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Traded Services in the GATT – What’s all the Fuss About?

International trade in services has not been governed by the GATT in the past. Opinion is divided over whether there is a real need for any separate agreement on services. The following article asks to what extent flows of goods and services can be properly separated in the first place, and whether it makes sense to attempt such separation.

For many years now, services have been regarded as the true motor of economic growth. In the developed countries, almost two-thirds of the gross national product is now attributed to the services sector. Cross-border trade in services accounted for 30% of world trade as a whole in 1987, and was valued at US$ 960 billion. Trade in services rose by 240% between 1979 and 1987, trade in goods by 150%. In order to ensure that this engine of growth was better integrated into the division of labour on a worldwide basis, it seemed only right to seek within existing agreements rules and principles by which cross-border trade in services could be governed. However, because many developing countries’ governments are fearful that their positions would become weaker still if services were to be brought under the GATT umbrella, a diplomatic device was agreed upon at the beginning of the last round of trade-negotiations in Uruguay in 1986 which would allow all concerned to keep face. The forum of the GATT round would also be used for negotiations on services. These negotiations would not, however, take place between the contracting parties to the GATT, but between ministers of countries which also happen to be GATT members. This “two-track” approach meant that, in strictly formal terms, the negotiations were conducted outside GATT.

The Uruguay Round negotiating positions of individual governments will not be set out here, but will begin by asking to what extent cross-border trade in services has attracted academic interest to date. The central hypothesis put forward in this article is that there is little point in separating trade flows into the categories of goods on the one hand and services on the other. The conclusion to be drawn from such a hypothesis is clear: if there is no substantial difference between goods and services trade, any attempt to pass a new framework agreement dealing exclusively with the regulation of services trade is superfluous.

The General Exchange Model

It is repeatedly emphasized by economists and jurists alike that the welfare effects associated with trade in services cannot be explained by using the tools of classical foreign trade theory. It is indeed the case that one central premise of the classical model is frequently not fulfilled by trade in services: before services can be tradeable in the first place, it is often necessary for a factor to be present at the location where the service is provided. The circumstances may therefore be such that services are only tradeable if factor mobility exists, yet the Ricardian model assumes that not to be the case.

These differences between goods and services are then often taken to infer that it would not be advisable to extend the rules of the GATT to trade in services. What is needed, the argument goes on, is a separate set of regulations for services. Indeed, demands are often put

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1 The 1987 trade statistics under the heading of "Developed Countries" show that an average of 63% of GNP was generated in the services sector. Among the countries with above-average values were the USA with 68% and Belgium/Luxembourg with 67%; see GATT International Trade, 1988-89, Vol. 1, p. 28.
2 According to IMF data, quoted from GATT Activities 1988, p. 56.
3 Cf. e.g. M. A. Kakabadse: International Trade in Services: Prospects for Liberalisation in the 1990s, Atlantic Paper No. 64, The Atlantic Institute for International Affairs, London et al. 1987. He states on p. 54: "However, economic theory is still underdeveloped with regard to services and the literature has not yet fully addressed the question as to whether, and to what extent, the principle of comparative advantage applies to international trade in services." A similar line is taken by T. P. Hill: On Goods and Services, In: The Review of Income and Wealth, Vol. 23 (1977), p. 315: "Indeed, large parts of economic theory may be irrelevant to the analysis of services anyway, precisely because they are not goods which can be exchanged among economic units."
forward for two regulatory levels to apply to services, with an "umbrella agreement" containing general rules on one level followed by specific regulatory mechanisms for individual service industries on another. 4

However, neither the fundamental argument nor the demands derived from it for a special regulatory mechanism for trade in services are especially convincing. The fact that a central premise of the Ricardian model is frequently breached by trade in services is not at all in itself a denial that such trade also results in greater welfare: it is simply a further piece of evidence that the comparative-advantage-model is based on assumptions which are far too restrictive. It would therefore seem appropriate to leave the close confines of the Ricardian approach and turn instead to the general trade model: this states that trade will take place whenever all the parties involved expect the transaction to improve their own situation. The information an observer gains from the fact that economic units from different countries engage in trade with one another is that they expect this to provide the best possible improvement of their positions, that is that they judge it to be possibly less advantageous to trade with economic units from their own country.

Attempts at Definitions

Setting out from the hypothesis that "services are not goods and their characteristics differ fundamentally from goods", 5 T.P. Hill attempted to establish a definition of services in 1977. According to Hill, they represent "... a change in the condition of a person, or of a good belonging to some economic unit, which is brought about as the result of the activity of some other economic unit, with the prior agreement of the former person or economic unit ... Services cannot be put into stock because a stock of changes is a contradiction in terms." 6 The definition subsequently distinguishes between "services affecting goods" on the one hand and "services affecting persons" on the other. 7 The argument continues that, if any dichotomy is desirable at all, then that between goods and services should be abandoned and a distinction should be made instead between goods and services concerned with goods on the one hand and services concerned with people on the other. 8 That article also initiated a discussion on cross-border trade in services. Other attempts to classify trade in services include that made by Bhagwati, who focused on whether it is necessary to be physically present at the same location as the customer to provide a service. If the latter is the case, he goes on to distinguish between situations in which

- the supplier is mobile, but the customer is immobile,
- the supplier is immobile, but the customer is mobile,
- both supplier and customer are mobile. 9

A similar attempt at classification was also undertaken by Sampson and Snape. 10 As the discussion on trade in services has continued, two of Hill's arguments, in particular, have cropped up again and again, namely that services cannot be put into stock and that an interaction has to occur between the service's supplier and its consumer, which often necessitates a factor movement.

All the attempted definitions so far mentioned have sought to suggest that it is indeed possible to make an unequivocal distinction between goods and services, and also that the distinction would be more than a mere academic definition since different rules would have to apply to cross-border trade in services than to similar trade in goods. This author proposes the contrary hypothesis that any such distinction will always be arbitrary and, as far as economic criteria are concerned, should be of no consequence for foreign trade policy.

Any exchange of goods always includes a certain proportion of services. For example, prospective customers in an electronics store will be given advice by sales staff, which should obviously count as a service. Even supermarkets provide a service by performing such tasks as labelling their products with their selling prices. On the other hand, restaurants not only sell a service, but

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4 Cf. e.g. R. R. Rivers, V.A. Slater, A. A. Paolini: Putting Services on the Table: The New GATT Round, in: Stanford Journal of International Law, Vol. 23 (1987), No. 13, p. 23: "The GATT principles currently used for goods may be usefully applied to services trade to create a regulatory umbrella, with industry-specific sectoral regulation following to address special issues pertaining to each services industry." See also J. H. Jackson: Constructing a Constitution for Trade in Services, in: The World Economy, Vol. 11 (1988), p. 191: "The top layer, often referred to as an 'umbrella agreement', would be complemented by a series of industry-specific agreements—for example on banking and on insurance."

5 T. P. Hill, op cit., p. 315.

6 Ibid., p. 318 f.

7 Ibid.

8 Ibid., p. 328; an earlier attempt at classification can be found in M. A. Katouzian: The Development of the Service Sector: A New Approach, in: Oxford Economic Papers, Vol. 22 (1970), pp. 365 ff. This paper distinguishes between "new" services which are in increasing demand as people receive higher personal disposable incomes and have more leisure time, complementary services for which the demand always arises in combination with the supply of goods, and "old" services which originated in pre-industrial times and have continually been declining in significance.
