

## **FOR THE RECORD**

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### **Services Trade Liberalization as a Foundation of Global Recovery**

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Searching for growth in the aftermath of the 2008 financial crisis, governments, businesses, and academics often see exports and trade as central to a healthy recovery. But policy has struggled to respond, and the world's major negotiating forum – the WTO's Doha Round – has been stalemated for a decade. In these circumstances, the world needs an agenda uniting major economies willing to work together for their own benefit and for the common good. A determined effort to open services trade is an attractive option, holding potential to:

- Spark growth by helping exporters in the United States and elsewhere tap pent-up demand for information, innovative health and financial services, and promote investment in communications, physical infrastructure, and other high-employment, productivity-increasing parts of the economy;
- Bolster market confidence during a period of global economic weakness;
- Over the long term, promote employment through direct investment, support development as low-income farmers and entrepreneurs get easier access to customers and capital, and raise living standards by reducing transactional costs that raise prices for families.

This hope rests on simple facts about the global economy and the global trading system. Since the world's services sector is so big – responsible for 70 percent of world output, and employing a similar share of workers – a policy that helps services grow will be a good way to create growth and jobs in general. And since WTO rules today do less to guarantee predictability and open markets in services than in manufacturing, farming, or resource industry, opening services trade and investment can be a powerful way to help services grow.

This paper aims to help create the intellectual case for such an initiative, rather than to define a detailed agenda. But the outlines of a program for both mid-term recovery from crisis and long-term growth are not difficult to suggest in principle. By topic, it would address both traditional negotiating topics and emerging 21<sup>st</sup>-century issues related to the Internet and trade facilitation. By venue, it would rest upon a plurilateral agreement under Article V of the General Agreement on Trade in Services, but also extend to ongoing trade negotiations, for example in the Trans-Pacific Partnership talks, the Obama administration's initiative for the Middle East and North Africa, the Transatlantic Economic Council with the European Union, and other fora as well. In general it would set four goals:

- Open markets, or at minimum preserve existing level of openness to trade in services; refrain from introducing new discriminatory measures, including nationality or local content requirements; and address a 'negative list' of sectors, that is all services industries other than those participants specifically decide to exclude.
- Commit to provide transparent, impartial services regulatory regimes, including competitive neutrality in regulation of state-owned and state-supported enterprises.
- Seek open, non-discriminatory services investment climates with no restrictions on foreign equity, juridical form or number of service suppliers;
- Create strong rules to ease the flow of services and data across borders.

To make this case, this paper draws on new research examining American services industries, but illuminating opportunities common to many countries. It addresses the following topics: The scale of services as employers, producers, and exporters; the tradeability of services and the nature of cross-border services trade; the implications of foreign direct investment in services; and the barriers to services trade and options for addressing them.

## **I: SERVICES IN THE GLOBAL ECONOMY**

(1) *Scale:* First, services are a powerful opportunity for growth and job creation because they are so big. They account for most of the world economy, and they employ most of the world's workers. They are also a powerful indirect way to promote healthy manufacturing, resource, and agricultural industries, because any complex goods-producing industry needs an efficient services sector to succeed.

- *Services make up most of the world economy:* The World Bank's annual *World Development Indicators* survey reports that services account for 70 percent of world GDP, up from 59 percent in 1990, and 64 percent in the millennial year 2000. <sup>1</sup> This is true for the United States as well as the world at large. American private-sector services output was \$9.95 trillion in 2010 – 80

percent of America's private-sector GDP,<sup>2</sup> and fully 16 percent of world economic output.<sup>3</sup> Figures differ only by degree between rich, middle-income, and poor countries – services are smaller shares of developing economies, but above 60 percent of economic output for the developing world as a whole and rarely below 50 percent for any individual country.

- *Services are the world's main employers and create most new jobs:* Of the world's 3.2 billion-strong labor force, about 60 percent of men and 70 percent of women work in services. Services industries employ 95 million of America's 110 million private-sector workers – again about 80 percent of the total, and more than 75 percent of workers in every Congressional district<sup>4</sup> - in jobs at all levels, from teenagers taking their first jobs in hotels and restaurants, to skilled blue-collar workers in logistics and telecommunications, to professional work in engineering, the professions, finance, and science. And as we will see below, at least in the United States exporting services industries employ more people than work in factories, farms, and mines combined.

(2) *Complementarities with industry:* Second, efficient services industries are essential to efficient goods production.

- *Services help produce advanced consumer goods:* The 1958 essay “*I, Pencil: My Family Tree*,” hoping to educate the public on the complexity of global manufacturing, defined a first-grader's pencil as a combination of graphite from Sri Lanka, rapeseed oil from Java, cedar wood from Oregon, and pumice from Italy, all processed in a California factory – and brought together by a sophisticated shipping and logistical industry; shaped by machines designed by researchers and engineers to shape wood, insert molten graphite, and shape a device easily used by the fingers; and kept stable by the financial services and telecommunications that provide credit and coordinate delivery.

Important to manufacturing then, services are all the more so today. The global economy of Eisenhower's age, complicated as it may have been, was a world of one container ship able to carry 58 standard shipping containers, five satellites, and a single copper transatlantic telephone cable able to carry 36 telephone calls simultaneously. The modern world is linked by 5,000 communications satellites, fiber-optic cables to every continent, thousands of daily air-cargo flights, and a shipping industry moving 14 million containers every day. And the 6-year-old of 1958, drawing with a pencil on paper, is the technophile Baby Boomer of today. Her tablet computer is a small, apparently solid device – but actually a combination of extraordinarily complex software and parts fitted precisely together.

To produce such a thing requires a services system as far beyond that of her childhood as a tablet is beyond a pencil. The device is a symbiosis of American engineering, software and design, Taiwanese manufacturing

- technique, Chinese assembly – and a logistical network involving trucking, air cargo and sea freight, coordinated by computer to deliver of millions of tiny parts at precise times each day, pick up completed goods from factories, convey them to ports and container ships in time to meet inventory schedules set by retailers worldwide, monitor production and delivery through ‘cloud’ computing, and coordinate credit and payment across a value chain using hundreds of firms.
- *Services bring the world high-quality food:* Modern agriculture likewise requires a sophisticated system of services. With an efficient logistics network - air and sea transport, computerized deliveries, cold-storage chains linking farms, ports, and buyers – American wheat and pork arrive daily in China for noodles and soups, Colombian flowers reach Chicago florist shops for Valentine’s Day, and Norwegian smoked salmon appears in Bangkok hotels. Without competitive logistical services, a third of India’s fruit and vegetable crop – for example, 10 million of 26 million tons of bananas –spoils between farm and market. This means lost income for hundreds of millions of Indian farm families, coupled with high food prices for India’s urban poor, who spend pay 49 percent of their income on food.<sup>5</sup>
- (3) *Services help raise living standards:* And just as closed services markets and monopolies often mean lower incomes and higher costs of living, the capacity to tap information flows, capital, and logistics are powerful ways to improve life for the poor and the middle class.
- *Services promote development:* Fishermen and farmers in poor countries and small island states use PDAs (personal digital assistants) to tap the Internet to track the weather and fishing stocks to avoid delays in marketing their goods, take out insurance policies on boats and small equipment purchases, or find micro-credit from on-line charities. Families in rural areas and urban slums, with a cell phone and a subscription, can maintain constant contacts with clinics when a child or elderly relative is sick and requires monitoring over time, or alert caregivers to an accident. In these circumstances, market opening often brings rapid and large scale results; one consequence of Indian liberalization in insurance, for example, is that 42 million Indians have taken private life insurance policies since the sector opened in 2000. Governments too use sophisticated services to improve public services while reducing cost; Brasilia’s capital police force, for example, uses cloud computing to create an ‘electronic police station’ that allows the public to instantly report accidents and crimes, with the information routed immediately to police on duty.<sup>6</sup>
  - *Services help middle-class families and shoppers:* For middle-class families in rich and poor countries alike, cloud computing, express-delivery firms, and technical innovation all unite to stretch family budgets an improve peoples’ lives. On-line auctions and stores enable individuals and families to compare

prices not only in local stores but also world-wide, find in minutes precisely the gift or necessity they need, and have it delivered to their home.

## II. "TRADEABILITY" OF SERVICES AND CROSS-BORDER TRADE

Services are big; services are important; services have value for the poor and the middle class. How do services *trade* and services trade *policy* help them grow? Services trade in fact has great potential to drive growth – both through exports and through the release of pent-up domestic demand – and services trade policy has great potential to increase trade.

### A. Many Services are Highly "Tradeable"

Many assume that services industries are not natural exporters. This is normal, since many of the services businesses one meets in daily life don't export. While a few restaurants, construction companies, hospitals, retail stores, and private schools are large enough to operate on global scales, most such businesses will always be local, relying on a small base of personally familiar customers. But many of these businesses can export as a secondary matter. A university can use on-line courses to teach students through distance education, while a hospital can offer radiological readings and monitor prescription use via telemedicine. And industries such as entertainment, financial services, computer and data services, and many others are as natural exporters as are car factories and wineries.

A rigorous look at services trade, done in 2011 by Dr. Bradford Jensen of Georgetown University explains in detail. Jensen's *Global Trade in Services: Fear, Facts, and Offshoring* defines and categorizes easily exported services in a strikingly original way, using a relative concept of "tradability" by looking at services which, within the United States, are bought throughout the country but produced in great quantities in a few places. If services are often bought in places where they are not made, they can also be sold across borders and are natural exporters.

By way of physical-goods analogy, clothes are worn and bricks used everywhere in the world, but clothes are highly tradeable and bricks less so. China and Vietnam make clothes in larger quantities than they need; Danes and Australians wear lots of clothes but make few. The production and use patterns show that clothes are highly tradable, and suggest (correctly) that Danes and Australians often wear clothes made in China and Vietnam. But bricks – in the United States as in Bangladesh, Paraguay and elsewhere – are usually made close to sites at which they will be used, as bricks are heavy, cheap, and relatively costly to ship over distances. The United States imports only 1 percent of the bricks it uses, and exports only 2 percent of the bricks it makes.<sup>7</sup>

Services are no different in principle, even if their output is weightless. Beauty services, produced everywhere and used at the point of production, are difficult to trade. Movies and news programs, often filmed in Los Angeles and New York, are

viewed nationwide in digital and broadcast form and are easy to export, assuming an open world market and a sophisticated telecommunications system.

Jensen identifies 27 especially easily traded services industries, with 6 receiving ratings of “3,” meaning most easily exported. These are movies, music, software, “other information services” (dominated by Internet service providers), high-level financial services such as securities trading and mutual fund management, scientific research and development. Another 21 industries receive a “2” rating, meaning moderately tradable. These include insurance, architecture, independent artists, advertising, telecommunications, and many others. Altogether, Jensen finds that these industries employ 18.4 million Americans, about 3 million more than work in manufacturing, agriculture, and resource industries combined.

**TABLE 1 SOME HIGHLY TRADEABLE SERVICES INDUSTRIES**

<b>Industry</b>	<b>Production Centers</b>
<i>Software:</i>	Production concentrated in Seattle, Boston, San Francisco/Silicon Valley, Raleigh-Durham
<i>Internet Services Providers:</i>	San Francisco/Silicon Valley
<i>Financial Services:</i>	New York, Boston
<i>Motion pictures:</i>	Los Angeles
<i>Call centers, travel booking:</i>	North Dakota, South Dakota

*Jensen, Global Trade in Services: Fear, Facts, and Offshoring, Peterson Institute for International Economics, 2011, pg. 45.*

These tradeable services industries, incidentally, turn out to be very good places to work: they are large employers, pay well, offer safe places to work, and weathered the financial crisis better than most businesses. They pay their workers an average annual salary of \$66,540, which is about 20 percent above the \$53,000 national private-sector average.<sup>8</sup> They suffer less than half the rate of on-the-job illnesses and accidents than America’s economy-wide average.<sup>9</sup> And their record as job-creators – especially the six industries rated “3” – has been strikingly good during a difficult period for the U.S. economy.

**TABLE 2 TRADEABLE SERVICES INDUSTRIES AND U.S. EMPLOYMENT, 2007-2012**

Industry	Jan. 2007	Jan. 2012	Change
All private-sector	115.0 million	109.9 million	-5.1 million / -4.5%
“2” services industries	13.66 million	13.24 million	-0.42 million / -3.0%
“3” services industries	2.11 million	2.18 million	+70,000 / +3.3%
Software publishing	248,000	270,000	+22,000
Securities/commodity trading	837,000	802,000	-35,000
Scientific R&D	528,000	573,000	+45,000
Movies & sound recording	378,000	371,000	-7,000
“Other information services”	120,000	165,000	+45,000
All other industries	99.2 million	94.5 million	-4.7 million / -4.7%

## ii. Services Exports are Growing

Many services industries therefore are highly tradeable in principle. The rapid development of global telecommunications and the Internet is making them steadily more so. Each year, services trade via the Internet grows cheaper and easier, as communications technology, the Internet, and cloud computing systems all improve and the global on-line public – the equivalent of the world market for digitally transferred information – grows larger.

The international phone call, in essence a small cross-border transfer of data, provides a simple and convenient measurement. Since the year 2000 – a rough date for replacement of the old copper-cable network by modern fiber-optics – the cost of an international phone call from the United States has dropped from 50 cents to a dime per minute, or by 80 percent.<sup>10</sup> As capacity has grown and prices fallen, the world's on-line public has grown from 300 million to over 2 billion, and information flows have grown at rates said by academic studies to be at 20 to 30 percent per year. These are the digitized versions of the images and sound that make up news and entertainment, payment of insurance claims and premiums, and the e-commerce orders between manufacturers or between shoppers and retailers.

The results are anecdotally obvious in industry and daily life alike. *iTunes* downloads, diagnoses delivered via telemedicine, news alerts arriving at computer terminals or TV screens, architectural blueprints bought by real-estate developers in Dubai and Shenzhen, pension accounts managed by New York financial industries, are all examples. How significant are they? Systematic data from the U.S. Department of Commerce and the World Trade Organization, published for the U.S. since 1986 and the world since 1999, suggest two points of reference.

(1) *Services exports are growing.* For the United States, cross-border exports of business services have risen by about \$200 billion, or from 8 percent of total exports in 2000 to 12.5 percent in 2010. For the world, growth as a share of world output has been only slightly slower, with business-service exports rising from 8.3 percent of the global total to 10.9%. The United States, as the largest exporter of business services, has had the most growth in absolute terms. But American export growth has been essentially average for the world, and export totals for many developing countries have grown even faster. India receives the most publicity but services exports from the Philippines, Morocco, Kenya, Georgia, Panama, and others have grown almost as rapidly as India's.

**TABLE 3 U.S. Services Trade Growth 1990-2010**

	1990	2000	2005	2010
US GDP	\$5,800	\$9,950	\$12,625	\$14,525
Total Exports	\$535	\$1,075	\$1,285	\$1,835
Services Exports	\$148	\$281	\$363	\$530
Transport	\$43	\$46	\$53	\$70
"Business services"	\$42	\$80	\$140	\$230
"Business services" export share	8%	8%	11%	12.5%

Source: Bureau of Economic Analysis, at [http://www.bea.gov/international/international\\_services.htm](http://www.bea.gov/international/international_services.htm)

**TABLE 3a World Commercial Services Trade Growth 2000-2010**

	2000	2005	2010	Growth 00/10
World GDP	\$32,216	\$45,525	\$62,911	95%
Total Exports	\$7,669	\$12,655	\$18,045	135%
Services Exports	\$1,483	\$2,496	\$3,695	150%
"Business services"	\$640	\$1,160	\$1,968	210%
India	\$16	\$52	\$123	670%
Georgia	\$0.2	\$0.6	\$1.5	650%
Morocco	\$3	\$7	\$12	300%
Philippines	\$3	\$5	\$13	330%
Panama	\$2	\$3	\$6	200%
Kenya	\$1	\$1.5	\$3	200%
United States	\$80	\$140	\$230	190%
Thailand	\$13	\$20	\$34	160%
Costa Rica	\$1.9	\$2.6	\$4.4	130%
South Africa	\$5	\$11	\$14	130%
United Kingdom	\$119	\$204	\$227	110%
Jamaica	\$2.0	\$2.3	\$2.7	35%
"Business services" export share	8.3%	9.2%	10.9%	

Source: World Trade Organization, trade statistics reports for 2001, 2006, and 2011.

(2) *But services exports are low:* Big as these numbers seem, though, they are smaller than they ought to be. America's \$530 billion in services exports is a large figure – more than the combined total of 2<sup>nd</sup>-ranked Germany and 3<sup>rd</sup>-ranked Britain – but it is less than 3 percent of America's \$16 trillion in gross services output. The \$230 billion in exports of finance and insurance, information, business, professional, and technical services is only slightly higher, a bit above 3 percent of the \$6 trillion in gross business-service output. By contrast, manufacturing exports run at 18 percent of gross output for America, and agriculture's figure is close to 30 percent. Global breakdowns by industry-sector are not so fine and less easily tracked by gross output, but appear similar.

**TABLE 4 U.S. Output and Exports: Services, Manufacturing, and Agriculture**

Sector	Gross Output, 2010	Exports 2010	Export Share of Output
U.S. Private-Sector:	\$25.81 trillion	\$1.820 trillion	7.0%
Agriculture/fishing	\$0.37 trillion	\$105 billion	28.0%
Manufacturing	\$4.83 trillion	\$885 billion	18.0%
Services total	\$16.37 trillion	\$530 billion	3.2%
Business Services	\$6.13 trillion	\$230 billion	3.8%
Resources	\$4.24 trillion	\$42 billion	1.0%

\* Bureau of Economic Analysis for Gross Output by Industry and for services exports; Census for agricultural, manufacturing, and resource trade data. Note that "Gross Output" is not a value-added measure, but the output by value of each part of a sector. Thus it is larger than GDP.

**TABLE 4a**                      **World Output and Exports: Services, Manufacturing, and Agriculture**

<b>Sector</b>	<b>GDP 2010</b>	<b>Exports 2010</b>	<b>Export Ratio</b>
World GDP	\$74.4 trillion	\$18.05 trillion	24%
Manufacturing	\$15.6 trillion	\$9.96 trillion	64%
Agriculture	\$2.2 trillion	\$1.36 trillion	61%
Services	<i>\$52.1 trillion</i>	<i>\$3.70 trillion</i>	<i>7.0%</i>

*\* WTO Annual Trade Statistics Report 2011 for exports; IMF World Economic Outlook database, September 2011, for GDP; World Bank World Development Indicators 2011 for the sectoral shares of services, agriculture, and manufacturing in world GDP.*

Thus services exports remain far below their potential. Jensen estimates that if the tradeable services industries exported in proportion to this potential, U.S. services exports could be about \$860 billion above their current level – that is, roughly \$1.4 trillion, rather than the \$530 billion recorded for 2010. Employment-to-output ratios suggest that this would likely mean a net addition of about three million more jobs. A similar calculation for the world as a whole yields a figure of \$15 trillion in exports – roughly a quarter of current world economic output, and a massive stimulus for employment in Europe, India, high-income Asia, the Philippines, the Caribbean, and many other parts of the world.

### **III. SERVICES AS CROSS-BORDER INVESTORS**

This potential for growth in cross-border exports is intimately linked to cross-border services investment, and a successful services initiative will need to address both.

#### **i. Scale of Cross-Border Services Investment**

The large role of services in cross-border investment is again familiar from daily life – and perhaps more so than cross-border services trade. An American household may choose to subscribe to a French cable channel, and an American company may arrange a relationship with Taiwanese researchers – but either requires an act of will and a conscious choice. Contact with foreign services investors, by contrast, often proceeds entirely unnoticed – as Americans deposit paychecks in British-owned banks, buy groceries from Australian-owned shopping malls, and place calls via Scandinavian telecommunications networks. American services investment abroad is similar, ranging from the American Hospital of Dubai’s specialist care in the United Arab Emirates, to management courses at the Johns Hopkins University Nanjing campus and lingerie sales at the Victoria’s Secret shops in Toronto’s Eaton Mall and Yorkdale Shopping Centre.

Again more systematic figures back up impressions from daily life. The basic data here are from the Commerce Department’s Bureau of Economic Analysis for the United States, and from UNCTAD for the globe. UNCTAD’s figures find world services direct investment stock at \$11.3 trillion in 2010, or nearly two-thirds of the world’s \$18 trillion in total FDI stock, as against \$4.6 trillion in manufacturing and



Equally interesting, services investments seem to have a good effect for employment in the investing country as well as the host. Some of this is natural, as new services industries often create many associated jobs. The development of on-line auction sites, for example, has spurred growth and employment in the express-delivery firms which bring the items one purchases on line to the home.

An August, 2011, working paper by the International Trade Commission staff suggests that FDI-based services sales have another effect – that is, they can be net creators of employment at home as well as abroad, because overseas investment projects are bases for large exports of services *from* parent companies *to* foreign subsidiaries.

How does one account for this positive association between increased affiliate activity and domestic employment in U.S. multinational service firms? Intrafirm exports appear to be a key part of the answer. Such exports are conduits for the transfer of intellectual property and business services that support day-to-day operations and production of the final services sold to affiliates' local consumers. U.S. parent firms' exports of services to foreign affiliates totaled \$109.1 billion in 2009, or 22.5 percent of total cross-border service exports. The majority of these exports were in the form of intangible intellectual property. Management and consulting services; research, development, and testing services; and financial services were other large sources of intrafirm export earnings.<sup>15</sup>

These exports are diverse, ranging from copyright and patent royalty payments from foreign subsidiary to home company, to revenue from management and consulting, research and development, financial services and so on. The total includes \$7 billion in telecommunications, or nearly half of total telecom services exports; \$9.3 billion in exports of research and development, more than a third of the \$21 billion total; and similar fractions for advertising, management, computer services, and other industries. These exports amount to nearly a quarter of American services exports. In other words, foreign subsidiaries are some of the main buyers of the cross-border services exports discussed above.

This makes them a stabilizing factor during periods of low demand and recession at home, as services exports remain strong. In good times, they are significant net job creators. During the period of the ITC working paper, overseas services investment implied a net increase in U.S. employment of 697,000 jobs across fourteen services sectors employing about 64 million Americans at home. Thus, if the ITC's computer model is reasonably close, their operations abroad meant a net employment gain of 1 percent at home. This seems credible placed against real-world performance – BEA reports that services businesses with overseas operations added a net of 1.4 million jobs in the United States between 1999 and 2009,<sup>16</sup> rising from 14.5 million workers to 15.9 million workers, as employment elsewhere in the private sector fell from 98 million to 96 million, or by about 2.5 percent. The comparison suggests that export earnings from successful foreign operations help to stabilize employment at American services providers during a period of slow growth.

Beyond the ITC's report, many overseas services subsidiaries are also large importers of goods. Health, telecommunications, and retailing are all examples. American retailers like Wal-Mart and Limited Brands – or European chains like Tesco and Carrefour – operate in dozens of countries, using established and trusted suppliers of consumer goods, medicines, and foods in the United States as well as local sources. Likewise U.S.-based hospitals have strong relationships with American manufacturers of medical devices, medical furniture, pharmaceuticals, and likely to use them for their foreign operations.

A final striking example comes from architecture and building. Specialized New York and Chicago architectural firms design most of the world's ultra-tall skyscrapers, such as Shanghai World Financial Center, Taipei 101, Burj Khalifa in the United Arab Emirates, and Freedom Tower in New York. These firms have designed 25 of the 37 ultra-tall skyscrapers opening around the world between 2008 and 2015.<sup>17</sup> Their long-standing relationships with U.S.-based suppliers of glass, hydraulics, and specialized building materials boost exports of these goods during construction and afterwards in maintenance.

### **iii. Market Barriers and Pent-up Demand**

But the very low level of cross-border services investments in lower-income countries suggests that as large as it may appear, global services investment is much lower than it could be. Here we find one of the world's major growth opportunities: a vast pent-up demand for sophisticated services, which in an opening world could simultaneously contribute to global growth and improve lives within developing countries. Three examples:

- *India* imposes across-the-board foreign equity limits on telecom service provision and bans investment in retailing and many transport sectors. Such policies have direct links to the rural poverty and food spoilage noted earlier. Poorer telecom quality means low-income and rural people cannot cheaply get information about daily-life needs – from weather reports to on-line conversations with hospitals. Limits on insurance trade likewise mean few farms, homes, and small businesses in developing countries are insured against floods or other natural disasters, which not only raises risks but limits entrepreneurialism and business formation. And of course the lack of sophisticated retailing and transport services industries, with their knowledge of supply-chain management and cold-storage transport of foods, is the main reason India suffers the high spoilage of food – and consequently the unnecessarily low rural incomes and high urban food costs referenced earlier.<sup>18</sup>
- *Ethiopia* bans foreign direct investment in micro-credit, a form of financial services directly designed to help the poor in urban slums and rural districts.<sup>19</sup>

- *Egypt* limits foreign equity in construction and transport, meanwhile, are deterrents to investment in a labor-intensive sector, in a country where high unemployment and weak job creation helped to prompt a revolution in 2011.

These blockages are comprehensible in political terms as the result of conflicts of interest between relatively small, focused monopoly industries serving as pressure groups on one hand, and the much larger but less focused interests of low-income farmers, consumers, and small entrepreneurs on the other. But in practice they are powerful ways to frustrate demand for investment in critical sectors, and to reduce flows of capital to people and businesses which could use them well.

#### **IV: THE INADEQUATE SERVICES TRADE REGIME**

To recapitulate: services are the global economy's largest sector and the largest employer. They are essential to the health of modern agriculture and the modern manufacturing value chain. The development of information and communications technology has reduced the cost of exporting services. And the pent-up demand for services of all types can be a principal driver of growth, not only in the United States but worldwide, for decades to come. And with services trade and services investment alike smaller than they should be, we come to policy.

Services trade agreements are no longer new and unfamiliar subjects for the world's trade negotiators. To briefly recap, negotiators have been working on services trade since the 1980s, and have some notable achievements:

- The WTO's General Agreement on Trade in Services (GATS) of 1994, which created definitions and sets out a rules framework somewhat like the GATT agreement of 1947 did for goods, with some limited success in liberalization;
- The WTO's agreements on Financial Services and Basic Telecommunications, respectively dating to 1997 and 1998;
- A 'moratorium' on application of tariffs to electronic transmissions over networks including the Internet, first agreed upon in 1998 and extended continuously since then.
- 15 agreements on WTO accession since the conclusion of these two agreements. These often (and unlike the GATS commitments of existing members) have stronger and more detailed provisions on services market access, and cover a series of significant trading economies – including China, Taiwan, Saudi Arabia, Vietnam, and Russia – which together cover about 8 percent of U.S. services trade and about 12 percent of world services imports.<sup>20</sup>
- And separately, the 17 FTA relationships the U.S. has developed over the past decade, which generally contain detailed services-trade chapters, create

obligations on a 'negative list' basis that include the whole of the services sector, and apply to about 10 percent of U.S. services trade.

These accomplishments provide an important base of rules and obligations. But they remain modest and flimsy in comparison to agreements covering trade in goods – and are growing weaker, as the rapid development of the Internet and cloud computing creates new forms of trade. WTO agreements have done less to reduce barriers to trade in services – whether border barriers or investment – than for manufactured goods or agriculture. Thus large economies often retain quite closed markets. Many economies have missed opportunities to ease access to information, improve local and international marketing of farm products and manufactured goods. And with the advance of technology, as services trade depends on reliable and predictable data flows, data storage, and data transfer, a set of agreements dating to the mid-1990s look antiquated.

### **i. High and Persistent Market Barriers**

Aaditya Mattoo, Ingo Borchert and Batshur Gotiiz of the World Bank have made a remarkable attempt to categorize services trade barriers and compare their severity across countries. Looking at the information available for five sectors - financial services, telecommunications, transport, retailing, and professional services such as medicine, architecture, and engineering – and examining barriers to entry, operations within a country, and the regulatory environment, they rate 103 countries on a scale from 0 to 100 of 'openness' to services, with 'zero' entirely open and 100 fully closed.

By subject area, the three authors find formal barriers most common with respect to direct investment. These range from full bans on investment, to limits based on equity caps – that is, legal limits on foreign owners to (say) 49 percent of a business – or numerical and geographical limits, which would mean a service can operate only 10 branches or in only 3 of 20 cities. Fewer formal barriers exist to block *cross-border* flows of services – but on the other hand, few countries have accepted trade obligations in the field, meaning restrictions can be applied quickly and predictability is absent.

By country type, the three find rich countries very open to trade and investment in finance, telecom, transport, and retailing, but often retaining relatively high barriers in professional services. Latin American services-trade policy is often comparable to rich-world policy (though some individual countries remain quite closed) except in telecommunications and financial services. East Asia and Africa are less open in general, and especially limited in telecommunications, while South Asia and the Middle East are most closed. By country, some samples:

- 0-20 – The most open countries (and many of the highest-income countries) have scores in this range. This range includes United States, Japan, Great Britain and New Zealand, all with scores around 20. Interestingly, these are

- still viewed as more ‘closed’ than Trinidad and Ecuador, likely because of professional standards-setting and limits on temporary migration.
- *20-40* – Relatively closed countries include several European states, in particular France and Italy, as well as Mexico, Russia, Korea, and a number of sub-Saharan African countries such as Uganda, Mozambique, and Lesotho.
  - *40-50*: More extensively closed economies include Egypt, China, and some major Persian Gulf economies such as Kuwait and Saudi Arabia.
  - *50 and above* – These are extensively closed markets, and include several more Gulf economies, and two large ASEAN states. (The Philippines and Indonesia). Five countries score above 60, implying that they are the world’s most closed services markets at least among the 103 surveyed countries: Ethiopia, India, Iran, Qatar, and Zimbabwe.

Services trade negotiations, so far, have made little impact on these barriers. The 1994 GATS agreement largely defined industries and modes of transmission across borders. The two agreements on Financial Services and Basic Telecom created ‘floors’ beneath which market access would not fall, more often than they actually opened markets. The same has been true for most WTO accession agreements since, though the networks of obligations these created for new members covered more industries. And the WTO’s Doha Round talks, over ten years, offered strikingly little in the way of changing this landscape. The Bank’s Aaditya Mattoo and Bernard Hoekman comment:

“As they stand today, Doha offers on services do not offer any liberalization of actual policy. Furthermore, two of the currently most protected areas in both industrial and developing countries, transport and professional services, are either not being negotiated at all or not with any degree of seriousness.”<sup>21</sup>

Beyond this, the prominence of state-owned and state-supported enterprises in a number of emerging-market economies – that is, businesses owned or supported by governments, but acting as actors in private-sector markets rather than purely as providers of public services – raises newer questions which earlier agreements addressed only in passing, from regulatory favoritism to procurement and intellectual property protection.

## **ii. Absence of Rules to Protect Flows of Information**

Thus the world services market remains relatively closed, with investment in poor countries depressed well below a ‘natural’ level and cross-border exports far less than they could be. And perhaps even more troubling than this is a widening gap in trade rules – the lack of protection for digital flows of information – which leaves the future of cross-border services trade highly uncertain.

Cross-border exports of business services, under formal definitions, proceed through several different “modes” – visits by individual businessmen and -women, mailed agreements and documents, and so on. But though formal data are lacking, it is likely that most cross-border services transactions – and very likely almost all growth in cross-border trade – reflects the transfers of information in digital form over the Internet. This is how most news, music, and audiovisual services reach buyers, how most financial transactions proceed, and how manufacturers and logistics industries coordinate production and delivery schedules for complex value chains. But though technology has made digital trade a large part of daily life, trade rules have not caught up.

Ideally, the WTO would have a binding agreement on data flows mirroring in virtual form the GATT agreement rules for tangible goods – that is, barring arbitrary blockages of data or requirements of “forced localization” of data within countries; creating exceptions to ensure the right to regulate in the public interest, whether for public safety, privacy, national concepts of public morals, or national security; and ensuring that these exceptions are invoked for good-faith regulatory policies which are non-discriminatory and apply to locally and internationally based information alike.

But very few such guidelines exist. No WTO agreement – and in fact no free trade agreement but the US-Korea FTA – has rules to help make data transfer policy as stable and predictable as goods flows. The only applicable multilateral rule is the temporary (though regularly renewed) 1998 WTO Ministerial Declaration on global electronic commerce, which stipulates that electronic transmissions should not be subject to tariffs.<sup>22</sup>

This leaves movements of data far more vulnerable than movements of tangible goods, whether to arbitrary blocks on cross-border flows to investment-forcing policies that require businesses to locate servers and data within borders. Kazakhstan has experimented with such regulations for Internet search engines, Russia with requirements that all credit-card transactions be processed within the Russian Federation. These raise questions about both privacy rights and due process about information relating to individuals, and practical issues about loss of efficiency and added costs in supply-chain management and financial transactions.

Information flows therefore have a basic lack of security and predictability; and though the Internet is quite new and Internet-based trade is developing rapidly, in the absence of a commitment to free flows of information, trade of this sort is likely to be much smaller and less powerful a driver of growth and innovation than it should be – not just in this decade as the world looks for a way to recover from the damage of the crisis, but for the next generation.

## V. CONCLUSION: TOWARDS AN AGENDA

A survey of services and their place in trade, then, shows facts, reveals an opportunity, and illuminates a large policy challenge. Services are the largest segment of the global economy. In principle, therefore, they can be a powerful driver of recovery from the crisis as exporters and investors.

The advance of information technology provides a necessary foundation for that role. The steady pace of satellite and fiber-optic deployment, 4G wireless serviced deployment, cloud computing, and Internet links among individuals, devices and firms all make trade in services steadily cheaper, faster, and simpler. In the right circumstances, services providers will be able to tap a gigantic pool of pent-up demand in the coming years for information, entertainment, financial services, health care, education and more tailored to families and communities of all types. The result can be a powerful support for growth, the creation of jobs, and an accelerated reduction of poverty.

But just as the invention of container shipping in the 1950s required the ambitious policy reforms of the Kennedy Round of the GATT system in the 1960s to match its potential two generations ago, so the world of services trade needs support from policy today. The edifice of services-trade policy built over the last two decades has done much, but remains a limited accomplishment. It has clarified issues and defined concepts through the GATS; experimented with broad agreements in Basic Telecommunications and Financial Services; and created smaller-scale precedents for more sweeping approaches through free trade agreements and WTO accessions. But these accomplishments remain limited, well short of a broad opening of markets, and falling behind real-world needs as cross-border trade shifts to the digital world.

The long-term weaknesses of the policy regime, meanwhile, are matched by an urgent real-world need for a source of growth. The crisis of 2008-2009 has faded. But economies remain weak almost everywhere in the world, sources of potential instability are apparent to all, and the demand necessary to drive investment is scarce. In such circumstances, the practical and psychological effects of an ambitious effort to open markets and tap demand can be powerful.

An ambitious services agenda that embraces all the regional and bilateral efforts to create open and fair services markets, would be greatly facilitated by a services free trade agreement - an International Services Agreement (ISA) - opening markets across sectors. An element of an ISA could be a binding agreement on data flows that would bar arbitrary blockages of data or requirements of forced localization of data infrastructure within a country, but reserve the right to regulate under agreed guidelines for public safety, privacy, public morals, and national security for example. The ISA would overarch and incorporate the services provisions of existing FTAs and the Trans Pacific Partnership, and new initiatives stemming from the EU-US High Level Dialogue, for example.

An International Services Agreement would be a next generation, powerful advance in the global trading system, helping to meet the immediate need for growth through exports and investment in a fragile post-crisis world economy, and to create a more efficient global economy with higher living standards in the long term.

In these circumstances, services trade policy reform can be both a basis for long-term growth, and a way to bolster the world's fragile recovery from crisis. There could be few better times to begin than now.

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- <sup>2</sup> Bureau of Economic Analysis, *GDP by Industry*, measured by value-added, <http://www.bea.gov/iTable/iTable.cfm?ReqID=5&step=1>
- <sup>3</sup> Figure for global economic outlook from International Monetary Fund, *World Economic Outlook Database*, September 2011 version, at <http://www.imf.org/external/pubs/ft/weo/2011/02/weodata/weoselser.aspx?a=1&c=001&t=1>
- <sup>4</sup> Bureau of Labor Statistics, *Current Employment Statistics survey database*, figures for November 2011, at <http://stats.bls.gov/data/>
- <sup>5</sup> N. Vishwanadham, *Can India be the Food Basket of the World?* Indian School of Business Working Paper Series, December 2005, at [http://www.isb.edu/faculty/Working\\_Papers\\_pdfs/Can\\_India\\_be\\_the\\_Food\\_Basket\\_for\\_the\\_World.pdf](http://www.isb.edu/faculty/Working_Papers_pdfs/Can_India_be_the_Food_Basket_for_the_World.pdf)
- <sup>6</sup> *Cloud Computing and the Future*, Transcript of Remarks by Brad Smith, General Counsel/Microsoft, April 6, 2011, at Public Sector Leader's Forum
- <sup>7</sup> *CIR MQ327D*, Census Bureau (Quarterly report on clay construction products, full year 2010), at [http://www.census.gov/manufacturing/cir/historical\\_data/mq327d/](http://www.census.gov/manufacturing/cir/historical_data/mq327d/), Table 3.
- <sup>8</sup> Jensen, Bradford, *Global Trade in Services: Fear, Facts, and Offshoring*, Peterson Institute for International Economics, 2011, pg. 41
- <sup>9</sup> Bureau of Labor Statistics, <http://www.bls.gov/iif/oshsum.htm#10Summary%20News%20Release>
- <sup>10</sup> *Statistical Trends in Telephony*, Federal Communications Commission, September 2010, pg. 6-3, at [http://hraunfoss.fcc.gov/edocs\\_public/attachmatch/DOC-301823A1.pdf](http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-301823A1.pdf)
- <sup>11</sup> *World Investment Report 2011*, UNCTAD, Annex Tables 25 and 27, at <http://www.unctad.org/Templates/Page.asp?intItemID=5545&lang=1>
- <sup>12</sup> *Direct Investment for 2007-2010: Detailed Historical-Cost Positions and Related Financial and Income Flows*, Survey of Current Business, September 2011, Table 8, at [http://www.bea.gov/scb/pdf/2011/09%20September/0911\\_usdia\\_tables.pdf](http://www.bea.gov/scb/pdf/2011/09%20September/0911_usdia_tables.pdf)
- <sup>13</sup> *Ibid.*, pg. 5
- <sup>14</sup> *Operations of U.S. Affiliates of Foreign Companies*, Bureau of Economic Analysis, August 2011, at [http://www.bea.gov/scb/pdf/2011/08%20August/0811\\_affiliates.pdf](http://www.bea.gov/scb/pdf/2011/08%20August/0811_affiliates.pdf)
- <sup>15</sup> *U.S. Multinational Services Companies: Effects of Foreign Affiliate Activity on U.S. Employment*, Office of Industries Working Paper, U.S. International Trade Commission, August 2011, at [http://usitc.gov/publications/332/working\\_papers/ServicesEmploymentWorkingPaperNEWFINAL\\_8.23.11.pdf](http://usitc.gov/publications/332/working_papers/ServicesEmploymentWorkingPaperNEWFINAL_8.23.11.pdf)
- <sup>16</sup> [http://www.bea.gov/scb/pdf/2011/11%20November/1111\\_mnc.pdf](http://www.bea.gov/scb/pdf/2011/11%20November/1111_mnc.pdf)
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- <sup>18</sup> *National Trade Estimate 2011*, Office of the U.S. Trade Representative, India chapter, at [http://www.ustr.gov/webfm\\_send/2709](http://www.ustr.gov/webfm_send/2709)
- <sup>19</sup> *National Trade Estimate 2011*, Office of the U.S. Trade Representative, Ethiopia chapter, at [http://www.ustr.gov/webfm\\_send/2702](http://www.ustr.gov/webfm_send/2702)
- <sup>20</sup> Bureau of Economic Affairs, op. cit., for U.S. services trade coverage; WTO, *International Trade Statistics 2011*, Table 1.10, for world services-import coverage.
- <sup>21</sup> Aaditya Mattoo & Bernard Hoekman, [http://www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/2011/01/03/000158349\\_20110103094557/Rendered/PDF/WPS5517.pdf](http://www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/2011/01/03/000158349_20110103094557/Rendered/PDF/WPS5517.pdf)
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