

LEGAL ASPECTS OF TRADE IN SERVICES :
SOME ISSUES AND IMPLICATIONS

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*Dissertation submitted to
the Jawaharlal Nehru University in partial
fulfilment of requirements for the award
of the Degree of*

MASTER OF PHILOSOPHY



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the award of MASTER OF PHILOSOPHY has not
been previously submitted for any other degree of
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To

Amma & Parents

ACKNOWLEDGEMENTS

I am grateful to a number of people who have assisted me in completing this work. First of all, I express my heart-felt gratitude to my Supervisor, Dr. B.S. CHIMNI for his invaluable and competent guidance. But for his indefatigable perseverance and constant encouragement, it would have been impossible for me to achieve this feat.


I am indebted to Dr. R.P. ANAND and Dr. RAHMATULLAH KHAN for enlightening me on various aspects of International Law. Thanks are also due to Dr. Y.K. TYAGI whose guidance on this study has been useful.

I owe my thanks to the authorities and staff of Jawaharlal Nehru University Library, Indian Council of World Affairs Library, United Nations Information Centre Library, American Centre Library, Nehru Memorial, Museum and Library. My special thanks in this respect are due to Mr. Biswas Chakravarty and Mrs. Saxena of the Indian Society of International Law Library.

I am thankful to many friends who have cooperated in the final stages of this work. Special mention needs to be made to Poonam, Anita, Sumathy, Meena, Sushila, Indira, Manoj, Vijay, Bharat, Naresh and Roshan, Vimal proved to be an ideal companion helping me in everything possible.

Finally I owe my profuse gratitude to Mr. R.S. Pandey, who has been an incessant source of inspiration and given his kind blessings, and Mr. A.K. Seth for typing this manuscript.

NEW DELHI
JANUARY 1989


MAYA M. ISSARANI

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ABBREVIATIONS

CE	:	<i>Council of Europe</i>
CCC	:	<i>Customs Cooperation Council</i>
FDI	:	<i>Foreign Direct Investment</i>
GATT	:	<i>General Agreement on Tariffs and Trade</i>
IBI	:	<i>Intergovernmental Bureau for Informatics</i>
ICAO	:	<i>International Civil Aviation Organisation</i>
IMO	:	<i>Intergovernmental Maritime Organisation</i>
ITU	:	<i>International Telecommunication Union</i>
MTN	:	<i>Multilateral Trade Negotiations</i>
OECD	:	<i>Organisation for Economic Cooperation & Development</i>
TDF	:	<i>Transborder Data Flows</i>
TNC	:	<i>Transnational Corporation</i>
UNCTAD	:	<i>United Nations Conference on Trade and Development</i>
UNCTC	:	<i>United Nations Centre on Transnational Corporations</i>
WIPO	:	<i>World Intellectual Property Organisation</i>

CHAPTER - I

THE SETTING

The transition from an industrial to a service economy is the hallmark of contemporary economic history. Not surprising that the ensuing theme for trade policy-makers which was limited to goods, has shifted to services in the 1980s. In fact, the issue of international trade in services has acquired much prominence in recent years. An important reason being the initiatives taken by the United States directed towards liberalization of international trade in services. In view of the expanding scope of the service sector in the world economy the recent consideration may appear to be timely. Services accounted for nearly 65 per cent of the world GDP in 1980. Available statistics indicate that exports of services increased from a level of about \$100 billion in 1970 to more than \$600 billion in 1980.¹ The expansion of the service sector is being enhanced by technological advancements which have brought to the forefront new groups of services and established stronger interlinkages among services on one hand and between goods and services on the other. These developments are bound to have a

1. Reports by the UNCTAD Secretariat, "Production and Trade in Services, Policies and their Underlying Factors bearing upon International Services Transactions", (TD/B/941 and Corr 1), p.22.

revolutionary impact not only on the production of services but of goods too. Consequently international trade is likely to undergo a sea change necessitating universal and interdisciplinary examination of the issues related to services trade in particular, and trade and development in general.

What however are "services"? Numerous attempts have been made to define the term "services", not altogether an easy task given the fact that it encompasses a heterogenous group of economic activities which range from legal, air and maritime transport to banking and other public services. So far there appears to be no consensus on the definition of "services", constituting one of the issues to be discussed during multilateral negotiations. From the perspective of the common man goods and services are distinguishable as tangible and visible and intangible and invisible respectively. In other words, one way of defining the service sector is to concentrate on the nature of the output of industries. Hence, some economists regard industries with intangible outputs as service industries. The problem with this definition is that it would entail leaving out many industries whose outputs are service

related but tangible namely, services like construction, motion pictures, publishing, etc.²

The other approach to defining "services" can be the one adopted in the International Standard Industrial Classification of All Economic (ISIC) activities used in national income accounting.³ Here services are defined in negation by stating what they do not constitute. Thus, it is said that services would consist of all economic activities except agriculture, mining and manufacturing. The emphasis is thereby on the nature of the industry rather than the nature of the output. This definition however does not take into account a number of manufacturing operations which incorporate service-related activities. Accordingly, all outputs of a non-manufacturing, non-mining and non-agricultural industry would be considered to be "services" while all outputs of a manufacturing industry would be considered to be "goods".⁴

Obviously, defining "services" involves answering a number of difficult questions. Yet, the definition is of fundamental importance in trade negotiations, for its

2. Tamar Atinc and others, "International Transactions in services and Economic Development", in *Trade and Development*, UNCTAD review, no.5, 1984, p.145.

3. Ibid., p.145.

4. Ibid.p.145.

interpretation will determine the scope of negotiations. Therefore, the definition itself is expected to be the subject of serious negotiation. However, in this dissertation there is no attempt to arrive at either a scientific or a consensus definition. Meanwhile, a core group of activities can be considered as "services", though opinions may vary on the precise scope of coverage, characteristics of activities, or outputs and types of transactions to be included. The wide variety of services now available, broadly include⁵, (a) infrastructural services such as transport, communications, electricity and water supply; (b) social services like education and health; (c) financial services such as banking, insurance, accountancy and brokerage; (d) technological services such as construction, engineering and consultancy; (e) marketing services such as advertising, wholesaling and retailing; (f) commercial services such as chartering, leasing and franchising; (g) professional services provided by doctors, lawyers, architects; (h) government services like public administration and defence; (i) services for personal leisure such as hotels, restaurants etc. Besides these obvious services, there is the subterranean world of services to be found in

 5. Deepak Nayyar, "International Trade in Services : Implications for Developing Countries", EXIM Bank Commencement Day Annual Lecture, 1986.

the parallel economy. These include smuggling prostitution, black-marketing, drug-trafficking etc.⁶

Besides the problem of defining the term "services", the meaning of the phrase "trade in services" also requires clarification. According to balance of payment conventions, international trade occurs when goods or services are sold or otherwise exchanged between residents of different countries. In case of merchandise trade goods move physically from the exporting country to the importing country. For services, the balance of payments conventions are the same, but the transactions are more varied, and cannot be characterized by simple analogy to the country-to-country movement of merchandise.⁷ A working definition of "trade in services" has been adopted by the United Nations Conference on Trade and Development (UNCTAD). It defines "trade in services" as all the transactions in the current account on the balance of payments, excluding merchandise trade and private transfer payments.⁸ Though this definition is not free of problems, yet it provides reasonable approximation.

6. F.F. Clairmonte and J.H. Cavanagh, "Transnational Corporations and Services : The Final Frontier", an UNCTAD Review, *Trade and Development*, no.5, 1984, p.222.

7. Bernard Ascher and Obie G Whichard, "Improving Services Trade Data", *Services World Forum* (Geneva, Switzerland), 13 May 1986, p.11

8. Nayyar, n.5.

International transactions in services generally occur in any of the four ways:⁹ (1) Some services are provided by resident firms or individuals across national boundaries to non-resident firms or individuals abroad. This constitutes the direct export and import of services like carriage of goods by air and sea, passenger transport, international reinsurance etc (2) Some services are provided through purely contractual relationships. They involve various associations with foreign firms abroad, which may be in the form of partnership arrangements, license or franchise relationship, contractual arrangements conferring right to use intellectual property, technology, or other intangible assets (e.g. patents, trade marks, copyright etc.). The result in such cases is sharing of earnings or an obligation to pay royalties, fees or some other remuneration. (3) Some services are provided within national boundaries to non-residents, e.g. tourism, airport and sea-port services. Although these services are not exported they have direct effect on balance of payments. (4) Many services are provided through foreign affiliates of a parent company i.e. the services can be provided by locating the operation in the market to be served through establishment of branches

9.Tamar Atinc and others, n.2, pp. 145-6.

or subsidiaries abroad, e.g. hotel and motel services, commercial banking, etc. The transactions may not be restricted in one of the forms listed; it may take place in more than one of these forms. For example, as a result of technological progress in telecommunications and international computer links, international transactions are bound to take more than one of these forms. This is particularly so when the flow of information is an important feature of the service, as in the case of international banking, insurance and telecommunications services.

Therefore, much work remains to be done before a meaningful regime can be developed both at the conceptual and substantive level. In the former instance it remains to be established that wide ranging activities in this field can be grouped together meaningfully for a unified negotiation, and in the latter case it has to be seen that trade barriers in services are spelt out clearly. Further, regulatory mechanisms have to be chalked out as also the legal form they will assume. So far, economists and lawyers have paid little attention to trade in services due to firstly, their preoccupation with international trade in goods, and secondly, non-availability of detailed data. A strong statistical base

is essential to answer questions like what is the overall magnitude of services trade? What would be the possible impact of liberalisation in this sector? And what economic benefits can be expected from free trade in services?

The collection of relevant data, however, is a serious problem in itself. This is, firstly, due to lack of consensus on what exactly will constitute the service sector and secondly, due to the very nature of services. Since services do not cross international borders in the same manner as goods, it is difficult to quantify the trade in services. Finally, the problem of data collection is compounded by the interdependence of goods and services on one hand and various services sectors on the other. It is difficult to draw lines between overlapping service sectors, e.g. "telecommunication" services would encompass, not only the transmission and reception of video, voice and data but also the material that is broadcast like news, information and various other programmes. In addition to this, there are activities like launching of satellites, laying of undersea cables, etc. which in one way or the other contribute to telecommunications. This multiplicity of activities

raises the problem as to which industry the value of a particular service should be ascribed.¹⁰ Not only are services interdependent amongst themselves, but some services may be required as inputs by goods producing industries. Hence, once again there is the problem of isolating the value of service activities from the value of goods, making data collection difficult. Segregation of goods from services is particularly complicated when tangible output (goods) serve as media for the delivery of services. Say for example, artistic or theatrical performances may be delivered through the media of photographic records as motion pictures. Books are another example which represent information in tangible form.¹¹

While the inadequacy of statistics on services hampers a detailed analysis of the components of the services sector, data provided by national income and balance-of-payments statistics are useful in capturing the relative magnitude of the service sector, and in identifying the broad trends in international services trade. This has been done in studies conducted by some

10. Bernard Ascher, n.7, p.10.

11. Ibid., p.9

individual governments and a number of international bodies. From the available statistics, it is evident that the economies of the developed countries have increasingly come to be dominated by the service sector. In 1979, the service sector accounted for 40 per cent of GDP in least developed countries and almost 67 per cent in developed market-economy countries.¹² Industrialized countries are by far both the largest producers and the largest consumers of traded services, accounting for 84.3 per cent of the credits and 73.6 per cent of the debits in 1980,¹³ with balance of trade in their favour. The balance of trade in services of these countries has shifted from \$1.5 billion deficit in 1970 to a \$15.0 billion surplus in 1980.¹⁴ The members of the European Economic Community (EEC), the United States and Japan are the largest exporters and importers of services. In the case of United States, services account for two-thirds of GNP and employment in services rose from 67 per cent of United States non-agricultural employment in 1970 to 75 per cent in 1985. The United States Bureau of Labour Statistics estimates that over the next decade, nine out of ten new jobs will be in

12. Study by UNCTAD Secretariat, "Services and the Development Process" (TD/B/1008/Rev.1), 1985, p.14.

13. Ibid, p.31

14. Ibid, p.36.

the service sector.¹⁵ However, the annual surpluses in the services account of the developed countries can be attributed to their competitive edge in many services like insurance, banking, satellite transmission, etc. Hence, the anxiety of developed countries spearheaded by the United States, for liberalization of trade in services.

There is no single explanation for the growth of services. More likely, multiplicity of factors have contributed to this rise. Prominent among them apart from rapid technological developments, being the role of state.¹⁶ Most developed countries have taken up welfare programmes like health, education and defence in a big way giving rise to a myriad of service jobs. The other reason is the emergence of transnationals which have largely been responsible for the internationalisation of services. This in turn has been possible due to developments in the application of technology, be it in the information, transport or communication industries. Thus, the technologically advanced countries are able to provide a wide range of

15. Craig VanGrasstek, "Trade in Services : Obstacles and Opportunities", *Policy Focus* (Published by Overseas Development Council), p.47.

16. Clairmonte and Cavanagh, n.6, p.220.

services efficiently. In this situation developing countries are faced with a dilemma. On the one hand, they require inputs of certain services for their development, if they are to retain their competitive position in the production of manufactures and agricultural products. On the other hand, acquisition of efficient modern services from developed countries may make their position more dependent. They also have to have a protectionist attitude towards certain service activities due to considerations like national security, protection of cultural values, reduction in dependency and infant-industry protection etc. At the same time the developing countries have to devote a higher share of their resources to providing basic infrastructural services than larger countries; this is so particularly in case of the least developed countries. To add to this the developing countries do not enjoy competitive edge in services vis-a-vis developed countries, instead they have been accumulating deficits in the services trade. The deficit in traded services by developing countries rose from \$3.9 billion in 1970 to as much as \$49.9 billion in 1980.¹⁷ There are only few services like "travel", "tourism", etc. in which some particular countries enjoy a comparative advantage. For example,

17. UNCTAD Study, n.12, pp.39-40.

"travel" accounts for \$513 million of 76 per cent of the surplus in traded services for Bahamas and \$577 million or 114 per cent for Tunisia.¹⁸

A full understanding of the true impact of key services in the overall efficiency of the economy as well as on the ability of countries to meet important social and cultural objectives, is a necessary condition for the formulation of any coherent policy geared to improving their contribution to growth and development. Policies with respect to services have to contend with many, and sometimes conflicting goals such as economic growth, employment and foreign exchange generation, national sovereignty etc. Besides, the developing countries and developed countries do not gain equally by the liberalisation particularly if it is a new field of services. Therefore, the impact of different policies at the individual country level needs to be systematically studied.¹⁹ However, that is not the objective of this study, which is a rather modest one.

OBJECTIVE OF THE STUDY

The "services" debate undoubtedly has become the major trade issue of the 1980s. There is a growing

18. Ibid., p.39.

19. Ibid., p.36.

realisation that services comprise a highly significant portion of international trade. An integrated approach to deal with services trade is almost non-existent at present. The negotiations to evolve regulatory mechanisms to deal with transactions in services are going on and this process will probably take some years before consensus on various issues which have come to the forefront can take place. In its background, an attempt has been made in the present dissertation to examine the relevant legal issues. While it is recognised that legal, economic, political and diplomatic issues are intertwined, the focus of the study would be on the legal dimensions of the problem, while not ignoring, whenever necessary, the other aspects. In this sense this study proposes to be of an inter-disciplinary nature. In view of the vast scope of the subject, it has not been possible to analyse the existing regulatory mechanisms or legal regimes of any particular service sector like aviation, shipping etc. though the work of some organizations in these respects has been mentioned; it is beyond the purview of this dissertation to deal with individual service sectors. The general issues confronting developing and developed countries have been taken up, highlighting particularly legal issues. The present dissertation by any standards

cannot be termed exhaustive since the trade policy regarding services trade is a subject of recent origin and in the negotiating stage, which to certain extent did create few problems in procuring the source material.

SCOPE OF THE STUDY

The study has been divided into five chapters including this introductory chapter. The immediately following chapter traces, albeit briefly, the history of negotiations and international agreements applicable to services and also mentions the work done by various international organisations like UNCTAD, GATT, ICAO, ITU etc; some of the organisations have dealt with services in general while others have taken up studies in particular service sectors. The third chapter briefly discusses the economic concerns of developing countries with respect to services trade. The legal aspects of including services trade within GATT legal framework as proposed by developed countries have been discussed in the fourth chapter. In this context other possible alternate legal frameworks have been explored. The concluding chapter recapitulates the issues raised in the preceding chapters and summarises the conclusions which emerge from the study.

CHAPTER - II
THE HISTORY OF NEGOTIATIONS AND
CONCERNS : AN OVERVIEW

Creating new rules and institutions to deal with contemporary problems of international trade is an uphill task given their complexity and the large number of countries participating in the negotiations. At the same time, the mere presence of international trade negotiations for dealing with contemporary trade issues has a crucial impact on the formulation of trade policy; they deter new protectionist actions and pressures. Trade in services is an area where rules are almost non-existent, except for individual service sectors like aviation and shipping where some sort of arrangements exist. But a whole range of services like banking, insurance, accounting, to name a few, remain unregulated. The developed countries as already noted, have initiated the process for liberalisation in services trade.

However, before describing the ongoing negotiations dealing with services, it may be mentioned that the first endeavour towards framing a world-wide commercial agreement of significance came in the form of

General Agreement on Tariffs and Trade (GATT) in 1947. GATT was originally designed to serve as a temporary expedient until the ratification of the draft charter for an International Trade Organisation (ITO). However, it continued to function in the absence of ratification of the ITO charter.¹ GATT was in its origin an agreement on tariff barriers. Therefore, the first five rounds of the Multilateral Trade Negotiations (MTN) of the GATT had negotiations on tariff barriers. But in the recent years even non-tariff barriers have assumed importance. In the Kennedy Round (sixth) and the Tokyo Round (seventh), negotiations on non-tariff barriers to trade were included too. With regard to services, which basically encounter non-tariff barriers, the first move came from the United States. The delegation from the United States entered the GATT Tokyo Round with a mandate to negotiate on services under Section 102 of the United States Trade Act of 1974.²

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1. G. Bronz, "The International Trade Organisation Charter", *Harvard Law Review*, Vol.62, no.7, 1949, p. 454.
 2. For the first time the U.S. Congress extended the definition of U.S. Commerce to include services in the Trade Act of 1974 establishing the U.S. negotiating authority for the Tokyo Round of trade negotiations. In addition, Section 102 of this Act authorised the President to negotiate non-tariff agreements covering services and Section 301 provided service industries with a mechanism for bringing trade problems to the attention of the US Government for remedial action. Quoted in Andre Sapir, "Trade in Services : Policy Issues for the Eighties", *Columbia Journal of World Business*, Vol.17, no.3, 1982, p.81.

During the Tokyo Round, held in Geneva from 1973 to 1979, Washington offered trade concessions to those countries which would remove service trade barriers³ and proposed including services in several of the non-tariff barriers codes under negotiation. While, on the whole, the achievement towards removal of specific barriers was negligible, the GATT Government Procurement Code was expanded to include services incidental to the trading transaction of goods. A reference to services was also included in the Subsidies Code. Not deterred by the negligible success, the U.S. administration continued to pursue the objective of liberalising trade in services both at the national and international levels. At the national level, the Trade Policy Committee of the Senate announced in 1981 a services work programme which included (a) the full use of existing bilateral arrangements; (b) domestic and international preparations for future multilateral negotiations on services; (c) review of domestic legislative provisions relating to the achievement of reciprocity for the U.S. service industries.⁴ At the international level, the efforts of the U.S. have mainly been directed towards inclusion of services trade in the GATT framework. Resistance came from developing countries,

3. The U.S. Trade Representative has documented nearly 500 selected barriers to services, trade and investment erected by countries at all levels of economic development.

4. Study by the UNCTAD Secretariat, *Services and the Development Process*, TD/B/1008/Rev.1, 1985, p.64.

especially Brazil and India. But despite the discouraging response the U.S. continued informal series of sessions in Geneva where interested parties could discuss services trade.⁵

Much heat was generated on the issue of admissibility of services trade within GATT legal framework, with developing countries opposed to it and developed countries in favour of it. To resolve this issue, it was decided in 1982, at the meeting of trade ministers, that "interested nations" would examine their own national interests in services and report to the GATT.⁶ Over the next two years the United States organised a series of sessions in Geneva where interested parties could discuss services trade. The GATT secretariat observed but did not "participate".⁷ In November 1984, the meeting of GATT Contracting Parties was convened in which the United States sought to involve GATT by establishing a working party on services. But due to the strong opposition a compromise settlement was arrived at. Instead of a working party on services, a "group" - an entity of lesser standing - was formed.⁸

5. Ronald K. Shelp, "Trade in Services", *Foreign Policy*, no. 65 winter 1986-87, p.78.

6. *Ibid*, n.5, pp. 73-74.

7. Meanwhile national studies on services by the US, Canada, Sweden and some other developed countries was submitted to the GATT Secretariat.

8. Shelp, n.5, p.75.

This group, composed of both industrial and developing GATT members, met nine times in 1985 under the Chairmanship of the Columbian Ambassador to GATT, Felipe Jaramillo. The report of the group was submitted to Contracting Parties in November 1985. The report did not make any recommendations but summarised the discussions ; the difficulties encountered in the services trade due to lack of data, the importance of separating services trade from service investment, the inconsistency of trade rules for services among different countries, etc.⁹

The Contracting Parties, at the meeting held in November 1985, agreed in principle to begin a new round of trade negotiations and initiated a procedure that led to the inclusion of services in the negotiations. The responsibility of preparing a master plan for a new round of MTN was left to a preparatory committee chaired by GATT Director-General, Arthur Dunkel.¹⁰ However, the Jaramillo group was not disbanded, but was asked to continue its work and report its findings.

9. Ibid. p. 74

10. Ibid. p. 74

The two-track approach was meant to allow time to the developing countries which were hostile to the basic idea of liberalisation, and more so to the initiatives of the United States to bring the negotiations within GATT framework to examine the matter more closely. By late July 1986, the Dunkel Committee had two versions of a draft ministerial declaration. One version, drafted by the United States, Japan, the European Community and 48 other countries, called for establishing trade rules for services and the other version submitted by Brazil and India along with Argentina, Cuba, Egypt, Nicaragua, Nigeria, Peru, Tanzania and Yugoslavia, opposed the inclusion of services issue in the new round of negotiations.¹¹ A compromise approach was proposed by the European community, whereby services would be negotiated outside GATT but the GATT secretariat would act as a principal coordinator of the negotiations. The issue was finally resolved by the GATT Contracting Parties which met for special session held on 20 September 1986 at Punta del Este. The Jaramillo group was dissolved and services were placed on the agenda of the new round known as Uruguay Round of MTN on Goods and Services. The session was attended by trade ministers

11. Ibid. p. 75.



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and representative of 74 countries which adopted a Declaration which was divided in two parts. Part I of the Declaration on Negotiation on Trade in Goods was a decision of the Contracting Parties at ministerial level. On the other hand, Part II of the Declaration relating to services was a decision of the ministers representing individual governments and not the Contracting Parties. This structure was adopted to ensure that the negotiations on services are conducted as a distinct process outside the framework of GATT. It was decided to establish a Trade Negotiations Committee (TNC) to carry out negotiations on services. In addition, Group of Negotiations on Services (GNS) was established which would report to the TNC.¹² Significantly, it was resolved that GATT procedures and rules would apply to goods and services negotiations alike. The result of the negotiations, slated to last for four years, is to be reported to a meeting of GATT ministers acting in their capacity as GATT Contracting Parties. They will then decide if the recommendations of the service negotiations are to be folded in to GATT.¹³

 12. P.S. Randhawa, "Punta del Este and After : Negotiations on Trade in Services and the Uruguay Round" *Journal of World Trade Law*, vol.21, no.4, August 1987, p. 163.

13. Shelp, n. 5, p.76

In this context, it is worth mentioning the progress made by developing countries at the ministerial review meeting of the Uruguay Round of GATT held at Montreal, Dec 1988. The developing countries were able to convince the developed nations about the need for their total "development dimension" in further negotiations on services and that the trade in services must not be a one-way traffic i.e. the developed countries must open up markets to labour-related services of developing countries. See, *The Times of India*, (New Delhi), 13 December, 1988.

Meanwhile many other international organisations have taken up studies related to services trade emphasising issues pertaining to services in general or particular service sectors.

CONCERNS AT INTERNATIONAL FORA

As a result of initiatives taken by the United States along with other developed countries towards the process of liberalisation of trade in services, many governmental and non-governmental bodies along with GATT have conducted studies relevant to services trade, although agreements pertaining to some of the services were in existence much earlier. However, a brief account of the work done by some of the organisations would facilitate further discussion on services trade and help in building up a perspective on the possible legal framework of a future regulatory mechanism.

COUNCIL OF EUROPE

The member countries of the Council of Europe have adopted a convention for the Protection of Individuals with Regard to Automatic Processing of Personal Data in January 1981.¹⁴

14. Explanatory report and commentary on the provisions of the Convention in *Transnational Data Report*, Vol.4, no.2, March 1981, pp 33-43.

It ensured the right of privacy of individuals, whether in public or private sectors, as far as processing of personal data is concerned. This Convention also contains reference to transborder data flows. The Council has also undertaken detailed studies of developments in civil aviation in 1973 and 1976, with special importance and stress on relative pricing of scheduled and charter services.¹⁵

CUSTOMS COOPERATION COUNCIL (CCC)

Customs administration and tariff harmonisation are the fields of specialisation of the Customs Co-operation Council (CCC). It plays an important role in the technical interpretation of the provisions of the agreement on customs valuations. This agreement came into force in 1980 for the EEC and the US and later it was open for other trading nations interested to join it. The CCC is involved in the studies on customs valuation and gives commentaries, advices and opinions on the same. As far as world-traded services are concerned, work is in progress on the issue of the inclusion or exclusion of the value of software in customs valuation procedures.¹⁶

15. Raymond J. Krommenacker, *World-Traded Services : The Challenge for the Eighties* (Artech House, Inc., n.p., 1984), p. 109.

16. *Ibid.*, p. 110.

INTERGOVERNMENTAL BUREAU FOR INFORMATICS (IBI)

IBI is an offshoot which has grown from International Computing Center set up by the United Nations Economic and Social Council (ECOSOC). It has convened two conferences viz. the Intergovernmental Conference on Strategies and Policies for Informatics (SPIN-I) in 1978 and SPIN-II in 1984, dealing with different aspects of informatics. Contemporary problems relating to use of information, access to information and the protection of individual privacy have been dealt with in these conferences. SPIN II in fact has laid emphasis on the impact of transborder data flows in the international division of labour and technological concentration.¹⁷

INTERNATIONAL TELECOMMUNICATION UNION (ITU)

ITU, set up in 1865, is the key organization involved in covering communications standards and regulations. Four principal organs viz. International Telephone and Telegraph Consultative Committee (CCITT), the International Radio Consultative Committee (CCIR), the International Frequency Registration Board (IFRB)

17. Ibid., p. 111.

and the General Secretariat assist the ITU in its work.¹⁸

The ITU provides an opportunity to its member countries for negotiations and revision of treaties affecting radio telecommunication. It also holds conferences called World Administrative Radio Conferences (WARCs) where the conflicts related to the use of the orbit/spectrum resource are resolved by the delegates of member nations. The Radio Regulations incorporated into the final acts of the conferences, governing the use of the resource, have the legal status of an international treaty when signed by members. More and more technical work is being done in developing world wide electromagnetic equipment compatibility and conventional establishment of international telecommunication services. Needless to say that the ITU is doing tremendous work which would facilitate some compromise between the developed and developing countries in very contemporary problems like the use of geostationary orbit and the planning of utilisation of space services.¹⁹ "The ITU is an important example of legal texts in the services sector that are drafted

18. Suman Kumar Modwel and others, *Trade in Services* (New Delhi: Indian Institute of Foreign Trade, 1984), p. 185.

19. Krommenacker, n.15, p.113.

with objective of setting norms of conduct in the sector and promulgating standards for adoption by Governments."²⁰

WORLD INTELLECTUAL PROPERTY ORGANISATION (WIPO)

The WIPO came into existence in 1970, with the aim to promote the protection of intellectual property, which includes the rights related to literary, artistic and scientific work, inventions, scientific discoveries, trade marks etc. The possibility of an international treaty on the protection of computer software and the development of better contractual arrangements for protecting the inventions made by joint enterprises is being looked into by the WIPO. WIPO has also scrutinised remedies to check piracy of intellectual property, relationship between copyrights and computers and protection of certain works against abusive exploitation. For facilitating the access of developing countries, to works protected by copyright, a joint UNESCO/WIPO service is offered.²¹

UNITED NATIONS ECONOMIC COMMISSION FOR EUROPE (ECE)

With more and more technological advancement, it is becoming difficult to restrict automatic transmission

20. UNCTAD Secretariat Study, n.4, p.55

21. Krommenacker, n.15, p.118.

of trade documentation. The ECE has devoted attention to this problem and is trying to evolve a standard for automatic trade data exchange, through its Working Party on Facilitation of International Trade Procedures. Besides, there is Inland Transport Committee of the ECE which looks into transport problems specifically whether it is rail, road, water or multimodal transport.²²

UNITED NATIONS CENTRE ON TRANSNATIONAL CORPORATIONS (UNCTC)

The socio-political and economic aspects of transborder data flows²³ and the impact of transnational corporations dealing with various services in developing countries has been emphasised by the UNCTC through studies and research papers. The very fact that transnational corporations are major "suppliers" of services directly through exports or indirectly through investment points to the need for regulation. The UNCTC has dealt with operation and strategies of TNCs in banking,²⁴

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22. Ibid., pp. 117-18. Also for further reference see Study by the ECE, *Committee on the Development of Trade, Transborder Data Flows*, TRADE/WP.4/R.200, 1982, p. 29.
 23. See United Nations Centre on Transnational Corporations, *Transborder Data Flows : Access to the International On-Line Data-base Market : A Technical Paper (ST/CTC/41)*, UN Publication, Sales No. E.83.II.A.1.
 24. UNCTC, *Transnational Banks : Operations, Strategies and Their Effects in Developing Countries (ST/CTC/16)*, UN Publication, Sales No. E.81.II.A.7, Paras 19-25, and 155-169.

reinsurance,²⁵ advertising,²⁶ and tourism.²⁷ Since the issues, related to role of transnational corporations in service sector have been rightly raised by the developing countries for future regulatory mechanism, the work done by UNCTC will prove to be helpful.

WORLD BANK GROUP

The World Bank and the International Development Association (IDA) finance projects in services industries. This involves the provision of technical assistance for managerial facilities and establishment of basic infrastructure to improve the institutional framework of the industries concerned.

The International Finance Corporation (IFC) has been involved with investment in the services sector. It has made most investments in the tourism sector and helps the developing countries to promote capital markets. This demands the establishment of the legislative and regulatory environment along with identification of needed institutions. The ongoing activities of the World Bank deal with international trade in service on a general plane

25. UNCTC, *Transnational Reinsurance Operations* (ST/CTC/15), 1980
UN Publication, Sales No. E.80.II.A.10.

26. UNCTC, *Transnational Corporations in Advertising* (ST/CTC/8)
UN Publication Sales No. E.79.II.A.2.

27. UNCTC *Transnational Corporations in International Tourism*
(ST/CTC/18), UN Publication, Sales No. E.82.II.A.9

and the participation of the developing countries in the services trade along with sector studies. These studies are helpful source of statistics and technical information related to the way concerned markets operate.²⁸

INTERNATIONAL CIVIL AVIATION ORGANISATION (ICAO)

The ICAO came into existence in 1944 as a result of the Chicago Convention, revised in 1980.²⁹ It lays down basic standards of conduct for effective international air transport. The rules laid down are adopted by the signatories to govern their own conduct. In respect to the use of all air navigation facilities, use of airports and the incurred charges for use of such facilities, it provides for the application of national treatment. The principle of non-discrimination with regard to freedoms (overland flight and landing) and for the inland services operation which granted by any country to a foreign country, is also established by the Convention.³⁰ Hence, this multilateral arrangement in aviation services can provide certain guidelines for the future regulatory mechanism for services trade because it already incorporates the much talked about principles of national treatment and non-discrimination.

28. Krommenacker, n. 15, pp. 118-19.

29. *Convention on International Civil Aviation*, Sixth edition, ICAO document 7300/67, Montreal, 1980.

30. Krommenacker, n.15, p. 111.

INTERGOVERNMENTAL MARITIME ORGANIZATION (IMO)

The basic reason why IMO came into existence was the keenness to improve safety at sea. It has evolved a number of International Conventions related to this area. Prevention of marine pollution is yet another area where IMO has been continuing its activities vigorously. In 1954 the Oil Pollution Convention was adopted which was subsequently followed by series of conventions produced by the IMO to deal with and prevent incidents like the Torrey Canyon disaster which took place in 1967. The basic question has been the legal liability in such cases. The International Convention on Civil Liability for Oil Pollution Damage has been concluded in this respect under the auspices of IMO. Safety at sea may not directly be relevant for the services trade but needless to say that it is important for the shipping industry as such. As far as trade in services is concerned the IMO's work on facilitation is directly relevant. The Convention on Facilitation of International Maritime Traffic adopted in 1973 is one such endeavour of the IMO; numerous other resolutions related to areas of safety administration, pollution, development of maritime administration and legislation have also been adopted by the IMO.³¹

31. Ibid. p. 112.

ORGANISATION FOR ECONOMIC COOPERATION AND DEVELOPMENT(OECD)

The OECD has been involved with studies on service sector for several years. The convention under which OECD was established in 1960 states that member countries will "pursue their efforts to reduce or abolish obstacles to the exchange of goods and services and current payments and maintain and extend the liberalization of capital movements."³² The instruments which have evolved under the auspices of OECD contain certain commitments relevant to trade in services. These are : the Code of Liberalization of Invisible Operations instructs the signatories to eliminate restrictions on current invisible transfers and transactions and covers a number of service sectors. The Code is already in force. How far it will be possible to expand it in scope and substance is yet to be discussed. Though it specifically includes many services (insurance, construction, professional services, advertising and transportation), it excludes many other services (communications, banking, computer services, health, education etc.)³³. The other relevant instrument is the Code of Liberalization of Capital Movements which provides

32. Steven F. Benz, "Trade Liberalization and the Global Service Economy", *Journal of World Trade Law*, Vol.19, no.2, March/April 1985, p.108.

33. Ronald K. Shelp, *Beyond Industrialization : Ascendancy of the Global Service Economy* (New York : Praeger Publishers, 1981), pp 128-29. The breakdown of what are considered current invisibles operations are also dealt in detail by the author, pp161-62.

for freedom of financial operations of the goods and services sectors among OECD members. Finally, there is the National Treatment Instrument which provides national treatment for foreign controlled firms operating in member countries in goods as well as services.³⁴

The OECD is pursuing activities in general terms covering problems common to a number of service industries and also specific problems dealing with a particular service industry. Various committees have undertaken the work in this regard. The Committee on Capital Movements and Invisibles Transactions (CMIT) is one such committee which works in close cooperation with other specialized committees involved with specific service sectors. The OECD Trade Committee is yet another which aims in its preliminary phase at identifying and analysing existing obstacles in construction, engineering, banking etc. as a part of its work programme. As far as dealing with specific services is concerned, attention is being given to maritime transport and insurance. A Working Group on the Liberalisation of Insurance has been established. The Financial Markets Committee reviews the regulations affecting international banking. The Committee for Scientific and Technological Policy gives attention to

34. UNCTAD Study, n.4, p. 72.

transborder data flows. A working party on information, computer and communications policy has been established to look into the effects of regulation on international telecommunications services. Emphasis is being laid on the legal aspects of flows of non-personal data. To discuss the proposals for research programme on non-personal data flows, a high-level conference on Information, Computer and Communications Policies (ICCP) was held in Paris in October 1980. A "Recommendation to Governments containing Guidelines Governing the Protection of Privacy and Transborder flows of Personal Data" was adopted by the OECD Council in October 1980. It restricts the member states from developing laws and regulations creating obstacles to transborder flows exceeding the requirements for protection of privacy. Problems relating to tourism sector are taken up by the Tourism Committee. Overall, the activities of OECD committees aim at improving the functioning of national markets for services.³⁵ On 18 May 1984, Ministers at the OECD Council adopted the following statement:

35. Krommenacker, n.15, pp. 113-15.

Recognising the importance of the issues raised by international trade in services, Ministers noted that as further analysis proceeds, the organisation would increasingly focus its efforts on ways to remove unjustified impediments and improve international cooperation. They expressed support for the efforts, under the aegis of the Trade Committee, to relate broad concepts relevant to trade in services to the problems identified in specific sectors. They also encouraged continued work to strengthen existing OECD agreements applicable to services. ³⁶

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT (UNCTAD)

UNCTAD has been involved with specific services (notably transport, insurance and financing related to trade) since its establishment. Certain agreements particularly in the area of maritime transport ³⁷ and transfer of technology have been negotiated under the auspices of UNCTAD. As a result of Trade and Development Board decision 250(XXIV), UNCTAD intensified its activities related to services in 1982. ³⁸ It was agreed in this decision that attention should be paid to services, while dealing with factors related to the issues of protectionism and structural adjustment and also policies influencing structural adjustment and trade. At the twenty-sixth session,

36. *The OECD Observer*, no.129, July 1984, p.8 quoted in UNCTAD Study, n.2, p.73.

37. The report by UNCTAD Secretariat "UNCTAD activities in the Field of Shipping" (TD/278 and Corr.1).

38. UNCTAD Study, n.4, p.1.

the first study undertaken by UNCTAD was presented to the Board.³⁹ Other studies related to services followed⁴⁰ and eventually agreement was reached on a work programme on services, particularly to "examine the role of services in the development process". Pursuant to this mandate, the UNCTAD Secretariat produced a general study on "Services and the Development Process",⁴¹ supported by papers on specific services and the development process (insurance, and transborder data flow)⁴² which were presented at the thirtieth meeting of Trade and Development Board, held in September 1984.

Shipping has held the attention of UNCTAD since a long time. Three multilateral agreements have been negotiated in the shipping sector, namely, the UN Conventions on (a) a Code of Conduct for Liner Conferences; (b) Carriage of Goods by Sea and (c) International Multimodal

39. Study by UNCTAD Secretariat, "Production and Trade in Services : Policies and Other Underlying factors bearing upon International services transactions" (TD/B/941 and Corr.1).

40. UNCTAD Study, "Protectionism, Trade Relations and Structural Adjustment" (TD/274 and Corr.1).

41. Study by UNCTAD Secretariat, n.4.

42. See the study by UNCTAD Secretariat "Insurance in the context of services and the development process" (TD/B/1013) and "International trade and foreign direct investment in data services : Transborder data flows in the context of services and the development process" (TD/B/1016) respectively. The other studies are in the field of maritime transport and technology transfer.

Transport of Goods.⁴³ The Committee on Shipping's Working Group on International Shipping Legislation is looking into the problems of marine insurance. The Committee on Invisible and Financing related to Trade (CIFT) looks into the insurance in general. The UNCTAD Secretariat has put down the chief purpose of this work on insurance as 1) to assist developing countries to establish or strengthen their national insurance, 2) to promote regional cooperation among developing countries, and 3) to improve the terms and conditions of insurance and reinsurance services that still have to be purchased internationally.⁴⁴ UNCTAD has also circulated a questionnaire to the countries related to services to which countries have responded individually in the form of national studies.

Besides these major international organisations which have undertaken activities related to services trade, developing countries have examined certain services issues

43. For the text of the three conventions see, respectively, *United Nations Conference of Plenipotentiaries on a Code of Conduct for Liner Conferences* (TD/CODE/13/Add.1), UN Publication, Sales No.E.75, II. D.12; *Official Records of the United Nations Conference on the Carriage of Goods by Sea*, UN Publication Sales No.E. 80,VII.1 (Part I) and *United Nations Conference on a Convention on International Multimodal Transport*, UN Publication, Sales No.E.81, II.D.7 (Vol.1) and Corrigendum.

44. Krommenacker, n.15, p.117.

at regional level, like for example in the Economic Commission for Latin America and the Caribbean (ECLAC). The non-governmental organizations pursuing activities in this area are the International Air Transport Association (IATA) and the International Chamber of Commerce (ICC). But to emphasize once again, the fact remains that an integrated approach covering all the services and all the countries, will evolve only after solutions to some of the issues raised are sought. Needless to add the work done by the different organisations enumerated above will help in formulating a trade policy on the service sector. At present, the details regarding data and trade barriers are yet to be spelt out, hence the preliminary task done by the organisations holds all the more importance. As a result of the current attention being given to the issue of services trade by various bodies, certain economic aspects have come to the forefront which forms the basis of opposition of developing countries to liberalisation of services trade. The subsequent chapter deals with these economic considerations briefly.

CHAPTER - III

SOME ECONOMIC ISSUES CONCERNING
DEVELOPING COUNTRIES

Economic development is characterized by a constant restructuring of economic activities. The agricultural economy has land as the most important factor which has now given way to industrial economy, in which capital, technology, skilled labour and management are the basic components. The economy dominated by services is the post-industrial phase in which services sector has begun to emerge separately and account for the largest share of gross domestic product.¹ Services account for a large share of economic activity in the developed and the developing countries since they form a part of the country's basic economic "infrastructure". A full understanding of the role of services in domestic economies and international trade and investment activities, has yet to be developed. Consequently, present economic policies do not take adequate account of the potential effect that service industries may have on growth, development and export expansion. The so-called three-step theory (Fisher/Clark theory), in which the

1. UNCTAD Study, *International Trade and Foreign Direct Investment in Data Services : Transborder Data flows in the Context of Services and the Development Process*, TD/B/1016, 27 August 1984, p.1.

process of development moves from agricultural production to manufacturing, and finally to a service economy (a "post-industrial state"), appears at best a partial explanation.² Whatever the analysis of this development be, the fact remains that the international economic system is undergoing transformation and the most important factor in bringing about changes in the structure of economic activities has perhaps been technological advancement, which has also thrown up new trade problems, confronting developed and developing countries alike. Trade in services is one such offshoot which has generated interest from both the blocks and numerous governmental and non-governmental organisations.

At present, liberalisation in services trade is in one form or another, on the agenda of almost all the relevant foras. The initiative has come from the developed market economies in general and the United States in particular. The developing countries as has been noted, have been apprehensive of these moves. It is worthwhile in this context to review economic issues and implications which concern developing countries.

2. Study by the UNCTAD Secretariat, *Services and the Development Process*, TD/B/1008/Rev.1, UN Publication (Sales No.E.85.11.D.13), 1985,p.6.

THE COMPARATIVE ADVANTAGE FACTOR

The proponents of liberalisation of services trade are countries with the biggest surpluses in services transaction. In general, as has already been noted, developed market economies are running surpluses on service accounts while developing countries are accumulating mounting deficits. The forecasted figure of this deficit has been surpassed, yet the upward climb continues unbroken.³ The surplus in trade in services for developed countries speaks for their comparative advantage in this field. It is to the abundance in physical and human capital to which this trend can be traced.⁴ The developed countries are in a position to apply the new technology to goods and services which in turn could well reduce labour costs per unit of output and thus undermine the competitive position of developing countries in the production of labour intensive goods and services.⁵ The impression is strengthened by data

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3. Wassily Leontief, *The Future of the World Economy : A United Nations Study* (New York, 1977), p.60. Leontief forecasted that developing economies would have deficits in services trade to the tune of \$30 billion by the year 2000. But the UNCTAD Study, *Trends in World Production and Trade* (TD/B/887/Rev.1) pp.20.21, reveals that net deficit of developing countries in services trade soared from \$14 billion to \$80 billion between 1967 and 1980.
 4. A Sapir and E. Luntz, *Trade in Services : Economic Determinants and Development Related Issues* (World Bank Staff Working Paper No.480, Washington, D.C., 1981); a detailed study on comparative advantage and the factors accountable for it. See also, Andre Sapir, "Trade in Services: Policy Issues For the Eighties", *Columbia Journal of World Business*, Vol.17, no.3, Fall 1982, p.79.
 5. UNCTAD Study, n.2, p.15.

collected in the case of production of textiles and clothing the effect of use of advanced technology by the developed market economies in textiles has eroded the comparative advantage of developing countries in terms of low labour costs and rendered their products uncompetitive on the world market.⁶

From an international perspective, comparative advantage in the production of services is associated with the application of diffusion of information technology, and the complex inter-relationship of services with the production of goods.⁷ In other words, a sophisticated knowledge-intensive and information-intensive sector is essential for efficient production. But information regarding latest technology and use of data services are fields where developing countries lag far behind, accounting for their inability to establish service firms in other markets. Lack of service know-how, inadequate knowledge of overseas markets and limited financial resources are some of the factors which inhibit the establishment and expansion of services industries of the developing countries. The result is that even if

6. J.F. Rada, "Advanced technologies and Development : Are Conventional Ideas about Comparative Advantage obsolete?" *Trade and Development* (An UNCTAD Review), no.5, 1984, p.275.

7. Ibid., p. 288

some of the developing countries have comparative advantage, say for example in tourism, the benefit of "natural" advantage fails to reap its fruits due to lack of knowledge. These countries are heavily dependent on developed countries for services like aviation, hotel-management etc., which in turn are largely provided by the transnational corporations.⁸ These corporations have easy access to advanced technologies, both nationally and internationally, hence can perform proficiently. In fact, the driving force behind liberalising trade in services has been the TNCs. But their participation in services trade without appropriate regulatory mechanisms is bound to have consequences contrary to national interests of the developing countries. This aspect is examined further in the next section.

It has so happened that the present negotiations have limited their agenda to proposals for liberalisation in capital related services, where the developed countries enjoy a comparative advantage.⁹ The developing countries

8. Report by the UNCTAD, *Production and Trade in Services, Policies and their Underlying Factors bearing upon International Services Transactions*, TD/B/941 and Corr. 1, 1983, p.9.

9. Deepak Nayyar, "International Trade in Services : Implications for Developing Countries" (EXIM Bank Commencement Day Annual Lecture, Bombay 1986) see also, by same author, "The political Economy of International Trade in Services", *Cambridge Journal of Economics*, Vol.12, No.2, June 1988, p. 279.

which have a revealed advantage in labour-intensive services have not figured on the schedule of present negotiations. These services inevitably involve migration of the labour which impinges on migration policies of the countries. The United States has however made it clear that its immigration laws will not be subject to negotiations, and the lengthy congressional experience with recent legislation passed to modernise U.S. immigration law (known as "Simpson-Mazzoli") demonstrates that the issues is tremendously controversial.¹⁰ Hence from the developing countries viewpoint, it is essential to eliminate the asymmetries implicit in the proposed agenda for negotiation.¹¹

10. Craig Van Grasstek, "Trade in Services : Obstacles and Opportunities", *Policy Focus* (Overseas Development Council, n.d.), p.50.

11. Nayyar, n.9. The author has suggested that labour services or any other service in which developing countries have a comparative advantage should be included for negotiations. Also, the temporary migration of labour across national boundaries should become possible and permissible.

TRANSNATIONAL CORPORATIONS AND
SERVICES TRADE

The multinational or transnational corporation is basically a firm which has a chain of companies, operating simultaneously in different countries and therefore under different national jurisdictions, but under the corporate control of the parent company. These corporations have entered the services sector in a big way. Though the role of TNCs in services sector is yet to be thoroughly analysed, it is anticipated that much of their impact is likely to be similar to that of transnational involvement in general and may, therefore, be addressed by general policies. Questions dealing with the transfer of technology, employment, competition, transfer pricing, etc. seem to have similar relevance in both the services and the manufacturing sectors.¹² The corporate power of TNCs can be assumed by the statistics available, which reveal that the combined sales of the world's top 200 corporations, in 1982 exceeded \$3 trillion or in other words the equivalent of one third of the world's GDP.¹³ Noteworthy is the fact

12. UNCTAD Study, n.8, p.4.

13. F.F. Clairmonte and J.H. Cavanagh, "Transnational Corporations and Services : The Final Frontier", *Trade and Development* UNCTAD Review, No.5, 1984, p.229.

that out of these 200 corporations, 116 have their bases in just five developed countries namely, the United States, Japan, the United Kingdom, the Federal Republic of Germany and France. The participation of firms from developing countries is almost negligible because only seven or eight firms from seven developing countries figure in these 200 corporations.¹⁴

The negative aspects of the operation of TNCs on the economies of developing countries are well known. The multinational enterprise "not only operates as an enclave (with no integration into the national economy in terms of the sale of its output and the purchase of its input), but also diverts resources from other activities, stifles indigenous substitute effort and distorts the development priorities".¹⁵ It tends to underdevelop rather than develop the economic infrastructure. They never set up basic and heavy industries in the developing countries, nor do they take up research and development activities, but instead keep the host countries dependent on obsolete and discarded

14. Ibid., p. 233.

15. Girish Mishra, "Taming MNCs : Need For a Code of Conduct", *World Focus*, No.3, 1986, p. 12.

imported technologies. The main reason for their expansion to developing countries is high profitability and absence of regulation. Although the parent company of a TNC and its subsidiaries are incorporated under national laws, the extension of the TNC network across national boundaries prevents municipal legal systems from effectively dealing with their activities. The fundamental basis for an assertion of national control is the territorial principle of jurisdiction, but since the TNC command centre (parent company) is often located outside the national territory, decisions of the TNC affecting a country may be beyond the control of the government in question. In effect, the TNC eludes complete regulation by individual municipal legal systems,¹⁶ and their profit maximising motive creates tensions for national economic policies.

The network of TNCs is spread far and wide, encompassing numerous countries. With their commercial flexibility and corporate power, the TNCs are in a position to have direct effect on the international economic environment, both through unilateral actions

16. S. Coonrod, "The United Nations Code of Conduct for Transnational Corporations", *Harvard International Law Journal*, Vol.18, No.2, 1977, p.275.

and by bringing pressure to bear on individual governments. Their power to establish company wide transfer prices can have substantial effects on the balance of payments and foreign exchange of individual governments.¹⁷ To add to this, the impact of TNCs on domestic enterprises is yet to be analysed because TNCs can have direct and indirect linkages with the domestic firms in numerous ways. The implications of these linkages can be anything from depriving the domestic competitors of markets at home and abroad, to reducing the resource base available to domestic enterprises for investment and production.¹⁸ The parent company tries to enlist the support of the parent government to lobby on its behalf in another country in which its foreign affiliates reside, hence affecting the economic growth and stability of the host country greatly.¹⁹ The stability of the host country may also be affected due to direct political pressure.

The world wide operations of TNCs in all economic sectors has been possible due to growing investment and

17. Research Paper, "Impact of TNCs on Balance of Payments", *CTC Reporter*, no. 22, 1986, p.14.
18. Research Paper, "TNCs and Linkages with Domestic Enterprises", *CTC Reporter*, no.22, 1986, p.11.
19. I.A. Litvak and C.J. Maule, "The Multinational Corporation: Some Economic and Political-Legal Implications", *Journal of World Trade Law*, vol.5, no.6, Nov-Dec. 1971, p.631.

use of crucial data services which include data processing, information storage, software and telecommunications services. The role of TNCs in services trade cannot be seen in separation from the investment and transborder data flows (TDF) because the TNCs are investing in foreign markets for the production of services and this investment is growing at an alarming rate. Earlier the investment was primarily in manufacturing sector but today it is largely in service industries. Noteworthy is the fact that United States is the principal country where investment originates, accounting for one-half of the total outflow from developed market economies.²⁰ Hence, the developing countries, keeping in view the national interest, cannot neglect this coexistent aspect of international trade.

Foreign direct investment (FDI), particularly in services, has been growing at rapid rate. Numerous factors account for this rise of investment,²¹ but to name a few, firstly, it is the nature of services. Most services are intangible and non-storable. In order to deliver such services to foreign markets FDI is essential.

20. Raymond J. Krommenacker, *World Traded Services : The Challenge for the Eighties* (U.S.A. Artech House Inc., 1984)

21. Karl P. Sauvart, "Services, TDF and the Code", *CTC Reporter*, no.22, 1986, p.71. see also, S.K. Varma, "Global Service Economy and Developing Countries", (paper presented at Seminar on "United Nations : Retrospects and Prospects", New Delhi, October 1985).

Secondly, the competition for markets abroad amongst the transnationals in search for new business opportunities. Thirdly, expansion of trade in goods and services in general has stimulated FDI in services interlinked to the production of goods. The emergence of Eurocurrency markets, rise in international lending, advances in communication technology, are some other reasons for expansion in FDI. The available statistics of the value of the stock of direct investment in developing countries show an increase, at current prices, from \$32.2 billion in 1967 to \$88.3 billion in 1978.²² The implications for the developing countries are serious because this tendency to invest directly in developing countries has generated an outflow of financial resources in the form of investment income payments, and parallel to this the inflow of technology and related services to developing countries has given rise to an outflow of financial resources in the form of payments and royalties and fees.²³

The FDI by transnationals continues to rise and it is greatly enhanced by the technological developments in communications, especially telematics, which is a merger

22. Krommenacker, n. 20, p. 26.

23. Ibid.

of informatics and telecommunications.²⁴ With telematics are associated a number of data services such as data processing, computers, information storage etc. and this extension of telematics into the international realm has given rise to transborder data flows (TDF)²⁵, i.e., the flow of data via computer communication systems spanning two or more countries. TDF basically involves rendering of data services across national boundaries, normally via transnational computer communication systems. It enables the TNCs to strengthen their capacity to manage their world-wide corporate systems and efficiently utilise the scarce resources. TDFs have been termed as "life blood" of the TNCs, because they have not only lead to greater tradeability of services but also to the facilitation of production of services in foreign subsidiaries.²⁶

The data services not only form part of the infrastructure of international economic exchanges, but also play a central role in trade and FDI in goods and services irrespective of the participating country being

24. UNCTAD Study, n.1, p.2.

25. The expression "Transborder data flows" (TDF) and "trade in data services" have been used interchangeably in this study.

26. See study by the UNCTC, *Transborder Data Flows : Access to the International On-Line Data-Base Markets* (ST/CTC/41), U.N. Publication, Sales no. E.83.11,A.1.

developed or developing. But implications are not similar for the two blocks because of origin of FDI in the developed market economies and their comparative advantage in this field over developing countries. In the absence of regulatory mechanisms either for services or for investment, the developing countries are apprehensive about liberalisation of services trade. They fear that they will be allocated the "bottom rung" of the intra-firm and international division of labour, as suppliers of relatively unskilled labour and merely as marketing and distributional outlets for TNCs.²⁷

In formulating policies in this area, developing countries face a two-fold challenge; first, to secure a position in the new industries arising from advances in electronics, and second to formulate policies which would need to provide an element of infant-industry protection.²⁸ In fact the present situation has put the developing countries in a dilemma. On the one hand they have to acquire imports of certain services for developing of goods and services industries and on the other, if they rely on acquisition of services from developed countries, it can create

27. UNCTAD Study, n:2., p.48

28. UNCTAD Study, n.1, p.7.

the problem of dependency along with lop-sided development of the indigenous industries. Therefore, overwhelming importance is being given to infant-industry protection in the services sector of developing countries. There are many services (e.g. tourism, construction , shipping etc.) where some of the developing countries possess a potential comparative advantage, which cannot be realised if there is an immediate liberalisation of trade in services, which does not provide them with sufficient time period to learn and become competitive in world markets. Therefore, the infant industry argument is of special relevance in the services sector for developing countries.

INFANT INDUSTRY PROTECTION

International trading rules allow temporary protection for "infant" industries to reach the point where they can exploit their natural comparative advantage.²⁹ Providing protection to the infant industries inevitably involves government interference in terms of offering incentives to the indigenous industries in order to help them compete at home or in third-country markets. While domestic and foreign firms are equally eligible for certain

29. J.J. Schott and J. Mazza "Trade in Services and Developing Countries", *Journal of World Trade Law*, Vol.20, No.3, 1986, p.54.

incentives and subsidies, preference may be given to domestic firms. This sort of regulation may not necessarily be due to economic compulsions but can have political considerations too. There are certain activities that governments support since they are considered to be of national importance. These may be activities that are strategic in nature and considered to be pivotal to national defence or national sovereignty. Yet, some other activities assume a national priority for socio-economic reasons, for example, in pursuit of the objective of maintaining a certain level of employment in a particular activity or region.³⁰

The sectors like banking and insurance, which mobilise resources to finance the process of development, are such in which most of developing countries wish to retain control. Similarly, telecommunications, aviation, shipping etc. are areas of economic activity where strategic considerations of national sovereignty, national security and national development are of vital importance.

A liberalisation of services trade and consequent reliance on foreign industries for these services, may well hamper national sovereignty in political terms.³¹

30. UNCTAD Report, n.8, p.55.

31. Deepak Nayyar, n.9

Therefore, any legal multilateral agreement dealing with services trade has to respect the pursuit of national socio-economic objectives of developing countries.

The national interests of developed market economies are clearly at variance with those of developing countries, hence it requires increased effort by the international community to establish an adequate and equitable legal framework. Since the process of negotiations has just begun, the issues raised by developing countries can be taken into consideration in order to avoid the far reaching implications for their development process. In this context, it is prime concern of the policy makers to device an appropriate legal framework to regulate services trade. The developed countries have proposed the GATT legal framework while developing countries have opposed the same. The arguments put forward for and against the GATT legal framework have been discussed in the coming chapter.

CHAPTER - IV
SERVICES AND THE GATT LEGAL
FRAMEWORK

The institution of the General Agreement on Tariffs and Trade (GATT) has been the source of considerable debate among policy-makers, government officials and scholars for almost three-and-a-half decades.¹ The structure of the GATT is not planned and well thought out because it was not intended to be an international organisation. "It began as only one wheel of a larger machine, the ill fated International Trade Organisation, and, when that larger machine fell apart before leaving the assembly line, this wheel became a unicyclcle on which burdens of the larger machine were heaped."² Yet somehow this institution of GATT seems to subsist with pragmatic additions to its structure which on the one hand have made it suitable to serve the changing economic time but on the other hand it has become a very complex legal framework. Surprisingly, despite its complexity, the GATT framework has been proposed for admissibility of

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1. For further reference see Robert E. Hudec *The GATT Legal System and World Trade Diplomacy* (New York, Praeger Publishers, 1975); John H. Jackson, *World Trade and the Law of GATT* (New York, Bobbs Merrill, 1969); Jackson, "The Crumbling Institution of the Liberal Trade System", *Journal of World Trade Law*, Vol. 12,, no.93, March-April, 1978.
 2. John H. Jackson, *ibid*, p.3.

negotiations pertaining to trade in services. Whether GATT as an institution can cope with the problems currently facing international economic relations and with the problems which are likely to confront it in the near and not-so-near future is questionable.

The answer is not easily provided. Moreover, the debate on how far GATT has been successful in dealing with international economic problems is beyond the purview of present dissertation. As far as admissibility of services trade within GATT legal framework is concerned two conflicting arguments have been put forward. One school of thought considers GATT a potentially useful instrument with which to establish trade disciplines because it is a contractually binding agreement, and also since it applies to a large number of developed and developing countries.³ Opposed to this argument are the developing countries. They fear that GATT, which serves the interests of developed countries would, if extended to cover services, only strengthen the control of the proponents of inclusion of services

3. *General Agreement on Tariffs and Trade (GATT)*, Exchange of Information pursuant to the Ministerial decision on Services, Communication from the United States, dated 25 January 1984.

within the GATT legal framework.⁴ Along with this thought the developing countries are of the opinion that long outstanding issues in the areas of tropical products, textiles, agriculture, etc. remain to be tackled, and GATT should not conveniently forget these issues in the new found zeal to tackle the services trade issue. It has further been argued that there should be no parallelism of multilateral action on the issue of services and in GATT negotiations on trade in goods.⁵ Discussing services issue in GATT could imply a link between trade in goods and trade in services and concessions with respect to such "trade". Thus discussion of possible concessions on services within the GATT framework of reciprocal concessions on access to markets could place developing countries in disadvantageous negotiating position.⁶ In this regard, amendments to section 301 of the U.S. Trade Act of 1974, contained in Title III of the 1984 Act are

4. Ronald K. Shelp, "Trade in Services", *Foreign Policy*, no.65, winter 1986-87, p.81.

5. Deepak Nayyar, "International Trade in Services : Implications for Developing Countries", EXIM Bank Commencement Day Annual Lecture, 1986.

6. Murray Gibbs, "Continuing the International Debate on Services", *Journal of World Trade Law*, Vol.19, no.3, May-June 1985, p.213.

relevant given the possibility they present for the application of trade restrictions in retaliation for "unjustifiable", "unreasonable" or "discriminatory" actions against U.S. interests in the services sector.⁷ Besides, the transactions in services inevitably involve FDI; this is one basic reason why services trade should not be put under the GATT framework since GATT has no mandate in FDI matters.⁸ Before taking upon negotiations on service trade, GATT has to lay down guidelines for the investment issue. To add to this, GATT has basically dealt with the negotiations related to tariff barriers encountered in trade in goods but the transactions in services face non-tariff barriers,⁹ and therefore much work remains to be done in the field of non-tariff barriers. GATT has had seven rounds of Multilateral Trade Negotiations (MTN) so far, out of which the first five rounds laid emphasis on negotiations relating to tariff barriers. It was only in the 'Kennedy Round' (1963-67) and the 'Tokyo Round' (1973-70) that non-tariff

7. Title VI of the U.S. Trade Act of 1974 links goods and services in the GSP context.

8. Karl P. Sauvart, "Services, TDF and the Code", *The CTC Reporter*, no.2, Autumn 1986, p.13.

9. The non-tariff barriers first studied by Baldwin have been analysed by Steven F. Benz, "Trade Liberalisation and the Global Service Economy", *Journal of World Trade Law*, Vol.19, no.2, March-April 1985, pp.95-120.

barriers were discussed and that too in the context of trade in goods. Hence the opposition to inclusion of services trade within the GATT framework. But the initiatives taken by the United States not only for liberalisation in trade in services but also to argue the extension of GATT so as to cover services is based on the arguments that GATT should change and adapt with the changing economic times. Also the Tokyo Round of MTN produced several GATT codes which aimed at reducing non-tariff barriers. Some of them also refer to services, though marginally. But according to proponents of admissibility of services trade within GATT, these can later be modified or new codes on those guidelines be evolved to deal with services trade.

The agreements containing references to services concluded during the Tokyo Round are Agreement on Subsidies and Countervailing Duties, Government Procurement Code; the Custom Valuation Agreement. A sectoral agreement on trade in civil aircraft also touched upon certain services.¹⁰ At present all of these codes contain provisions for consultation and dispute settlement, but

10. The agreements are reproduced in the twenty-sixth supplement of the *Basic Instruments and Selected Documents* (BISD), GATT, 1980, pp. 8-188.

do not apply to services independently of goods. These agreements need emphasis and elaboration here, since they potentially relate to services or now apply when traded in company with goods.

GOVERNMENT PROCUREMENT CODE¹¹

This agreement is the only MTN code that specifically requires signatories to consider developing rules for trade in services. But the agreement covers services only incidental to the supply of products procured by the entities listed in annex I to the agreement if the values of these incidental services does not exceed that of the products themselves. In November 1983 negotiations took place to expand the Procurement Code, so as to include services contracts. The GATT Committee on Government Procurement is considering at present the services actually procured by governments and whether it would be beneficial to extend the non-discrimination provisions of the Code to service contracts. Presently, signatories are required not to discriminate against or among the products of other signatories in purchases covered by the agreement. The

11. The analysis given here relies heavily on Raymond J. Krommenacker *World Traded Services : The Challenge for the Eighties* (Artech House, Inc. Washington, 1984), p.143; and Benz, n.9, pp. 116-17.

agreement so far includes only governments, entities listed in the agreement and excludes construction contracts, and purchases by state and local governments. Hence there is need to expand the agreement to commercial contracts to make it more effective. The United States in this respect is pleading for inclusion of leasing which too like construction contracts has not been included in the Code.

THE CUSTOMS VALUATION AGREEMENT¹²

The Agreement sets up detailed rules for the valuation of customs of imported goods for assessment of duties. It excludes from customs value certain charges or costs paid for various types of services when these costs are distinguished from the price actually paid for the imported goods. The aim is to avoid artificial increase in the value of a good and thus increase the tariff return. Various methods for valuation have been set out. The code includes some services such as brokerage fees and commissions which are associated with goods trade, but majority are excluded from its purview e.g., transportation costs, insurance etc. which

12. Benz, n.9,0.118

are left to the discretion of national governments. But the Code to some extent defines whether the value of transport services are to be included in determination of the duty of a good or not. For example, brokerage fee incurred by the buyer, the approtioned value of engineering, etc are added to the price of the good if these services are to be used in the production of the entering goods. Yet there is a need for the inclusion of services in an expanded customs valuation agreement because as technological skills in the form of services increase, foreign customs practices can hamper trade flows. At present also some governments (for example, Britain) have made attempts to develop means of measuring the value of stored data and computer software.

AGREEMENT ON SUBSIDIES AND COUNTERVAILING DUTIES¹³

Under this Agreement the items relating to the provision of services on terms more favourable for exports than domestic goods (e.g. taxes and charges) are prohibited under the list of export subsidies provided in the Annex to the Code. Agricultural subsidies are also proscribed if they displace the exports of another signatory.

13. Krommenacker, n.11, p.144.

The services issues covered in the Tokyo Round may seem justifiably inconsequential but this was a first step. The extension of the GATT to non-tariff barriers is significant, as it represents that the course of the GATT can be altered and adapted to changes in the international economic relations. While it may be impractical to try to extend the GATT to services, many of the concepts and principles in the GATT might form the basis of a general framework for the reduction of barriers to trade in services. In this context the two principal GATT provisions are worth mentioning.

MOST FAVOURED NATION (MFN) TREATMENT (ARTICLE 1)

The major GATT-MFN clause in Article I, paragraph 1 is divisible into two concepts : (1) the scope of the clause, and (2) the obligation of the clause.¹⁴ The scope is set out in a series of clauses¹⁵ that establish that within the MFN obligation come the (1) Customs duties and charges of any kind imposed on or in connection with importation, exportation and international transfer of payments for imports or exports; (2) the method of levying such duties and charges, (3) all rules and

14. Jackson, n.2, p.256.

15. Ibid., p. 802, GATT, Art I, para 1.

formalities in connection with importation and exportation;
(4) all matters referred to in Article III - paras 2 & 4,
(which cover internal taxes and regulatory laws) and (5)
all the above apply only to products.¹⁶ The "obligation"
part of the clause ensures that "any advantage, favour,
privilege or immunity granted by any contracting party
to any product originating in or destined for any other
country, shall be accorded immediately and unconditionally
to the like product originating in or destined for the
territories of all other contracting parties". Therefore
any market access or other concessions granted to any
one country gets automatically extended to all contracting
parties. This principle ensures non-discrimination
among all nations willing to accept the provisions of the
GATT with some exceptions like differential treatment
may be granted to developing countries, members of
custom unions, free-trade areas or other regional trading
arrangements (Article XXIV) or when a country has been
granted waiver of GATT/MFN obligation (Article XXV). On
the question of whether it would be appropriate to apply
the MFN concept to services, one has to assume that the

16. Ibid., p.256.

MFN principle has had beneficial results for goods which would similarly correspond to services. But scholars have altogether different views on the success of the MFN clause, Raul Prebisch, former Secretary-General of the UNCTAD had asserted : "However valid the MFN principle may be in regulating trade relations among equals, it is not a suitable concept for trade involving countries of vastly unequal economic strength."¹⁷

In the beginning, the developing countries had expected to benefit from the creation of trade through the application of the MFN principle. Instead goods from international market flooded their own market threatening the existence of their nascent industries. Competition was overwhelming and along with it tariff and non-tariff barriers hampered the products of labour related industries in which the developing countries might have had a competitive advantage.¹⁸ From the

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17. Raul Prebisch, "Towards a New Trade Policy for Development", Report by the Secretary General of UNCTAD (UN, New York, 1964) p.66. For further reference on non-discrimination, Richard H Snape, "Is Non-discrimination Really Dead", *The World Economy*, Vol.11, no.1, March 1988, pp. 1-18; and Ernst Ulrich Petersmann, "Economic, Legal and Political Functions of the Principle of Non-discrimination", *The World Economy*, Vol.11, no.1, March 1988, pp. 113-21.
18. John F. Dorsey, "Preferential Treatment : A New Standard for International Economic Relations" *Harvard International Law Journal*, Vol.19, no.1, 1977, p.114.

arguments enumerated in the preceding chapter, one can realise the same being repeated in case of services too. The comparative advantage of developed countries in services trade would accrue the benefits of liberalisation to them even if preferential treatment to developing countries is granted. Also the point to be noted is that labour related services have somehow not been included in the agenda of present round of negotiations in which developing countries can claim to have comparative advantage.

The MFN principle is also hampered due to inherent discrepancies of the GATT i.e. Article XIX,¹⁹ which allows withdrawal of obligations on certain grounds, and in a way induces protectionism rather than liberalisation.²⁰ Under this clause of MFN treatment, the principle of reciprocity is implicit which assumes that contracting parties will grant one another substantially equivalent advantages and rights on a reciprocal basis through commercial negotiation. But reciprocity is applied only

19. GATT, Art XIX, Jackson, n.2, p.838.

20. For further details, Gerald M. Meier, "Externality Law and Market Safeguards : Applications in the GATT Multilateral Trade Negotiations", *Harvard International Law Journal*, Vol.18, no.3, 1977, p.511

to comparable cases, preferences for partners in regional groupings prevail. This outcome has convinced the developing countries that MFN, rather than reducing inequality has increased it.²¹ In case of services this argument holds all the more validity because there are so many countries which either do not have particular service industries or are in developing phase and need some degree of national control. In such cases is it possible to hold the reciprocity principle valid?²²

NATIONAL TREATMENT (ARTICLE III)

This provision of the GATT ensures that imported merchandise is required to receive treatment equivalent to that given to domestically produced goods with respect to taxes and regulations. It provides that products "be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws,

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21. H.G. Espiell, "The Most-Favoured Nation Clause : Its Present Significance in GATT", *Journal of World Trade Law*, Vol.5, no.1, January-February 1971, p.36; H.R. Kramer, "Changing Principles Governing International Trade", *Journal of World Trade Law*, vol.8, no.3, 1974; Robert G. Berger, "Preferential Trade Treatment for Less Developed Countries : Implications of the Tokyo Round", *Harvard International Law Journal*, Vol.20, no.3, 1979, p.559.
 22. On the reciprocity principle, J.N. Bhagwati and Douglas A. Irwin, "The Return of the Reciprocitarians : US Trade Policy Today", *The World Economy*, Vol.10, no.2, June 1987, p.117.

regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution, or use."²³ This clause is the one which impinges most directly on the domestic policies and internal politics of member governments; it becomes more quickly embroiled in domestic politics than any other GATT obligation and it may be one that is often breached.²⁴ In case of services trade which is much more heavily regulated by governments, it is difficult to perceive of situation in which foreign companies would be treated at par with domestic firms especially crucial service industries like banking, insurance and telecommunications.

Moreover, the services trade inevitably involves the question of establishment which is at variance with national treatment. For example, a prohibition with respect to the formation of new corporations may be discriminatory if foreign firms have not had enough time to establish a presence. Also, since different countries have different regulations for industries, particularly industries like banking, strict but equal control of

23. GATT, Article III, Jackson, n.2, p.808.

24. Ibid., p.274.

business activities affects the foreign service firm to greater extent.²⁵ Therefore, any extension of national treatment to services will have to take into account many national sectoral interests. The extension of the principle of national treatment and most favoured nation principle arises if GATT rules are to apply to services Trade. In this context two alternative approaches seem possible if GATT rules and principles were to be applied.²⁶ One is that since GATT deals with trade in large number of goods therefore the services linked with goods like transportation, distribution, advertising, etc. can very well have the application of trade liberalisation which applies to goods trade. Thus the possible argument can be that some restrictions on services are already forbidden by international agreement because they nullify or impair tariff reductions made under GATT. The second possible approach could be that some principles which apply to trade in goods should apply to services transaction too. In other words, any violation of GATT rules regarding trade in goods should be considered a violation of rules in services trade. These approaches

25. Benz, n.9, p.115

26. William Diebold, Jr. and Helena Stalson, "Negotiating Issues in International Services Transactions", in W.R. Clive (ed) *Trade Policy in the 1980s* (Institute for International Economics Washington, 1983) p. 596.

are valid only if GATT legal framework were to be applied to the services trade. But the problems of extension of GATT legal framework to repeat are with respect to investment and transnational corporations which play very important role in the services trade and GATT does not deal with either of them. In this context it has been suggested that the negotiating process should be limited to the developed countries,²⁷ and OECD could be an appropriate forum. Once the developed countries agree on the rules and regulations related to a specific service industry, a sort of nucleus would be formed in which the developing countries could later be included. This is to suggest the exclusion of developing countries in order to achieve faster results. Such an approach would not take the issues raised by developing countries into account and therefore the members joining the "nucleus " later would have to accept (or choose not to accept) the already existing rules. This would ensure short-term results but long-term instability in trade relations. Hence, a possible framework could be in the form of multilateral agreement

27. H.P. Gray, "A Negotiating Strategy for Trade in Services",
Journal of World Trade Law, Vol.17, No.3, Sept/Oct 1983, p.386.

in specific sectors.²⁸ Since there are already agreements dealing with aviation, telecommunications existing in the form of ICAO and ITU, the basic existing infrastructure is ensured. Such agreements take into account the issues related with one particular service industry in detail, and developing countries can participate in the services trade on equal footing. They would have the opportunity to redress their deficit accumulated in capital related Services by way of gaining in labour related services. Whether the sector - specific agreements should be negotiated separately or within GATT framework is still debatable.²⁹ If the GATT framework is to be applied even for specific-sector agreements, then the question arises regarding the future of existing agreements like ICAO, HTU etc. Since the detailed regulatory mechanism of any of specific agreement is difficult to analyse, it is beyond the perview of present dissertation to discuss the pros and cons of specific sector agreements

 28. Deepak Nayyar, "International Trade in Services ; Implications for Developing Countries", EXIM Bank Commencement Day Annual Lecture, 1986. Also, D. Nayyar, "The Political Economy of International Trade in Services", *Cambridge Journal of Economics*, Vol.12, No.2, 1988, p.279.

29. The possibility of separate specific service agreements within GATT framework have been discussed in aviation and telecommunications equipment by Daniel Roseman, "Towards GATT Code on Trade in Telecommunications Equipment" *The World Economy*, Vol.11, no.1, 1988, p.135; D.M. Kasper, "Liberalising Airline Services How to get From here to There", *The World Economy*, Vol.11, no.1, 1988, p.91.

being included within GATT framework. At present it is difficult to lay down in concrete terms the blueprint for the future regulatory mechanism dealing with services trade. The ongoing process of conducting Studies in international bodies and by individual countries will help in understanding the problem in detail. But far as GATT framework is concerned, keeping in mind its present entanglement with unresolved issues of agricultural products, textiles,³⁰ etc. and its non-existent rules with respect to investment and non-tariff barriers its feasibility for services trade seems to be doubtful. In that case specific sector approach seems to be appropriate, and that too outside the GATT framework on the lines of already existing agreements like ICAO and ITU. Agreements in other specific services like banking, insurance, etc can be negotiated, which will ensure equal participation of developing and developed countries along with equal attention to issues raised.

30. In this context, it is worthwhile mentioning the outcome of ministerial review meeting of the Uruguay - round of GATT-MTN held at Montreal in December 1988, which ended in total disagreement on the key issues of agriculture, textiles, intellectual property rights and safeguards "GATT meet draws a blank", *The Times of India* (New Delhi, December 11, 1988).

CHAPTER - V

SUMMARY AND CONCLUSIONS

To recapitulate, the world economy is undergoing a structural change with services taking the centre stage. The service sector, which already accounts for almost two thirds of world GDP, has thus become the subject of much controversy in the international context. The United States along with other developed countries are the proponents of liberalisation of services trade, of which eventually they would appear to be the main beneficiaries. To begin with, by virtue of technological advancement developed countries possess a comparative advantage in the service sector. Transnational corporations, which have their bases largely in developed market economies and are a major driving force behind internationalisation of service trade, represent the second reason for domination of developed countries in services trade. On the other hand, the developing countries led by India and Brazil have opposed the process of liberalisation on various developmental grounds.

The developing countries, unable to cope up with rapid technological progress are already dependent

on the developed countries for the import of technology. Liberalisation in services trade would only go to enhance this dependency. It is, in fact, essential in this regard to strike a balance between import of necessary services and providing encouragement to indigenous service industries. In the latter context, the developing countries have put forward the infant-industry argument, which would allow temporary protection for "infant" industries so as to overcome the initial period of financial stress and become competitive in the world market. This would eventually enable the developing countries to acquire a strong indigenous service sector and reduce their dependence on imported services. Finally, services comprise the core activities of infrastructure like banking, telecommunications, insurance, etc. Therefore, liberalisation of services trade would open the door for TNGs to enter the traditionally domestic sectors like finance and defence. The well known difficulties in regulating TNCs could eventually mean a threat to national security and sovereignty. Hence, the apprehensions of developing countries of the move directed towards liberalisation of services trade.

In the legal sphere, the developing countries have opposed the proposition of developed countries to

include services in the GATT legal framework.¹ The developed countries have insisted on such an inclusion on the ground of its wide ranging membership and its being contractually binding. It is also pointed out that GATT has functioned well in the past decades and could well adapt to the changing economic relations by taking up contemporary issues. But the developing countries consider that its domination by developed countries would result in the formulation of rules in their favour. Secondly, GATT is a structure which was evolved basically to regulate trade in goods which in many ways is different from trade in services. Hence, issues like investment, regulation of TNCs etc. which are inevitably linked with services trade are not dealt with by GATT. Thirdly, by including services trade within GATT legal framework, there is the fear of possible linkage between access for goods for developing countries on one hand and concessions in services on the other. Fourthly, problems of international trade in agriculture, textiles etc. have not yet been adequately tackled by GATT and need attention before it takes up the

1. Deepak Nayyar, "International Trade in Services : Implications for Developing Countries", (EXIM Bank Commencement Day Annual Lecture, Bombay, 1986).

issue of services trade. As far as GATT principles of national treatment and most-favoured-nation treatment are concerned, it may not be possible to award the same treatment to foreign firms as accorded to domestic firms, keeping in view the very nature of services and their role in the development-process.² Similarly, the principle of reciprocity may prove to be redundant in case of services due to the inability of many developing countries to reciprocate.

The two possible alternate legal frameworks could be sector specific agreements covering each service sector individually³ or an umbrella code (outside GATT) covering all the services in general. The sector specific approach could prove to be advantageous on the grounds of already existing structures in specific services which lay down norms of conduct for all the signatories and deal in detail with specific services. Secondly, this would ensure the exchange of concessions in an equitable and meaningful way keeping in view the economic, political and social considerations of each signatory, which may or

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2. Murray Gibbs, "Continuing the International Debate on Services", *Journal of World Trade Law*, Vol.19, no.3, 1985; William Diebold, Jr. and Helena Stalson, "Negotiating Issues in International Services Transactions", in William R. Cline, ed., *Trade Policy in the 1980s* (Institute for International Economics, Washington, D.C., 1983).
3. Deepak Nayyar, "The Political Economy of International Trade in Services", *Cambridge Journal of Economics*, Vol.12, no.2, June 1988.

may not decide to become party to it. In this context an unacceptable suggestion has been to limit, in the first place, the negotiating process to developed countries.⁴ Once the developed countries have reached an agreement, it is contended, they can form a nucleus of nations in which national treatment or free-trade will be the rule and reciprocity can be accorded to the non-members. The proposal is that the nucleus can accept new members on an individual basis and each specific service industry can have its own club of nations trading freely in that service. Such formation of a core group in each industry would be the first step. It can be hoped that with passage of time these core groups will grow further in membership and involve larger group of countries. This approach appears to keep away the developing countries for the first round of negotiations which in a way means that rules and norms already formulated during the first round by the developed nations would have to be followed by the members joining later on. But to exclude the developing countries from the negotiating process will do more harm than good since to arrive at a stable and equitable regime, it is imperative to reach an agreement through consensus.

4. H.P. Gray, "A Negotiating Strategy for Trade in Services", *Journal of World Trade Law*, Vol.17, no.3, 1983.

The other option of multilateral framework in the form of umbrella code covering all the services would be less advantageous and a more difficult approach because it not only has to consider the various issues raised by developed and developing countries but also adopt codes on TNCs and FDI due to their inevitable linkage with the services trade. Secondly, the umbrella code would have to define its relationship with already existing agreements in specific services. That is to say, whether these agreements would be disbanded or brought under the aegis of the new code. These agreements it may be noted, have been the outcome of long and tedious negotiations and, therefore, cannot be easily disbanded. Thirdly, there are various bilateral practices with some relevance to services in force between countries. What would be their position vis-a-vis the umbrella code? A possible argument in favour could be that cross-sectoral multilateral negotiations could help the participating countries in arriving at a package deal through mutual conversions in diverse services which would be acceptable to all.

The approach towards negotiating regulatory mechanism for services trade could therefore, either be sector-specific or an umbrella code. But it is necessary that prior to any such negotiations, in depth studies on

the service sector must be taken up as a pre-requisite. At present there is no well defined concept of services trade nor adequate data available. Hence efforts must be made to fill these gaps. The process has already begun with different countries conducting national studies on services. As more and more studies come forward, the various aspects of services trade will become clearer which eventually will help the trade policy makers in balancing conflicting interests and devising an appropriate coherent policy.

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