Services vs. Foreign Direct Investment

Before essaying that evaluation, a second definitional issue should be noted. Even if one can define a separate category of services, it is not a simple matter to identify the instances of international "trade" in services. The common definition declares that any activity performed by a citizen of one country and paid for by a national of another to constitute such trade.<sup>19/</sup> This activity, however, blends into another category of international business transactions.

The efficient vehicle for provision of many services by

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<sup>19/</sup> International Monetary Fund, Balance of Payments Manual (1977), para. 408 (hereafter "IMF").

producers in one country to consumers in another has been through creation of a permanent presence in the foreign country, as by the establishment of foreign affiliates. Investment of capital in such affiliates or in permanent structures from which services will be sold is denominated as foreign direct investment (FDI) rather than as trade in services.<sup>20/</sup>

The magnitude of trade in services bears no determinate relation to FDI. Large FDI can generate little trade in services (as opposed to returns from home country investment in provision of services to foreign nationals by foreign nationals); small FDI can generate large trade in services.

The two phenomena are, however, related. It is notable that FDI is especially significant in many service industries -- communications, computer services, construction and engineering services, educational services, franchising, health services, insurance, banking, and motion pictures<sup>21/</sup> -- and accounts for a substantial share of the income of many firms

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<sup>20/</sup> The IMF defines trade as "transactions between residents and non-residents"; it defines FDI as the acquisition of "an effective voice in the management of the enterprise." See IMF, supra.

<sup>21/</sup> U.S. Department of Commerce, U.S. Services Industries in World Markets: Current Problems and Future Policy Development (1976), at 27-29. For example, in 1950 only seven American banks had activities abroad; by 1984 more than 150 banks with over 1000 branches had overseas assets of more than \$337 billion. I. Walter, Global Competition in Financial Services: Market Structure, Protection, and Trade Liberalization (1988), at 10.

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in such industries.<sup>22/</sup> In 1982 the average value of foreign direct investment per U.S. affiliate abroad was \$11 to \$12 million in banking, insurance and retail trading.<sup>23/</sup> Between 1977 and 1985, the U.S. services industries' stock of foreign direct investment abroad grew from \$60 billion to \$111 billion, representing 44 percent of the total U.S. stock of foreign direct investment.<sup>24/</sup> Many other advanced economies also had a substantial share of their total FDI invested in service industries.<sup>25/</sup>

Our focus is on trade in services rather than foreign investment or trade in goods, but we recognize that the distinctions among these categories arbitrarily divides events

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<sup>22/</sup> Indeed, for numerous services industries, FDI is the predominant means of providing services to foreign customers: the insurance, engineering, data processing, investment banking and brokerage, advertising, leasing, accounting, and retailing industries all derived more than 75% of their total foreign revenues through the sales of foreign affiliates (and thus through means other than what is officially counted as "trade in services"). Indeed, travel, franchising, and licensing, which earn much of what is counted as service export earnings, are defined as trade and hence conceptually cannot derive their earnings from "sales of foreign affiliates," whatever their local investments may be. United States Office of Technology Assessment, Trade in Services: Exports and Foreign Revenues, at 43 (1986). Those service industries in which both exports and FDI sales appear to be important include transportation, communication, construction, film rentals, health, information, consulting, and software. Id.

<sup>23/</sup> U.S. Department of Commerce, U.S. Direct Investment Abroad: 1982 Benchmark Survey Data (1985).

<sup>24/</sup> Sauvant and Zimny, Foreign Direct Investment in Services: The Neglected Dimension in International Service Negotiations, World Competition 27, at 28. (Oct. 1987).

<sup>25/</sup> For example, the comparable figure was about 30 percent for Japan and Canada, and 10 percent for the FRG. Id.

that, if separable, are functionally linked.<sup>26/</sup> We also recognize that discussion of trade in services must be sensitive to the similarities, as well as the differences, between that and other forms of commerce within and among nations.

### III. The Economics of Trade in Services

#### Practical Aspects of Services Trade

In evaluating the economics of trade in services as distinct from trade in goods, the aspect of service activity that may be significant is the absence of a physical product that can be seen moving across borders. The issue of tangibility does not have direct economic implications, although as discussed below, it has indirect implications. More significant is the fact that for many services there is no end product at all, separate from its provider and recipient, to move in international commerce. For trade in such services to take place, the individuals who provide or receive the service must be mobile. That requirement poses very real practical obstacles to international trade in such services. Thus, services such as hairstyling and cutting or routine medical or dental care, for instance, are essentially local events. The service itself cannot be rendered at a distance, and given the

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<sup>26/</sup> Some commentators have argued that the failure accurately to separate FDI from trade in services seriously distorts the official figures on each. See, e.g., J. Francois, Producer Services and the International Division of Labor, US Int'l Trade Comm'n (1988).

value of these services and the costs of transporting the participants in them, it is quite unlikely that international trade will be significantly implicated in their provision.<sup>27/</sup>

These examples do not, however, capture the full range of services. For some services, trade is economical even where the service can be traded only through the movement of individuals. Moreover, other services yield (or use) a product that, although not tradeable in the sense of ordinary commercial goods, can travel in international commerce.<sup>28/</sup> For many of these services, such as laundering and drycleaning, the value of the service will not justify the cost of transportation for the goods on which the services are performed. But for yet other services, such as data processing, the cost of the movement of goods to obtain or provide the service often will be relatively slight in comparison to its value. Indeed, services range from those for which trade

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<sup>27/</sup> Perhaps we should say that international trade generally does not play a significant direct role in the provision of such services. It may play a much more substantial role indirectly through the international transportation of information about these services, including international transportation of individuals who have acquired knowledge about the service abroad, for instance the "cordon bleu" trained chef or the Paris-trained hairstylist. See G. Feketekuty, supra.

<sup>28/</sup> Such services have been referred to as "separable." See Sampson and Snape, Identifying the Issues in Trade in Services, World Economy 171, 172-173 (June 1985). Any service that consists mainly of provision of information (which can be transcribed onto a computer tape or onto a piece of paper or communicated electronically) can be thought of as separable.

seems quite unlikely to those for which trade is uncommonly economical when compared to the mine-run of goods.

The considerations that govern the flow of services -- in persons providing or receiving services or in goods on which services are performed or that, as with specialized information, are the product of the service -- appear indistinguishable from the forces that determine trade flows in goods. Of course, this must be true at the level of tautology: the magnitudes, directions, and composition of both sorts of trade are determined by the relative balances of costs and benefits of trade for the goods and services. Less obviously, the sources of those benefits for services -- the efficiency gain attainable from performance of a given activity by particular individuals or at particular sites, which might be referred to as the value of mobility -- are essentially the same as the sources of gains from trade in goods, including differential access to physical resources, specialized skill or knowledge, and economies of scope or scale.<sup>29/</sup> We review briefly the sources of both gains and costs for trade in services.

#### Gains from Trade

The theory of comparative advantage, first explicitly articulated by Ricardo, explains much of the gain from trade

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<sup>29/</sup> See, e.g., Grubel, There is No Direct International Trade in Services, Am. Econ. Rev. Papers & Proc. (Mar. 1987); Mundell, International Trade and Factor Mobility, 47 Am. Econ. Rev. 321 (1957). So-called "learning curve" effects reflect both specialization and economies of scope or scale.



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in services.<sup>30/</sup> Comparative advantage begins with differences  
in factor endowments.<sup>31/</sup> Some country-specific factors are an  
obvious basis for international trade in services; tourism  
provides obvious examples. While the efficiency gain attain-  
able from having access to a particular hairstylist seldom  
will justify the cost to either producers or consumers of  
travelling to the other country, for many people the value of  
seeing the Eiffel Tower in person or walking along the Champs  
Elysee more than justifies the cost of getting to Paris.

The theory of comparative advantage shades into newer  
theories of international trade that differ in emphasis and,  
to some degree, prediction respecting trade flows.<sup>32/</sup> New

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<sup>30/</sup> See Deardorff, Comparative Advantage and International Trade and Investment in Services, in R. Stern (ed.), Trade and Investment in Services: Canada/U.S. Perspectives (1985); A. Sapir and E. Lutz, Trade in Services: Economic Determinants and Development-Related Issues, World Bank Staff Working Paper No. 480 (August 1981).

<sup>31/</sup> B. Ohlin, International and Interregional Trade (1933); Samuelson, International Trade and the Equalization of Factor Prices, 58 Econ. J. 163 (1948); Samuelson, International Factor Price Equalization Once Again, 59 Econ. J. 181 (1949).

<sup>32/</sup> S. Linder, An Essay on Trade and Transformation (1961), was an early statement of the view that trade may reflect economic forces other than comparative advantage. Later works explain why trade patterns at times appear to violate predictions based on comparative advantage, e.g., the existence of much trade among countries that are similarly capital-rich (rather than between countries of differing capital abundance). See, e.g., E. Helpman and P. Krugman, Market Structure and Foreign Trade: Increasing Returns, Imperfect Competition, and the International Economy (1985). In substantial measure, these phenomena can be explained by more discriminating accounts of national comparative advantage (e.g., differences in cost of employing specific factors such as capital of various sorts as opposed to overall size of capital stock; after all, trade among capital-rich nations should be

theories of trade emphasize the existence of differences in the pace of development of new technology in different countries as the explanation of trade between those countries.<sup>33/</sup> Technological disparities may result from differences in domestic market characteristics and size (which often have been identified as sources of comparative advantage),<sup>34/</sup> or from national patterns of investment in research and human capital.<sup>35/</sup>

Scale economies -- efficiencies generated when more of a given service is provided utilizing common inputs -- are another source of differential efficiency in provision of services in particular countries. Such economies are associated more frequently with new, capital intensive technologies than with older, labor-intensive technologies. Similarly, economies of scope -- efficiencies generated when related services are provided utilizing common inputs -- may

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expected to dominate trade between rich nations and poor nations for the reason Willie Sutton gave for robbing banks: that's where the money is). See Feketekuty, Negotiation Strategies for Liberalizing Trade in Investment in Services, in R. Stern (ed.), Trade and Investment in Services: Canada/U.S. Perspectives (1985).

<sup>33/</sup> See E. Helpman and P. Krugman, supra.

<sup>34/</sup> Ricardo, who developed the theory of comparative advantage, emphasized the importance of differences in technology between countries as a source of comparative advantage. D. Ricardo, The Principles of Political Economy and Taxation (1817).

<sup>35/</sup> See E. Helpman and P. Krugman, supra.



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provide a basis for concentration of benefits in a particular  
country.

Much of the recent writing respecting international trade has explored the trade implications of such economies.<sup>36/</sup> These writings suggest that the country that, for whatever reason, has made the earlier or larger investment in the use of a new technology with scope or scale economies can enjoy significant cost advantages in its exploitation; that country then will export the products or services produced with the new technology.

In some measure, either explanation -- comparative advantage or economies of scale or scope -- fits the provision of some services by a small number of specialists (in medical procedures, in architectural or fashion design, in putting out oil-well fires, or in other services) whose skill cannot readily be duplicated. Such specialists embody "human capital" (from education or experience) which will not be evenly distributed across countries, providing a source of comparative advantage and, like other forms of capital investment, specialized knowledge or skill, often will generate economies of scope or scale over some region of output. This sort of specialized skill or information appears

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<sup>36/</sup> See, e.g., E. Helpman and P. Krugman, *supra*; P. Krugman, ed., (1987); Brander & Spencer, Strategic Commitment with R&D: The Symmetric Case, 14 Bell J. Econ. 313 (1983); Gruenspecht, Dumping and Dynamic Competition, 25 J. Int'l Econ. 225 (1988).

increasingly to be a component in much of the observed trade in services.<sup>37/</sup>

#### Costs of Trade

The cost of trade in services also responds to considerations similar to those that govern the cost of trade in goods. The similarity between cost of trade in services and cost of trade in goods is greatest where the service at issue is performed on tangible goods, as with the drycleaning example. Where goods are the most mobile element in a service relationship, the weight of the goods, their durability or fragility (perishability is a subset of this more general set), and the time frame within which their movement is to be accomplished generally will set the cost parameters.

This last variable often will distinguish movement of goods for purposes of trade in those goods from movement of goods for purposes of trade in services. The manner and timing of movement appropriate to a given service may differ significantly from the manner and timing appropriate to trade in goods. Such differences in the cost of mobility, along with differences in the value of mobility, may make it

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<sup>37/</sup> See S. Sagari, The Financial Services Industry: An International Perspective, unpublished doctoral dissertation, Graduate School of Business Administration, New York University (1986) (test of the Heckscher-Ohlin model of comparative advantage on international patterns of bank lending, finding that skilled labor is a significant determinant of comparative advantage). See also Walter, supra, at 82 (importance of specialized information). Cf. Baldwin, Determinants of the Commodity Structure of U.S. Trade, 61 Am. Econ. Rev. 126 (1971).

economical only to perform services locally on some goods that are routine commodities for international trade. Although clothes and carpets, for example, are routinely traded, they are not shipped similar distances for cleaning, partly because similar economies of specialization do not occur in respect of cleaning services and partly because the cost of transportation for cleaning would be significantly higher given the time demands associated with such services.

The two service-related goods that routinely appear to have quite low marginal costs of mobility are information (which often is the product of services) and money (the good on which financial services are performed). The two are closely related, as today the movement of money often consists of communication of information about financial credits and obligations.<sup>38/</sup> The information itself is intangible (hence, extremely lightweight) and has near-zero marginal costs of production beyond the first unit -- once produced, there is (virtually) no cost to repetition, so that communication to a group is more costly than communication of the information to a single client only so far as additional transmission costs are incurred. The communications services that perform the transmission function for information-based goods are charac-

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<sup>38/</sup> See, e.g., A. Saunders, The Influence of New Communications Technologies on Banking and Finance [check w/ EN for full cite]

terized by substantial economies of scale.<sup>39/</sup> Such economies may be associated with transmission of some particular type of message, but more often will be a general function of the flow of all communications over the transmission medium.

Important to understanding the apparent substantial increases in the international trade of services is the dramatic decline that has occurred over the past four decades in the cost of communications (especially as adjusted for speed and quality). For example, the annual cost for a transatlantic circuit has declined from more than \$40,000 in the mid-1950s to under \$400 in 1988 and is projected to drop below \$120 dollars in the near future.<sup>40/</sup> Although regulatory constraints have kept prices of many communications services from declining so rapidly as costs, it is becoming almost as inexpensive to deal with an expert halfway around the globe as with one across town.

The cost associated with movement of individuals who may be providing a service or receiving a service also is likely in part to vary with the movement of all individuals over similar transportation vehicles and paths. The cost of sending a lawyer from New York to London or Tokyo is much less than the cost of moving the same lawyer to Ouagadougou or Bahia Bianca, not only as a consequence of the distances

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<sup>39/</sup> See, e.g., D. Evans, ed., *Breaking Up Bell: Essays on Industrial Organization and Regulation* (1982).

<sup>40/</sup> 1987 Kessler Marketing Intelligence, *Worldwide Markets for Undersea Fiberoptic Systems*, at 49.

involved but, more importantly, of the economies of scale attainable with the movement of larger numbers of passengers.

The other principal determinant of the cost of mobility of individuals is the opportunity cost of their travel. Individuals with higher incomes generally have higher opportunity cost for their time relative to that of individuals with lower income, but often experience some savings as a result of the frequency of their travel (lowering costs associated with learning how to get from one place to another and how to adjust to being in the foreign environment). The costs of long-term movement may be particularly great for high-income individuals, who generally have considerable capital associated with their permanent location in a given place, such as valuable, established business relationships and property.

#### Services' Tradeability

Consideration of the costs and value of mobility suggests differences in the likelihood that, other things equal, certain generic types of services will be significantly involved in international trade while other services are extraordinarily improbable candidates for trade. The clearest dividing line separates "up-scale" from "down-scale" services.

It is relatively unlikely that low-skill, low-wage services, such as waiting tables, housecleaning, or other domestic work, will be traded frequently. These services do not require specialized information or experience and do not

exhibit significant economies of scale or scope. There will, thus, be little gain from concentrating provision of services in a single enterprise, and given the necessity of local performance of these services there is no prospect for geographic concentration of their production.

This does not deny that some nations will have a comparative advantage in the production of these services. Manifestly, nations in which there is a large labor force that has few highly remunerative options enjoy such a comparative advantage. Down-scale services in these nations will initially be offered at lower prices than in other nations. Because factor movements can substitute for trade in the end-product itself,<sup>41/</sup> economic forces that promote uniform prices for given products can be expected to induce some movement by both potential recipients of these services and potential providers. Both tourism from capital-rich to labor-rich nations and immigration in the opposite direction can, to some extent, be characterized as such factor flows. Tourism in particular is an important vehicle for trade among nations, although it very often is tied to factors unrelated to labor costs, such as natural geophysical endowments (mountains, beaches, and so on) or man-made creations (such as Disneyland or, to take a less modern example, the treasures of ancient Greece or Rome or Israel).

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<sup>41/</sup> See, e.g., B. Ohlin, *Interregional and International Trade* (1933).

Differences among nations in the pool of low-skilled, low-wage labor, standing alone, are not likely to lead to substantial trade in the ordinary sense; and, despite the sort of factor movements noted above, there will be a continuing difference in the cost of services using such labor at least so long as significant inhibitions exist to movement across national borders.<sup>42/</sup> In a world of immigration constraints, we can expect long-term differences in returns to such services. We also can expect the mechanism for such progress toward international equilibration in the cost of these services to be more by means of permanent or quasi-permanent movement of providers, than by movement of recipients who generally will have higher opportunity costs associated with such movement.<sup>43/</sup>

The services that are most likely to be traded internationally on a routine basis will be those characterized by specialized skill or knowledge and relatively inexpensive movement of the service-related good (especially information and financial accounts) or, in lesser measure, of the service provider. Such services, for which productivity differentials among countries are most likely to be large enough to exceed

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<sup>42/</sup> Bhagwati, Why Are Services Cheaper in the Poor Countries?, 94 Econ. J. 279 (1984). See also Bauer and Yamey, Economic Progress and Occupational Distribution, Economic Journal 741 (Dec. 1951); Kravis, Heston, and Summers, The Share of Services in Economic Growth, in F. Adams and B. Hickman, eds., Global Econometrics: Essays in Honor of Lawrence R. Klein (1982).

<sup>43/</sup> See Bhagwati, supra note 42.



the costs of mobility, will be those in which the more advanced industrial economies should enjoy comparative advantage.<sup>44/</sup>

For these reasons, the United States, in sharp contrast to its trade in goods account, has shown substantial annual surpluses in the services account of its balance of payments consistently since the late 1970s.<sup>45/</sup> A similar propensity to engage in services trade characterizes other advanced economies. According to the International Monetary Fund's estimates for 1988, exports from the countries comprising the European Economic Community accounted for about half of the global trade in services (much of that, trade among the member countries).<sup>46/</sup> Exports from the United States accounted for an additional 10 percent of such trade, with Japan's exports accounting for about 6 percent and Austria just under 4 percent.<sup>47/</sup> These top 10 service exporters, all relatively

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<sup>44/</sup> Evidence for this proposition is presented in Feketekuty, *supra* note 32.

<sup>45/</sup> Shelp, *Trade in Services*, Foreign Policy 64, at 76 (Winter 1986-87). See also, Electronics in the World Markets-Production/Trade 149, 161, 175 (graphically depicting very different developments in U.S. trade flows in certain information services and related goods). Furthermore, the Congressional Office of Technology Assessment argues that U.S. exports of services between 1982 and 1984 were underestimated by between \$73 billion and \$128 billion. *Id.* at 77.

<sup>46/</sup> Services exports from the United Kingdom were estimated at \$37.1 bil; West Germany \$33.8 bil; France \$33 bil; Italy \$23.5 bil; the Netherlands \$18.6 bil; Belgium \$14.9 bil; Spain \$12.2 bil.

<sup>47/</sup> The IMF's figures for 1988 show exports of \$19.4 bil. for Japan and \$10.8 bil. for Austria.



advanced economies, accounted for more than two-thirds of the global trade in services.

While substantial growth in services trade clearly has occurred, especially among advanced economies, the difficulties of separating trade in services from other economic activity, discussed above, make all of the precise measurements of such trade suspect. The measurement difficulties are particularly evident when one reviews estimates of the trade in services for which the composition of trade is specified.<sup>48/</sup>

Still, certain trends in such trade are evident. Whatever the precise composition of the trade in services, it appears that the growth in this trade traces to increasing productivity differentials in services, especially in information-based services, and decreasing costs in transportation and, even more, in communication have provided the critical supports to an increasing trade in services.<sup>49/</sup> Information

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<sup>48/</sup> Economic Consulting Services, *The International Operations of U.S. Service Industries: Current Data Collection and Analysis* (June 1981), at 8, 70-194, 294. (providing different assessments of the composition of U.S. services trade for a single year).

<sup>49/</sup> See Gibbs, *supra*. In linking the growth in services trade to the decline in the cost of transportation and, even more, communications, we should be careful not to draw too simple a connection between changes in these costs and services trade flows. Improvements in the technology on which a service relies do not necessarily affect trade flows. Take, for examples, improvements in communications and data processing that decrease the cost of any constant quality unit of service. The price of such services, however, may or may not fall relative to other commercial activities. Prices are in part functions of relative marginal productivities. The

services have grown particularly rapidly, in part through increased specialization to capture economies of scale commonly associated with information. This development also is related to another development, sometimes referred to as the growing "globalization" of business enterprises. In large measure, the increase in services trade represents the disaggregation of a wide variety of commercial activities, with trade occurring in the most mobile portion of the activity. A large construction company such as Bechtel in California, for example, is not so much involved in actual building as in its coordination utilizing specialized information. Through its private networks, Bechtel arranges for a construction project in Riyadh using financing provided in New York and Zurich, insurance from London, transportation from Rotterdam, construction subcontractors from Seoul, engineering in India, and

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improvement in communications or data processing technology might generate an even larger increase in the productivity of another sector of the economy (such as industrial manufacturing), increasing the marginal productivity of labor employed in that sector. The increased value of labor in this sector of the economy may increase labor costs within that sector, secondarily increasing the cost of labor elsewhere, including for services. Considerable information, thus, would be necessary to determine the consequence of a given technological change for the composition of commercial activity within the society and for its trade with other countries. See Baumol, Information Technology and the Service Sector: a Feedback Process, in G. Faulhaber, E. Noam, and R. Tasley, supra, at 183-193. That noted, it seems that in fact cost reductions (productivity gains) in communications and information processing have exceeded those occurring in other sectors of advanced economies.

European materials.<sup>50/</sup> Similar examples can be found in many disparate lines of business.

Summary: Economics of Services Trade

In sum, the economic considerations that govern trade in services are services are not distinguishable from those governing trade in goods. These considerations do not seem to make services systematically more tradeable or less tradeable than tangible goods. That is not to say that the trade patterns for services and goods will be congruent. As compared to goods, services encompass both activities that seem particularly improbable candidates for trade and activities that (in whole or in part) appear eminently tradeable.

The vehicles for trade services do differ from those by which goods are exchanged. In some measure services trade is through movements of individuals, often ones who possess specialized information (but in some cases, notably tourism, of individuals who are to be service recipients), and more generally of information and financial accounts. The use of different vehicles for trade in services, however, does not have clear implications for the resulting trade flows or the rules appropriate to such trade.

That is not to say that the means by which trade is conducted are irrelevant to either the pattern of trade that

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<sup>50/</sup> See, e.g., P. Keen, *Competing in Time* \_\_\_\_ (1987) [check w/EN]

will be observed or the rules that are apposite to trade. Indeed, for information-based services, the mechanism for trade seems to be as significant as the nature of the product traded. The prospects for substantial economies of scale in both the information "product" that serves as the intermediary for these services and in the communications medium over which such information travels offer significant impetus to trade. But there is no a priori basis for predicting that for any particular information-based service, much less for services as a whole, these economies necessarily will be greater than those associated with a given category of goods or with goods as a class. There is, thus, little in the economics of services that suggests a basis for trade rules different from those governing trade in goods.

#### IV. The Politics of Services

If the economics of services do not offer a systematic basis for distinguishing rules appropriate for services trade from those for international trade in goods, perhaps the politics of services do. In particular, political responses derivative of three attributes of services may provide some basis for distinction. First, as commonly understood and as we have emphasized in defining them, services are not fully embodied in tangible, tradeable goods. This fact may alter the effects of political supervision over this business activity and also may affect the form of any such superven-

tion. Second, services trade occurs in part through movement of individuals. Political sensitivity to human ingress and egress traditionally has been greater than sensitivity to international movements of goods. Third, many services are integrally related to communication and to capital flows, matters that also touch sensitive nerves for most governments. Political reactions to these attributes are reflected in the current pattern of national regulation of services.

#### Government Regulation

It should be manifest from our earlier discussion of the difficulty of separating goods from services that we would be surprised to find any sharp distinction between goods and services, including a political distinction. Before turning to the political regulation of services, we should note that many products are subject to governmental regulation of one or another sort -- for instance, controls on the creation of new pharmaceutical products, requirements regarding the safety of equipment, the flame retardancy of clothing, or the emissions from engines, or programs conditioning benefits for agricultural producers on reductions in the levels of production. For some products, such as pharmaceuticals, governmental regulation is extensive. Even where explicit regulatory controls are not used, governmental regulation in the form of tax laws, labor laws, generic health and safety regulation, or product liability laws often affects the cost of inputs or the

means chosen for production of goods.<sup>51/</sup> Moreover, while the particular occasions for governmental intervention may differ, regulation of goods generally responds to the same basic political instincts as informs regulation of services.

That said, regulation of services appears at least arguably distinguishable on several grounds. For one, particularized governmental regulation of specific products is more the exception than the rule in most market-oriented economies, certainly in the United States. The reverse appears true for services. Further, products seldom are subject to the sort of comprehensive governmental regulation that is often common for services. The form of regulation also differs, with exclusionary licensing common along with other control mechanisms over the provision of services but quite rare for provision of goods.

These differences appear responses to the attributes noted above. For example, as services are not embodied in tangible, tradeable goods, it often will be more difficult to regulate services by imposing performance requirements on the products of service-producing businesses than by imposing such requirements on goods. This partially explains the greater reliance on exclusionary licensing of service providers. Of course, the relation between particular attributes of business activity and the structure (or likelihood) of regulation

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<sup>51/</sup> See, e.g., P. Huber, *Liability: The Legal Revolution and Its Consequences* (1988).



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depends on the ends to which governmental regulation is  
directed.

### Regulatory Goals

In this section, we briefly outline four possible bases for regulation of services. Three of the four regulatory goals can be characterized simply as different types of wealth redistribution, but we think they suggest disparate regulatory forms or incidence.

### Public Interests

First, regulation might be predicated on public interest concerns. Health and safety concerns could explain many regulations, as has been urged, for example, with governmental regulation of the medical profession and of food services.<sup>52/</sup> Other regulations have been defended on efficiency grounds; while market forces generally will move prices toward costs, the absence of tradeable markets for services' products arguably eliminates one important market impetus to efficient pricing.<sup>53/</sup> Inefficient forms of "price discrimination" hence

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<sup>52/</sup> A wide variety of materials on regulation of food and drugs in the United States is collected in R. Merrill & P. Hutt, *Food and Drug Law* (1980). For an example of the pervasiveness of the assumption that regulating medical practice is a legitimate exercise of governmental power to promote citizens' health and safety, see Henkin, What of the Right to Practice a Profession?, 67 Calif. L. Rev. 131 (1970).

<sup>53/</sup> Of course, if international factor flows are not impeded, the adjustment in factor inputs should produce the same equilibration as would trade in end-products. See, e.g., Mundell, International Trade and Factor Mobility, 47 Amer. Econ. Rev. 321 (1957). As indicated above, however, international movement of factors critical to services, such as individuals with specialized knowledge, often are impeded by

may be more common in respect of services than in ordinary commercial goods and government regulation of services, hence, more beneficial to the public.<sup>54/</sup>

Although exclusionary licensing or other "front-loaded" measures are not necessarily required to capture this benefit, for some services, ex ante government regulation may prove a more efficient means of deterring undesirable activity, such as fraud, than ex post sanctions.<sup>55/</sup> This may be especially true for services, such as insurance, that involve up-front payment for services to be performed perhaps well in the future. Even where businesses individually might take "bonding" measures to assure prospective customers of the trustworthiness of that particular enterprise (allowing competing enterprises to distinguish themselves on that score),<sup>56/</sup> governmental regulation may provide a less costly and more secure alternative.<sup>57/</sup>

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both legal and practical constraints.

<sup>54/</sup> See, e.g., A. Kahn, *The Economics of Regulation* (1971).

<sup>55/</sup> An excellent discussion of the choice between ex ante and ex post regulation, albeit in the context of safety rather than fraud, is Shavell, Liability for Harm versus Regulation for Safety, 13 J. Legal Stud. 357 (1984).

<sup>56/</sup> See, e.g., Jensen & Meckling, Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure, 3 J. Financial Econ. 305 (1976).

<sup>57/</sup> Of course, the question what mode of control is an empirical one. See, e.g., Coase, The Problem of Social Cost, 3 J. L. & Econ. 1, 16-18 (1960).



Nearly any prohibitive regulation of services, indeed, has at least some possible public interest explanation, even if such explanations prove offensive to many conceptions of the general public's interest. Thus, for example, some restrictions on services might be premised on concerns for national cultural identity, a form of public good. For instance, a requirement that entertainment or other services be provided only in the national language might be promoted on this ground.<sup>58/</sup> So, too, restraints on immigration, an indirect limitation on individuals' ability to perform particular services in a given country, arguably are intended to preserve the cultural identity of the country.<sup>59/</sup>

#### Limiting Competition: The Simple Case

Many commentators who have examined governmental regulation of services (indeed, governmental regulation in general) have been quite skeptical of these public interest explanations. In the United States, governmental licensing restrictions have attached to hundreds of service occupations.<sup>60/</sup> Almost all of these restrictions have been justified as promoting the public health and safety or protecting the public against possible fraud.

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<sup>58/</sup> Note Quebec French-language rules

<sup>59/</sup> An example of this is the reticence of Japan to permit the immigration of non-Japanese workers despite the apparent labor shortages within Japan.

<sup>60/</sup> See Gellhorn, The Abuse of Occupational Licensing, 44 U. Chi. L. Rev. 6 (1976). See generally, S. Rottenberg, ed., Occupational Licensure and Regulation (1980).

It strains credulity, however, to assert that restrictions on the vast array of regulated occupations -- covering barbers and beekeepers, tattooers and taxidermists, threshers and textbook sellers, beauticians and boiler inspectors, photographers and plumbers, social workers and septic tank cleaners, house sellers and horseshoers -- are necessary to protect public health, safety, and security. Credulity is further tested by recognition that the demand to regulate "rarely comes from the members of the public who have been mulcted or in other ways abused by members of the occupation. On the contrary, the pressure invariably comes from members of the occupation itself."61/ Even if one reads the history of occupational regulation as providing a more mixed picture, it remains true that the regulated occupation generally plays a significant role in shaping the government's regulatory program.

The simplest explanation offered for a wide array of governmental regulations, such commentators suggest, is the desire for practitioners of various occupations for limits on competition. Many regulated services can be provided only by a restricted group, not infrequently by well-connected and politically influential groups such as lawyers and doctors who collectively seem to be able to protect their economic interests more effectively than many others. The restrictions frequently apply only to new entrants, and almost always have

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61/ M. Friedman, *Capitalism and Freedom* 139 (1962).

the effect of limiting additional competition with the individuals now providing the services at issue.<sup>62/</sup>

In many nations, special restrictions are placed on communications services, limiting who can provide such services (commonly allowing only a single, government-owned entity to provide many communications services) and also regulating what can be said.<sup>63/</sup> While communications regulations have many explanations, the personal interests of government officials as a class often may be implicated in these regulations in a more direct manner than with the general run of commercial regulations.<sup>64/</sup> Limitation of competition in communications facilitates promotion of policy-makers' personal interests as well as the interests of those who operate (or, in many instances, who do business with) permitted communications enterprises.

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<sup>62/</sup> See, e.g., Benham, The Demand for Occupational Licensure, in S. Rottenberg, supra; Gellhorn, supra; Rose, Occupational Licensure: A Framework for Analysis, 1979 Ariz. St. L. J. 189.

<sup>63/</sup> See, e.g., P. Lahav, ed., Press Law in Modern Democracy: A Comparative Study (1985).

<sup>64/</sup> This observation has been offered to explain the particular restriction imposed on speech regulation in the United States. See, e.g., Blasi, The Checking Value in First Amendment Theory, 1977 Am. B. Found. Res. J. 521. This explanation does not fully account for the structure of American law on speech regulation, but its focus on official incentives does offer an important datum for analysis of this area of law. See Cass, The Perils of Positive Thinking: Constitutional Interpretation and Negative First Amendment Theory, 34 UCLA L. Rev. 1405 (1987); Cass, Commercial Speech, Constitutionalism, Collective Choice, 56 U. Cin. L. Rev. 1317 (1988).

So far as national regulations specially limit competition from international competitors,<sup>65/</sup> these can be seen as a subset of the more general category of competition-restricting regulations. The principal difference is that foreign interests are excluded from participation in the decision-making processes of government (certainly as a formal matter, and to a great degree as a practical matter as well); hence, they can be expected systematically to be handicapped by competition-restricting rules, while the distribution of benefits and burdens of such rules across each nation's citizenry is less determinate.<sup>66/</sup>

#### Cross-Subsidy

A third purpose for regulation of services is redistribution of wealth among the users of a service, generally one that is ubiquitous, such as telephone service. One commentator has labelled this phenomenon "taxation by regulation."<sup>67/</sup> The insight encapsulated in that label is that

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<sup>65/</sup> Although such restrictions often are covert, at times they are quite explicit and their rationale similarly clearly articulated. For example, Brazil has explained various restrictions on international trade in services as designed to assure "national control over the production of information resources," in particular to develop its own computer, software, data base, and data processing industries. See Shelp, supra, at 69-70.

<sup>66/</sup> See, e.g., Brock and Magee, The Economics of Special Interest Politics: The Case of the Tariff, 67 Rev. Econ. & Stat. 465 (1985); Finger and Nelson, The Political Economy of Administered Protection, 72 Am. Econ. Rev. 452 (1982).

<sup>67/</sup> Posner, Taxation by Regulation, 2 Bell J. Econ. & Mgt. Sci. 22 (1971).

prices, terms of provision, and entry into and exit from the industry providing a service often are regulated in ways that effect redistributive transfers from one class of consumers of the service to another.

The explanation for this use of regulation resembles one public interest argument for regulation of services, but with a very different emphasis on the goal for regulation. Unlike standard goods, which generally can be resold to undermine efforts at price discrimination, services often can be priced discriminatorily for extended periods. The discrimination in pricing can increase returns to the service provider as well as redistributing wealth among service consumers. In the United States, regulation of telephone services, securities brokers' services, banking, and rail transport, to name just a few, has mandated (or at least encouraged) such cross-subsidy between service users.<sup>68/</sup>

While restriction of competition may not be the primary goal of such regulation, it is a necessary concomitant. Without some restriction of competition, it is extremely unlikely that cross-subsidies can be maintained. The experience of American telephone regulation over the past two decades is testimony to the conflict between subsidy and competition.<sup>69/</sup> In many other countries, the relation between

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<sup>68/</sup> Id.

<sup>69/</sup> See, e.g., D. Evans, ed., supra note 39; G. Faulhaber, Telecommunications in Turmoil (1987); Besen & Woodbury, Regulation, Deregulation, and Antitrust in the Telecommunica-

competition and subsidy is less evident as governmentally-operated monopolies provide the vehicles for shifting costs among groups of service users.<sup>70/</sup>

#### International Wealth Transfer

A final set of regulations appears designed to shift resources in a different way. Rather than effect a transfer among users of a particular service or from consumers to producers, this final set of regulations is directed at transferring wealth from residents of one nation to residents of another.

Unlike the other regulations discussed above, the sort of governmental regulations most clearly designed to serve this function, such as foreign exchange restrictions and limitations on the transfer of funds out of a country, do not appear directed specifically at particular services. Indeed, they may not be. However, especially when combined with requirements that services be offered only by enterprises with a given commitment of resources in the regulating nation, such restrictions can impose significant costs on enterprises offering various services.<sup>71/</sup>

#### Regulation and Trade: Concerns and Implications

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tions Industry, 28 Antitrust Bull. 39 (1983); Carlton & Lavey, Economic Goals and Remedies of the AT&T Modified Final Judgment, 71 Geo. L. J. 1496 (1983).

<sup>70/</sup> See, e.g., J. Foreman-Peck & J. Muller, eds., European Telecommunication Organisations (1988).

<sup>71/</sup> Feketekuty at 138.



The existence of regulatory programs, informed by different and often by multiple (and not necessarily compatible) goals, limiting legally authorized provision of numerous services may provide a partial explanation for the absence of clear rules governing trade in services. At a minimum, these programs considerably complicate discussion of trade in services. Political reaction to the growth in services trade illustrates the problem; such reaction has taken form as two competing concerns. One concern sees growth in services trade as desirable and focuses on the effect that governmental regulation of services can have on inhibiting trade in services. Correlatively, some officials are concerned over the effect that trade in services can have on governmental regulation.

The two concerns are quite closely related, as both the benefits and costs of governmental regulation of services are determined largely by the same factors. The factors that determine the tradeability of services -- and, hence, other things equal, the expected flows of trade in services -- also partially determine the degree to which regulation will be effective at limiting trade in particular services, either for good or for bad. Further, governmental regulation itself can create differences in the efficiency of services rendered in different places, serving as an inducement to trade that might not occur if all services were subject to the same regulatory regime.

### General Implications

For trade negotiators, there seems little prospect for quick agreement on a single formula governing trade in services. Put differently, any general formula will be unlikely to be sufficiently clear and binding to eliminate dispute over regulatory limitations on particular services. Each dispute over service regulations is likely to present a difficult empirical question: to what degree do concerns over international competition explain such regulations, as opposed to independent, political considerations internal to the regulating country? While not necessarily critical to resolution of trade disputes, this question often will be a source of debate. More important, liberalization of service regulations generally may be resisted as an interference with internal politics, since very frequently, no matter what the impact on trade, the service regulation is supported by independent, internal political concerns.

Although concerns independent of trade will not always provide a complete explanation for all such regulations, there is no ready means for identifying instances in which regulations are intended to handicap trade. Reasoned analysis can contribute only modestly to resolution of this question. Plainly, it is quite difficult to structure observable data in a way that provides determinate information about the purposes that governmental officials who designed particular regulations, or who administer them, truly intended those regula-

tions to serve. Inductive reasoning, thus, is unlikely to resolve differences in this arena. Nor will deductive reasoning provide a solution to disputes. Without a strong positive theory of the political economy of regulation, it is not possible to predict the types of regulation that will in fact be adopted with respect to various services. Such a theory does not exist as yet, and we certainly are in no position to remedy that deficiency.<sup>72/</sup>

It is, however, possible to describe the way in which trade in services interacts with governmental regulation of services. The effect of governmental regulation will be a function principally of the tradeability of the regulated service, but also will vary with the design of the regulation and the particular commitment of local and external components to the specific service.

At the outset, it should be clear that there is substantial basis for concern -- both for those who focus on limitation of imports and for those who focus on expansion of exports -- about the interaction between trade and regulation of services. Regulations that are designed to inhibit efficient provision of services necessarily interfere with trade flows, which are driven by pursuit of such efficiencies, and are threatened by the prospect that successful trade in such services will break down the regulatory scheme, much as

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<sup>72/</sup> See, e.g., Cass, Privatization: Politics, Law, and Theory, 71 Marquette L. Rev. 449, 471-81 (1988) (discussing current positive political theories).

free trade in agriculture would threaten agricultural subsidies.<sup>73/</sup>

The following sections describe generally the effects of regulation on trade in services and of trade on services' regulation. We begin with the role played by the degree to which a particular service is tradeable.

#### Tradeability and Regulation

As a rule, the more tradeable a given service, the more likely it is that imposition of domestic constraints on it will drive the activity offshore. For that reason, it is quite difficult to use a highly tradeable service to effect subsidies to one class of users from another. In contrast, some goals for government regulation can be sustained even with markedly declining levels of service. Thus, for example, concerns about the cultural consequences of particular services can be ameliorated even if the service is highly mobile; in the face of regulation, both the benefits and perceived costs of the service are likely in some measure to go away.

It should be noted in addition that, while tradeability raises the cost of attempts to use the regulated service to accomplish particular ends, it also can increase the benefits associated with exclusionary regulation. Certainly, local

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<sup>73/</sup> Thus, restrictions on agricultural imports generally are the byproduct of agricultural subsidies, and at times this linkage is explicitly acknowledged. See, e.g., Agricultural Adjustment Act, §22.

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competitors have relatively little to fear from import of services that are not very tradeable; by definition, no significant imports of such services should be expected. Hence, it is plausible to expect greater efforts to enact competition-constraining regulation of more tradeable services.

At the same time, from consumers' vantage, countries might be urged to compete in the liberality of their regulation of such services, in the hopes of inducing internationally mobile resources to move to those countries,<sup>74/</sup> or only to regulate those services toward ends unaffected by their migration.

#### Decomposing the Service: The Role of Options

Although tradeability is critical to assessment of trade flows, even in the face of regulation, the full effect of regulation on trade in services cannot be understood apart from the international distribution of the component elements that must come together in some fashion for a service to be performed. Differences in the alternatives available to various participants in the purchase and sale of services-- in economists' terms, the price elasticity of supply for productive factors and the price elasticity of demand for the

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<sup>74/</sup> This seems to be the case, for example, in the competition among the states of the United States for investment, seen in the variety of tax and other incentives provided by states to business investments made within their borders.

service at issue -- will determine the actual distribution of effects.

Any national regulation that increases the cost of providing a service in effect constitutes a tax on domestic sale of that service. As with other taxes, the cost will be borne principally by the participant with the worst alternative choices (that is, the least elastically supplied factor or the consumers whose demand is relatively price inelastic).<sup>75/</sup> National advantage, thus, seems most likely to be associated with regulations that are tied to relatively immobile aspects of services and private, competitive advantage with regulations that restrict access to (and escape by) immobile consumers. So far as consumers are the least mobile element of a service transaction, however, regulation will serve to disadvantage domestic consumers and hence may produce a net loss to the regulating nation.

Given these consequences, it is plausible to expect that the sort of regulations imposed by various governments will differ substantially among nations and among services. Nations with especially strong concerns about national security or independence (Israel might be an example), or with especially immobile consumers, should be expected to impose greater restrictions on services as well as on some goods. Similarly, industries with especially strong political influence should be particularly interested in obtaining

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<sup>75/</sup> See, e.g., R. Musgrave & \_\_\_ Musgrave.



regulation that inhibits competition when consumers are relatively immobile, when consumer demand for the service is relatively inelastic, and when domestic firms are less well positioned than potential competitors to exploit comparative advantages or economies of scale or scope.

Conversely, for sectors with highly mobile consumers or resources, the gains to domestic firms from restrictive regulation will erode quickly, and the additional costs incurred by domestic consumers of the service may outweigh the benefits to domestic producers sufficiently to make such regulation politically as well as economically disadvantageous. Also, nations with special advantages in provision of particular services can be expected to adopt regulatory regimes more conducive to (less restrictive of) such services.

It is worth reiterating that politicians themselves may have strong self-interest in restrictive regulation of some services, such as mass communications, even where the distribution of costs and benefits to others does not suggest that such regulation would be advantageous. Of course, the prospects for regulation increase when politicians' self-interest coincides with the interests of other influential groups. Moreover, the costs of maintaining restrictive regulations, and the distribution of such costs across the politicians' constituencies, will respond to the forces outlined above. These considerations will redefine to some extent the politicians' self-interest; they, along with the

freestanding self-interest of those in positions of power, will influence (in manners and degrees that vary with the particular form of government) government policy.

Summary: Politics of Services

In sum, while the same generic forces affect the politics of trade in services as affect trade in goods, there is reason to expect more political interest in regulation of services, a different form for such regulation, and more conflict between such regulation and international trade. Services regulation often is undertaken for reasons that do not directly focus on international trade. Often, however, the "internal" aims of service regulation can be characterized as principally comprising the generic set of competition-limiting (and cognate) goals for which restriction of international competition constitutes a natural subset.

The degree to which nations engage in regulation that restrains international trade will vary considerably, in part because residents in different nations perceive their national interests disparately and in part because different governmental structures produce divergent responses to any given combination and distribution of interests. Moreover, although nations with developed economies should be more interested in exporting services (other than tourism, at least), there is no reason to expect any individual nation to adopt a comprehensive strategy with respect to services regulation. Many

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nations can be expected to allow some services free rein while others are tightly regulated and competitive entry into them severely restricted.

This array of diverse political interests, more than anything peculiar to the economics of services, explains both the absence of international rules for trade in services and the difficulty of securing agreement on a meaningful general rule. As with goods, however, nations that believe their interests are served by liberalized trade in many services may be prepared to embrace rules generally promoting liberalization, even if decisionmakers for those nations would prefer to liberalize trade for only some services. Given the political sensitivity of some services trade and the frequent difficulty of liberalizing trade without compromising the regulatory scheme -- unlike tariffs, which can be reduced in stages, many forms of exclusionary regulation are ill-suited to partial liberalization -- the number of countries interested in general liberalization of services trade is apt to be lower than the number interested in generally liberalized trade in goods.

#### V. Regulation of Services and United States' Trade Law and Policy

While other nations may be ambivalent, the United States has considerable interest in the liberalization of services trade. As noted earlier, the United States is a principal producer of tradeable services and, indeed, is a leading

exporter of services. At the same time, the United States also is a substantial importer of services.

The manifest interest of U.S. consumers of services in facilitating imports is not, with relatively rare exception, much at odds with the rules that govern provision of services in the United States, and liberalization of restraints on imports has not been a focus of U.S. trade policy. Although liberalization of U.S. restraints on services is not logically or legally dependent on reciprocal liberalization by other nations, practical and political forces may constrain the degree of unilateral liberalization notwithstanding the prospect of gains to the domestic economy from such action. For that among other reasons, U.S. policy respecting trade in services is focused primarily on securing access to export markets.

In this part of our paper, we review United States' law and policy respecting trade in services. We first review the United States concerns with and efforts to enhance exports' market access. Next, we outline the manner in which bilateral trade agreements to which the United States is a party have treated services. Finally, we explore the manner in which certain selected services are regulated in the United States and especially the implications of those regulations for trade into the United States.

### Response to Foreign Regulations and Barriers

#### Foreign Barriers

The United States Trade Representative (USTR) has catalogued extensively trade barriers that affect American companies. The generic list includes: denial of national treatment; denial of right of establishment; denial of cross-border access; denial of access to and use of domestic distribution systems; unfair practice by state-sanctioned monopoly; discriminatory professional qualifications requirements; lack of transparency, notification or due process, discriminatory government procurement practice; denial of adequate and effective intellectual property protection.<sup>76/</sup>

More particularized information respecting the sorts of barriers encountered in provision of services<sup>77/</sup> generally suggests that governmental regulations are used in large measure to inhibit trade where services are highly tradeable but consumers are relatively immobile. Regulations of many services appear targeted at protecting local enterprises that suffer some disadvantage in competition with international providers of the tradeable service.

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<sup>76/</sup> Transnational Data Report Trade Barriers Affecting Computer, Value-added and Information Services 28 (Oct. 1988).

<sup>77/</sup> See Feketekuty, *supra*. His description of barriers to trade in services is drawn from three sources: a survey of barriers to trade in services carried out in 1979 by the U.S. Chamber of Commerce in cooperation with the Office of the U.S. Trade Representative; two comprehensive surveys by Price Waterhouse of the problems encountered by U.S. services industries in selling abroad, performed in 1983 and 1985, respectively; and a report prepared by Peat, Marwick, and Mitchell for the Commission of the European Community in 1986. Feketekuty at 130-131.

The most common barriers to trade in services limit the establishment of local operations for sale of the services.<sup>78/</sup> Concentration of such barriers in banking and insurance services is particularly high.<sup>79/</sup> So far as banking is concerned, regulatory barriers might reflect government officials' desire for tools to help support monetary and fiscal policies. This does not, however, seem a complete explanation for much regulation of banking or for insurance regulation.

Such regulations may also serve the interests of incumbent businesses. Given the mobility of money and the relative immobility of those who would use investment and insurance services, at least apart from major commercial enterprises, regulatory constraints on local establishment appear designed largely to retard competition in such services.

Restraints on banking and insurance services are almost universally imposed, and it is difficult to determine how stable or suitable restraints on establishment of these services are for particular settings. Such regulations would seem least useful to nations with substantial amounts of international commercial activity, as such activity provides a

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<sup>78/</sup> Id. at 137.

<sup>79/</sup> Nearly forty nations indeed prohibit the establishment of foreign banking operations altogether. In addition, many more countries place severe restrictions on the form in which foreign banks may enter the domestic market, on the activities in which they may engage, or on their acquisition of ownership interests in domestic banks. Walter, supra, at 165.



means for the most important consumers of banking and insurance services to escape the regulatory system. At the same time, these countries also may be the very ones most likely to advantage a domestic service industry at relatively low cost; they well may have more ability to attract capital without establishment of foreign banks or insurance companies and may have skills (or information) required for provision of these services that are more nearly comparable to the excluded competitors' than can be found in more insulated economies.

For some services, such as construction, medicine, law, and architecture, the principal form of regulation is ostensibly intended to protect health and safety and does not appear targeted directly against international competitors any more than against potential local competitors. These services, including many common professional services, tend to have less mobile inputs as well as relatively immobile consumers. Not infrequently, there are complaints that general rules for health or safety -- applicable to anyone seeking to offer a given service -- are applied in a manner calculated to disadvantage foreign competitors.<sup>80/</sup>

For other services with little obvious basis for health or safety regulation but significant connection to particular locations, foreign exchange restrictions and limitations on the transfer of funds from the importing country to the home

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<sup>80/</sup> See, United States Trade Representative, 1989 National Trade Estimate.

country are the regulations of major concern.<sup>81/</sup> Among the services in this category are the tourism, motion picture, computer service, and car rental industries.<sup>82/</sup>

#### U.S. Law: § 301 and Friends

The principal vehicle for addressing particular foreign barriers to U.S. services exports has been Section 301 of the Tariff Act of 1930, a provision that, although inserted into the older statute, actually dates only from 19\_\_\_. Section 301 provides general authority for the United States Trade Representative to address any unfair trade practice by another nation. The section, as interpreted by USTR, covers "unfair" restrictions on export of services, as well as goods, from the United States. The scope of Section 301's actual coverage, however, is quite ambiguous, and the USTR mainly has used the Section as a basis for bargaining with other nations' trade ministries, usually in the absence of a formal declaration by USTR that a particular practice is unfair within 301's meaning but occasionally after such a formal finding.<sup>83/</sup> The least common resolution of a contemplated invocation of Section 301 is the imposition of unilateral trade sanctions by the United States following a formal decision under 301 and unsuccessful efforts at negotiation.

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<sup>81/</sup> Feketekuty at 138.

<sup>82/</sup> Feketekuty at 138-139.

<sup>83/</sup> [INSERT description of agreement with Japan re construction services]

As part of the revision of U.S. trade law under the Omnibus Trade and Competitiveness Act of 1988,<sup>84/</sup> several new provisions respecting trade in services were added. Some provisions simply require the collection of data on trade in services and to report certain data on services to Congress.<sup>85/</sup> Other provisions suggest more pointed inquiries.

One, for instance, directs the USTR to investigate Japanese "acts, policies, and practices" that impede U.S. export of architectural, construction, consulting, and engineering services.<sup>86/</sup> This investigation may provide a basis for further negotiations with or restrictions directed at Japan. Another provision mandates investigation of foreign practices that impede U.S. shipping services and, subject to some exceptions, directs the U.S. Federal Maritime Commission to take actions designed to "offset" such practices.<sup>87/</sup>

The most aggressive actions explicitly targeted at barriers to U.S. services exports are those required by provisions dealing with telecommunications services. In provisions (collectively known as "special 301") that cover both services and products, Congress instructed the President, and by delegation the USTR, to identify nations that inhibit

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<sup>84/</sup>

<sup>85/</sup> Omnibus Trade and Competitiveness Act of 1988, §§ 5408-5413.

<sup>86/</sup> *Id.* at §§ 1305.

<sup>87/</sup> *Id.* at § 10002.

telecommunications trade and to take actions necessary to secure U.S. firms' access to foreign telecommunications markets (including local telecommunications networks) on a nondiscriminatory basis.<sup>88/</sup> The special 301 provisions parallel the more general provisions known as "super 301" directing USTR to identify "priority countries" that impose significant barriers to U.S. exports, to report USTR's findings to Congress, and to take actions aimed at removing those barriers.<sup>89/</sup>

#### Trade Agreements and Negotiations

While much attention has focused on these efforts to open foreign markets to U.S. services exports and especially on the adoption of "action-forcing" legislation to prod administrators toward even greater efforts, the United States also has agreed to certain standards for bilateral treatment of services trade and has proposed an approach for multilateral adoption. The Free Trade Area Agreement between the United States and Canada contains a number of provisions respecting trade in services.

The basic undertaking by both actions provides for national treatment and nondiscriminatory regulation of a broad range of services.<sup>90/</sup> These include the general run of agricultural services (except veterinary services), architect-

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<sup>88/</sup> Id. at §§ 1375-1382.

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tural, construction, sales, advertising, forestry, mining,  
management, engineering, accounting, leasing, franchising,  
insurance, testing, repair, research, tourism, and some  
telecommunications services.91/

The agreement does not prescribe the elimination of  
licensing and certification requirements, nor does it prohibit  
all differential treatment of the other nation's services.  
Rather, it mandates that regulations and requirements be  
limited to assuring professional competence and protection of  
matters such as health and safety, that they be even-handed  
(so that, where regulations differ for domestic and foreign  
services, the regulations are "equivalent in effect"), and  
that the importing national both notify the exporting nation  
of any proposed difference in treatment and satisfy the  
exporting nation of the propriety of such treatment.92/

The U.S.-Canada FTA is instructive in several respects.  
For one, the agreement suggests only partial acceptance of the  
notion that a consistent set of rules can be worked out for  
the group of activities called services. The FTA accepts a  
generic approach to the principles that should govern these  
activities, but it excludes some services from coverage even  
in principle. The exclusions are particularly striking given  
the absence of a generic definition for services. The  
agreement lists on a line-of-business basis the service

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activities that are and are not covered, but nowhere defines what aspect of each activity constitutes the covered "service."

Further, even as to services that are within the general provisions of the agreement, the FTA indicates reservations about protecting services trade through generic principles; several "sectoral annexes" are included in the agreement, and more are contemplated.<sup>93/</sup> The sectoral annexes reveal considerable differences in the particular issues relevant to trade in those specific services. Financial services are covered by a wholly separate set of provisions, outside the general framework for services, and with quite modest agreement on actual liberalization.<sup>94/</sup>

The United States also has signed a Free Trade Area Agreement with Israel. Unlike the U.S.-Canada FTA, the U.S.-Israel agreement does not cover trade in services at all. That FTA Agreement states simply that the United States and Israel "recognize the importance of trade in services and the need to maintain an open system of services exports which would minimize restrictions on the flows of services between the nations."<sup>95/</sup> Having pronounced that platitude, the parties agreed "to develop means for cooperation on trade in

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<sup>93/</sup>

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<sup>95/</sup> Article 16 [Trade in Services], U.S.-Israel Free Trade Agreement.



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services pursuant to a Declaration to be made by the Parties."96/

The Declaration does not provide any real basis for assuring free trade in services, consisting mainly of relatively "soft" statements of principle. It states, for example, "Each Party will endeavor to achieve open market access for trade in services with the other nation, taking into account the different regulatory regimes for specific service sectors in the two nations<sup>97/</sup> and "Each Party will endeavor to assure that its regulatory agencies will accord national treatment to suppliers of the service from the other nation, to the extent that such treatment is consistent with those agencies' legal authority.<sup>98/</sup> Lest one fear that these general aspirations of openness will provide a basis for trade, the Declaration expressly states that these principles are non-binding.<sup>99/</sup> Perhaps the most significant aspects of the Declaration are the definition of services in line-of-business terms<sup>100/</sup> and of trade in services (tautologically) as the export of a service from one nation and import into the other.<sup>101/</sup>

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96/ Id.

97/ Declaration on Trade in Services, Principle 2.

98/ Id., Principle 5.

99/ Id., Preamble.

100/ Id., Principle 1.

101/ Id.

The United States has taken a less reticent stance with respect to services in multilateral negotiations. The U.S. has proposed expansion of the General Agreement on Tariffs and Trade to cover trade in services, broadly conceived, suggesting adoption of principles similar to those covering trade in goods. This approach has been resisted vigorously by some nations, almost entirely those that provide exportable services and substantially restrict imports of services. The compromise that appears to be emerging is movement toward a general principle of nondiscrimination, or at least reduced discrimination, except as necessary for specified types of domestic interests. Movement beyond this relatively spongy commitment seems to require negotiation over particular types of services. In the absence of the multilateral consensus, the near-term resolution may be agreement by the "club" of more developed nations to a set of reasonably detailed commitments that provide relatively free trade for a few services and considerably less fully liberalized trade for others.

#### Regulation of Services in the United States

The United States, with a quite open economy consisting almost entirely of privately owned and operated firms, puts relatively few hurdles in the way of international trade in services. There is, to be sure, considerable regulation of services in the United States, if not by world standards certainly in comparison to much U.S. economic activity. A

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recent survey of eleven service sectors in the United States  
by the U.S. International Trade Commission, however, found  
that instances in which such regulations posed a significant  
barrier to international trade in services were rare. That  
survey has not been released, and we will not attempt to  
recapitulate it here. Instead, this section briefly reviews  
regulations applicable to four service industries in the  
United States with special attention to constraints on  
international trade in such services. The four industries,  
which include those that are most restrictive of trade, offer  
insurance, banking, communications, and legal services.

#### Insurance

The US insurance market is not regulated by the federal  
government, but instead is regulated under the laws of the 50  
states and the District of Columbia. All states set condi-  
tions under which out-of-state insurers may be admitted to,  
and operate within, the state. And all states substantially  
constrain the business operations of enterprises authroized to  
offer insurance within the jurisdiction.

Regulation of insurers arguably can be justified as  
responding to public interests, serving as an efficient method  
of preventing fraud in markets that are not so readily policed  
by consumers as are markets for many goods. Although it is  
not clear that the regulations of the various states actually  
meet this test, certainly public interest considerations might  
support certain bonding requirements or other long-term

commitment of resources to guarantee satisfaction of the insurer's obligations. Most of the states' regulations of insurers deal with matters such as bonding and capitalization, imposing requirements that appear designed to protect consumers against default by the insurer.

The actual impact of these requirements on trade is less plainly benign. The consumers of many types of insurance appear to be relatively immobile while the inputs to insurance (principally money) are quite mobile. Even if formally even-handed, particular state requirements might be more onerous in respect of enterprises whose business principally lay outside the jurisdiction. Regulation by the various states, thus, might provide a vehicle for reducing competition within each state. This appears in fact to be at least in some measure the design of the state laws, which generally impose more stringent requirements on insurers incorporated outside the United States (alien firms) and in some instances on insurers incorporated in other states.<sup>102/</sup>

Many states require that an insurer's incorporators or directors reside within the state or be U.S. citizens. A few states require an insurer licensed within the state to hold in-state shareholder meetings. Most states require higher paid-in capital for alien insurers than for U.S. insurers, and most states also require alien insurers to maintain minimum

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<sup>102/</sup> U.S. General Accounting Office, "International Insurance Trade -- U.S. Market Open: Impact of Foreign Barriers Unknown," GAO/ID-82-39, (August 23, 1982) ("GAOI"), at 5.

paid-in capital and surplus funds in trust, deposited with officials of that state or of another state or with a bank or trust company.<sup>103/</sup> New York requires alien firms to maintain capital and surplus requirements in certain specified types of securities. California requires proof of successful operation before it will admit an alien branch. With some exceptions, an alien branch must show proof it has transacted business for three years in the classes of insurance for which it seeks admittance before a license can be granted.

States generally require alien branches to appoint a U.S. manager responsible for providing access to records and assuring compliance with reporting requirements. States also often provide less generous renewal terms for alien firms than for domestic insurers.<sup>104/</sup> New York limits the amount that may be repatriated from an alien insurer's New York operations without approval from the Superintendent of Insurance.<sup>105/</sup> Alien branches and foreign companies (firms organized in other U.S. States, whether under U.S. or non-U.S. ownership) were subject to additional taxes of 1 to 2.6% in New York and 2% in Illinois. In addition, the New York insurance law provides

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<sup>103/</sup> U.S. Department of Commerce, Report to the Congress, Foreign Direct Investment in the United States, Volume 7, Appendix K, Table 10, at K-230 (1976).

<sup>104/</sup> A license issued to an alien branch in New York is subject to renewal each year, while a domestic company's license, although subject to revocation, runs for an indefinite period.

<sup>105/</sup> Id.

for a fire department tax amounting to \$1.80 per \$100 of premiums written by alien branches and foreign companies licensed to cover fire insurance.<sup>106/</sup>

The various discriminatory state provisions probably do not affect all types of insurance similarly. While much commercial activity, and presumably the insurance for it, is mobile, for insurance bought by individual consumers-- insurance against damage to real property, individual life insurance, health insurance, or ordinary automobile insurance-- state regulation cannot be avoided by moving the locus of the insurance transaction. Even for the insurance clearly subject to particular state regulations, however, the discriminatory provisions do not clearly impose major handicaps on outsiders.

#### Banking

Banking is another heavily and diffusely regulated business. Banking activity in the United States is regulated at both the federal and state levels. Regulators at both levels have imposed a variety of constraints on banking. For example, states generally prohibit the establishment of branches in one state of banks chartered in another state, so that a New York bank, say, could not open a branch in New Jersey. Banks also are prohibited from engaging in a variety of activities, such as underwriting or securities brokerage.

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<sup>106/</sup> All of the foregoing information is taken from GAOI at 5-7. That report also presents an analysis of requirements that apply to foreign owned insurance companies in the four states they researched, reproduced here.

They are subject to minimum capitalization requirements and asset-to-loan ratio requirements. This list could be extended substantially.<sup>107/</sup>

The extensive regulation of banks arguably presents serious obstacles to efficient banking, but there are few restraints specially directed at non-U.S. banks. The International Banking Act of 1978<sup>108/</sup> established the policy of national treatment in banking in the United States. Under that Act, foreign banks operating in the United States are eligible for a federal charter and are subject to essentially the same regulations as other federally chartered banks.<sup>109/</sup>

Independent regulation by the states, however, is specifically preserved by the Act, and the states may choose to treat foreign and domestic banks differently.<sup>110/</sup> Federal laws permit the states to determine which out-of-state banks, including foreign banks, may establish banking offices within the state.<sup>111/</sup> About one-third of the states explicitly permit foreign banks to establish either branches or agencies

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<sup>107/</sup> See generally E. Symons & J. White, *Banking Law* (2d ed. 1984) (providing materials on an array of banking regulations).

<sup>108/</sup> 12 U.S.C. § 3101 *et seq.*

<sup>109/</sup> 12 U.S.C. § 3102(b).

<sup>110/</sup> See, e.g., 12 U.S.C. §§ 3103(a)(1)(A); 3103(a)(2), (3), (4), and (5).

<sup>111/</sup> For a dated but comprehensive description of the various state regulations applicable to foreign banks, see U.S. Department of Commerce, *Report to the Congress, Foreign Direct Investment in the United States*, Vol. 7, Appendix K, Table 9, p. K-204 (1976).



within their borders. Even states that do not, however, generally do permit foreign banks to own bank subsidiaries chartered either by the state or federal government.

There are a few differences between domestic and foreign banks. For instance, foreign banks are not always permitted to issue reinsurance standby letters of credit (RSLC).<sup>112/</sup> When a US insurance company reinsures through a foreign reinsurer, the obligation of the foreign reinsurer to the insurance company must be secured by collateral that is acceptable to the appropriate state insurance department, usually a standby letter of credit issued by a bank on behalf of the foreign reinsurer in favor of the US insurance company. Foreign banks had been prevented from being active in the market for RSLCs because many state insurance regulators adopted regulations that only Federal Reserve System member banks be permitted to issue or confirm RSLCs, in the belief that membership was an important indication of bank credit quality. US branches of foreign banks cannot become members of the Federal Reserve System, although foreign bank subsidiaries can qualify.

Another difference is the limited daylight overdraft capacity permitted foreign banks on the Fedwire, one of the electronic transfer systems allowing banks to clear their

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<sup>112/</sup> Reinsurance is acceptance by one insurer of all or part of the risk of loss of another insurer. With a standby letter of credit, a bank guarantees payment to a third party should the holder of the letter fail to meet his financial obligations or perform according to contract.

balances with other banks through balances held in Federal Reserve banks. U.S. banks' access to Fedwire overdraft capacity is based on their worldwide capital, but foreign banks' access is generally limited to five percent of their third-party liabilities in the United States unless their overdrafts are fully collateralized. Thus, a foreign bank would be allowed only a portion of the uncollateralized overdrafts on the Fedwire permitted a U.S. bank of equivalent size.

The Federal Reserve limits the uncollateralized daylight overdrafts that foreign banks may have on the Fedwire because of the risk that foreign institutions might be unable to meet their obligations for payment messages they have sent over the Fedwire. This is done for prudential reasons to protect the funds of the U.S. government. As the ultimate guarantor of all transactions made on the Fedwire, the Federal Reserve must cover all payments for institutions unable to do so and believed a different rule was necessary in order to limit its exposure respecting foreign banks.<sup>113/</sup> Again, this restriction only applies to branches of foreign banks and not to foreign subsidiaries chartered in the United States.

The federal regulation of banking, thus, generally presents no significant obstacles to foreign trade. The most

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<sup>113/</sup> U.S. General Accounting Office, "International Finance: Competitive Concerns of Foreign Financial Firms in Japan, the United Kingdom, and the United States," GAO/NSIAD-88-171 (June 1988) at 25.

substantial impediments to trade in banking services appear to be state laws that require creation of separately chartered bank subsidiaries. Such laws can impede achievement of some of the economies of scale possible with banking across jurisdictional lines. These laws, however, generally constrain U.S. banks as well as foreign banks; indeed, they may interfere more seriously with U.S. banks' operations, preventing achievement of economies of scale in their home operations where such economies may be more likely and more significant.<sup>114/</sup>

Given the tradeability of many banking services, we would expect serious interference with efficient banking operations to spur creation of non-regulated (or less regulated) alternatives. Casual empiricism suggests that this has happened in response to various banking regulations, such as limits on interest payments to depositors, limitations on interest charges to borrowers, and, increasingly, to restrictions on the other activities that can be engaged in by banks.<sup>115/</sup> There is every reason to expect this trend to continue.

#### Communications

Unlike most other nations, in the United States the communications industry is composed of privately owned

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<sup>114/</sup> See generally C. England & T. Huertas, eds., *The Financial Services Revolution: Policy Directions for the Future* (1988); Federal Reserve Bank of Chicago, *Proceedings: Conference on Bank Structure and Competition* (1985).

<sup>115/</sup> See, e.g., L. Bryan, *Breaking Up the Bank: Rethinking an Industry Under Siege* (1988).

businesses that operate in substantial measure free of governmental restriction. Further, in general the American communications industry is open to U.S. citizens and non-U.S. citizens alike. Apart from the limitations described below, foreign citizens or entities can, without restriction, own newspapers, magazines, cable television systems, or other communications enterprises and, to the same extent as U.S. nationals, use them as they see fit -- a considerable freedom given the constraints on governmental regulation of communications in the United States.

There is, however, substantial regulation of many electronic communications media, including direct restrictions on foreign operation of electronic mass communications media. U.S. law, for example, prohibits issuance of a radio or television broadcasting licence or a license as a communications common carrier to any non-U.S. citizen or to any entity that is controlled by a non-U.S. citizen, a prohibition that stops short of proscribing all foreign ownership of such enterprises.<sup>116/</sup> U.S. law also regulates the pricing and

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<sup>116/</sup> 47 U.S.C. § 310(a). Foreign ownership is defined to include "[a]ny corporation of which any officer or director is an alien or of which more than one-fifth of the capital stock is owned of record or voted by aliens or their representatives or by a foreign government or representative thereof, or by any corporation organized under the laws of a foreign country; or any corporation directly or indirectly controlled by another corporation of which any officer or more than one-fourth of the directors are aliens, or of which more than one-fourth of the stock is owned or voted by aliens, their representatives, or by a foreign government or its representative, or by any corporation organized under the laws of a foreign country . . ." *Id.*

related practices of enterprises offering telephone communications services.<sup>117/</sup>

Most regulation of electronic communications is by the federal government, and federal law narrowly circumscribes the permitted ambit of state regulation in this sector. State governments, with rare exception, may not regulate any aspect of broadcasting, but they may regulate some aspects of intrastate communications common carriage. A few states have used this authority to place limits on foreign participation in communications common carriage. One state (Alaska) explicitly makes foreign telephone and telegraph companies ineligible for intrastate operation, and five other states exclude companies not incorporated under their laws.<sup>118/</sup>

U.S. federal law also imposes limits on foreign participation in communications carriage via satellite. Although in general, so far as U.S. law is concerned, foreign communications operations can freely contract with U.S. communications carriers to provide for U.S. carriage of their communications, carriage of communications transmitted through the international communications satellite system, INTELSAT, is by law restricted to a monopoly enterprise, COMSAT.<sup>119/</sup> All members of the board of COMSAT must be U.S. citizens,<sup>120/</sup> and

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<sup>118/</sup> J. Aronson & P. Cowhey, *When Countries Talk*, at 33 (1988).

<sup>119/</sup> 47 U.S.C. §§ 701(c), 702(7).

<sup>120/</sup> 47 U.S.C. § 733(a).

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while non-U.S. citizens can hold stock in COMSAT, the amount  
of such holdings also is restricted by law.<sup>121/</sup>

The broadcast and common carriage restrictions appear to be products of somewhat different regulatory instincts. Foreign participation in ownership of broadcasting facilities has two arguable bases. The most obvious is that such ownership raises fears of external control of information, fears that support restrictions on communications around the globe.

In the United States, however, this instinctive aversion to free trade in information generally has not prevailed, and there is negligible or no government control over the content of material offered over communications media (including radio and television) and no restriction over the source of the communications. There is, for example, no restriction on the importation of foreign programs for broadcast in the United States or on importation of foreign broadcast channels for transmission over cable television channels.<sup>122/</sup> This is in marked contrast to other, even relatively open, countries. In Western Europe, for example, a Green Paper of the EC Commission proposes the requirement that each member country

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<sup>121/</sup> Not more than an aggregate of 20% of the shares of stock of the corporation held by parties other than "authorized carriers" may be held by non-U.S. citizens. 47 U.S.C. § 734(d).

<sup>122/</sup> While the United States does not have any import restrictions on foreign films (obscenity aside), the U.S. does permit the denial of duty free status to what are deemed political propaganda films.



transmit a minimum of 60 percent (recently modified to "a majority proportion) EC produced television programs. This document, despite its liberal-sounding title "Television Without Frontiers," aims externally at a required maximum quota on American media imports.

An alternative explanation for the one substantial restriction imposed on foreign participation in the U.S. mass communications media -- the limitation of broadcast ownership -- traces the restriction more to the nature of those licenses in the United States than to considerations involving international trade or to external control of information. The broadcast license is a government grant, without explicit charge, that can be used for highly remunerative private purposes (especially as the government has chosen an allocation scheme that does not maximize the number of signals receivable but instead compromises that goal with other goals such as "localism"). Under this view, the restraint on foreign ownership in U.S. law simply limits the immediate beneficiaries of this form of largesse.<sup>123/</sup>

Restrictions on common carriers do not fit either of the explanations for limitation of broadcast ownership. Common carriage restrictions instead appear designed to maintain various forms of cross-subsidy that are threatened by open entry. This certainly seems to be the case with COMSAT and

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<sup>123/</sup> Ultimately, however, this restriction may actually reduce the value of licenses because the holder cannot "sell" the license to the highest bidder, foreign or domestic.



also with state limitations on telephone company licensure. The major impediments to competition are the regulations of the terms of communications carriage and the rates that can be charged; these apply with equal force to all carriers. In both forms of communication, there seems little basis for belief that foreign enterprises would be the principal beneficiaries of more liberal regulatory regimes.

There are no restrictions on resale services by foreign firms, who thus can and do participate in the American long distance market. Nor are there are restrictions on foreign value-added or enhanced services offered in the US. This liberal attitude is not usually matched elsewhere. The US-Canadian free trade agreement, for example, excludes telecommunications services, presumably to protect the higher-priced Canadian communications carriers. In Canada, a leased high capacity line (so-called T-1 carrier) costs twice as much for the distance Toronto-Montreal than in the United States for a similar connection for the much longer distance from New York to Los Angeles. Similarly, restrictions on competition in communications common carriage in Europe have affected service quality as well as price. Thus, a 1988 study by the European Association of Information Services (EUSIDIC) reviewing over 5000 attempted data calls found that the European public data

networks had a completion failure rate of 25.4 percent, most of them due to network problems.<sup>124/</sup>

US firms also object to the burden, at this point more theoretical than real, of restrictions on the transborder transmission of data containing personal information. These rules, while often enacted with the laudable intent of protecting personal privacy, also establish the potential for protectionism in data processing and on-line data base provision. In the case of a country such as Brazil, they are openly used as part of an industrial strategy of reducing American services.

In the absence of an open international regime for value-added (VAN) services or even a commitment to such a regime by a large number of other countries, the United States has entered into bilateral agreements with a few countries, including many of the primary users of VAN services, such as Japan, the UK, and the Netherlands, permitting importation of VAN services. Much of the international VAN service is offered through collaborative arrangements. Under collaborative agreements with other national carriers, four U.S. carriers (AT&T, MCI, US Sprint, and International 800 Telecom) now offer so-called international 800 service, in which a user in a foreign country can make free calls to a US number. Such arrangements have the potential of expanding the reach of

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<sup>124/</sup> Gartner Group, *Strategies in Telecommunications Services* (Sept 9, 1988)

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American mail-order houses and other businesses that benefit from ready customer accessibility and are willing to pay for it. They provide one indication of the role greater liberalization in telecommunications service trade can play in expanding trade in other goods and services.

#### Legal Profession

The states alone regulate the admission to the state bars and the practice of law within each state. While it is common for nations to prohibit the practice of many professions by non-citizens,<sup>125/</sup> U.S. federal law prohibits the states from denying admission to the state bar to non-U.S. citizens.<sup>126/</sup> Nor can states require that applicants for admission to the bar be state residents.<sup>127/</sup>

States may, however, require that applicants for admission to the bar swear or affirm that they will support the Constitution of the United States and the United States' "form of government."<sup>128/</sup> Federal court decisions have construed

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<sup>125/</sup> In accounting, many nations have citizenship requirements that make it virtually impossible for a foreign accountant to practice. Some countries prohibit reciprocity for professionals of other nations under any circumstances. Similar restrictions frequently apply to legal services; they include limits on the licensing nonnationals, bars against association with local law firms, and the absence of reciprocity for foreign professionals. R. Shelp, *Beyond Industrialization*, at 102 (1981).

<sup>126/</sup> Application of Griffiths, 413 U.S. 717 (1973).

<sup>127/</sup> Supreme Court of New Hampshire v. Piper, 470 U.S. 274 (1985).

<sup>128/</sup> Law Students Civil Rights Research Council, Inc. v. Wadmond, 401 U.S. 154 (1971). Such oaths are acceptable "in light of appellees' construction that the Rule places no

the permissible scope of such "loyalty oaths" quite narrowly; in effect, the oath only binds a lawyer to act in accordance with the nation's most basic governing law, the Constitution, rather than to swear allegiance solely to the United States or to embrace the U.S. system of government in general.<sup>129/</sup> So construed, the oath requirement does not seem to pose any real impediment to non-citizens.<sup>130/</sup>

A more serious impediment might be the requirement adopted in many states that members of the bar have graduated from a law school approved by the American Bar Association. The ABA only approves American law schools, making this requirement tantamount to attending an American law school. Foreign citizens can be admitted to U.S. law schools on the same terms as U.S. citizens, and even in states that limit admission to those with degrees from ABA-approved schools foreign practitioners can become eligible for admission to the bar through special programs without pursuing the standard U.S. law school curriculum. Nonetheless, this restriction

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burden of proof on the applicant, that the 'form of government' refers solely to the Constitution, and that the oath's references to 'belief' and 'loyalty' mean no more than a willingness to take the constitutional oath and the ability to do so in good faith." *Id.* at 163.

<sup>129/</sup> Application of Griffiths, 413 U.S., at 726, nn. 16 & 18.

<sup>130/</sup> *Id.* at 726, n. 18.

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obviously presents an obstacle to admission to the bar in the  
United States.<sup>131/</sup>

We note, however, that admission to the bar is not likely to be a sine qua non of the sort of legal work for which efficiencies of international trade are implicated. Foreign firms can participate in providing advice and other legal services whenever they are the efficient providers of such services, subject only to the requirement that this be done in conjunction with a lawyer licensed in the relevant U.S. jurisdiction. Given the number of U.S. lawyers, the competitiveness of the U.S. legal profession, and the amount of money likely to be involved in cases of the sort for which foreign lawyers or firms are likely to enjoy advantages of specialized knowledge, it is almost certain that enough willing U.S. lawyers will be found not merely to allow the foreign lawyers' participation but to do so without extracting a significant tariff as the price of admission.

## VI. Conclusion

Devising international rules for trade in services presents political problems rather than economic issues. The economic aspects of trade in services differ little if at all from those of trade in goods. At the same time, there are

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<sup>131/</sup> U.S. medical licensure statutes do not contain a similar restriction. Although graduates of foreign medical schools must pass a different national licensing examination than graduates of domestic schools approved by the American Medical Association, the examinations are generally quite similar.

significant differences among services. They vary in both economic and political dimensions in the characteristics most important to assessing trade and regulatory effects.

So, too, analysis of trade in services cannot be divorced from the governing institutions through which political decisions are made. In this regard, it is important that while some groups gain from regulations that impose barriers to trade in any given service, others within the regulating country (as well as outside it) stand to lose; indeed, often, the costs of regulatory barriers will be concentrated within the regulating country. Regulatory effects do not divide up simply on the basis of national identity.

These factors together make it difficult to address trade in services issues generically. At least as much as for trade in goods, issues respecting trade in services will ineluctably be fragmented into separate discussions respecting particular services, if not even more specific contexts.

That does not mean that progress toward a general principle is either undesirable or infeasible. Even if the general principle does not provide a mechanism for eliding argument over particular impediments to trade in particular services, it serves a useful function in framing the terms of debate. A generic principle similar to that governing trade in goods, positing trade liberalization as the goal against which national actions should be measured appears as well suited to the loosely defined category of activities commonly

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referenced as services, whether or not that category is  
meaningfully distinguishable from goods. From our perspec-  
tive, movement toward liberalization of trade in services,  
although presenting a number of political difficulties, is  
plainly beneficial for the United States and for global  
economic development.