

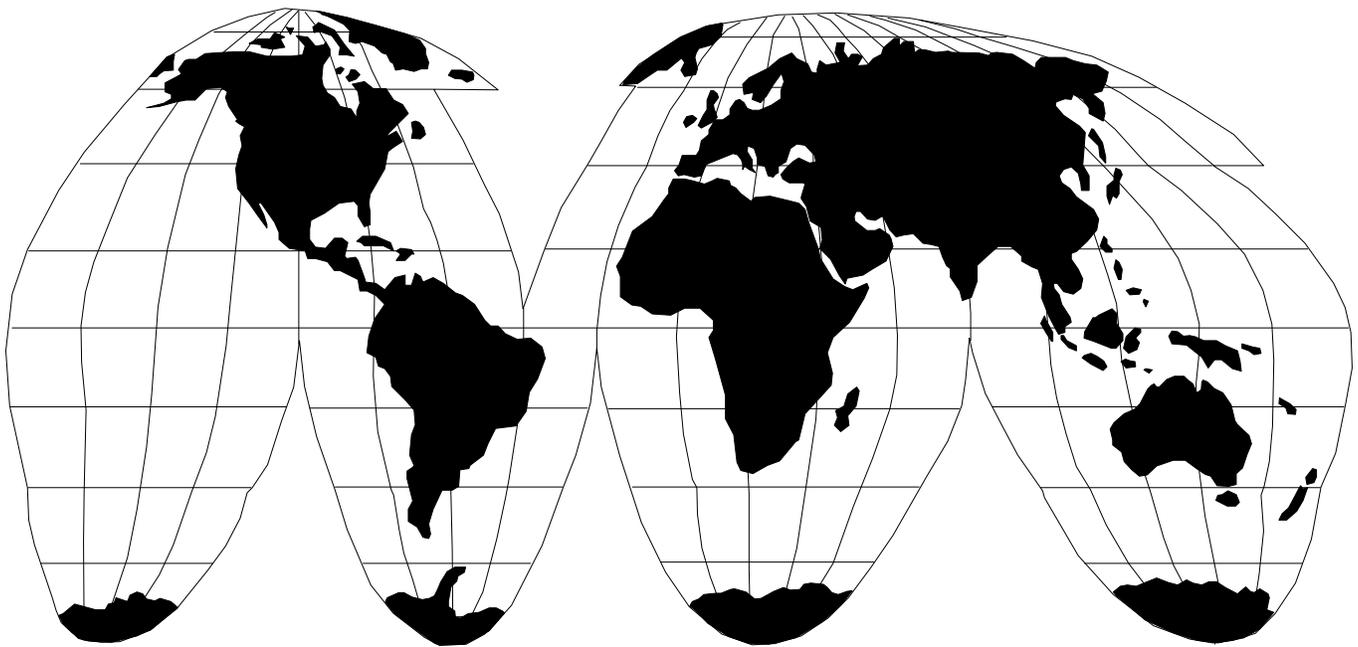
Recent Trends in U.S. Services Trade

1999 Annual Report
Investigation No. 332-345

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U.S. International Trade Commission



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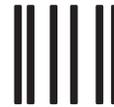
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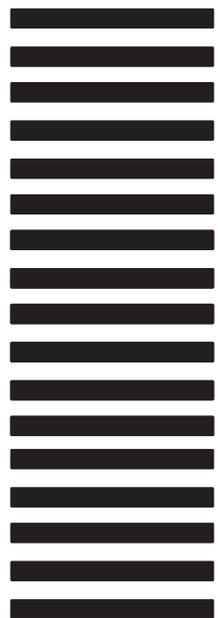
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Recent Trends



PREFACE

On August 27, 1993, on its own motion and pursuant to section 332 (b) of the Tariff Act of 1930 (19 U.S.C. 1332(b)), the U.S. International Trade Commission (USITC) instituted investigation No. 332-345, *Annual Reports on U.S. Trade Shifts in Selected Industries*. The current report format was developed by the USITC in response to Congressional interest in establishing a systematic means of examining and reporting on the significance of major trade shifts, by product, and with leading U.S. trading partners, in service, agricultural, and manufacturing sectors. A significant amount of the information contained in this recurring report reflects basic research that is required to maintain a proficient level of trade expertise. The Commission has found such expertise to be essential in its statutory investigations and in apprising its varied customer base of global industry trends, regional developments, and competitiveness issues.

On December 20, 1994, the Commission on its own motion expanded the scope of this report to include detailed coverage of service industries. Under the expanded scope, the Commission publishes two reports annually, one entitled *Shifts in U.S. Merchandise Trade* (July) and the second entitled *Recent Trends in U.S. Services Trade*¹ (May). Services trade is presented in a separate report in order to provide more comprehensive and timely coverage of the sector's performance.

The current report begins with a statistical overview of U.S. trade in services and a discussion of key trends. Thereafter, the report presents industry-specific analyses that focus on trends in exports, imports, and trade balances during 1992-97. Industry-specific analyses also identify major trading partners during the subject period. The report concludes with an examination of the U.S. professional services sector, emphasizing the sector's importance and reviewing recent efforts to liberalize trade in professional services.

Further USITC analyses of trade in services include a series of reports on U.S. trading partners' schedules of commitments under the General Agreement on Trade in Services (GATS) administered by the World Trade Organization. The schedules of commitments indicate the extent to which U.S. trading partners grant market access and national treatment to service providers from other countries, including the United States. The USITC reports are entitled *General Agreement on Trade in Services: Examination of Major Trading Partners' Schedules of Commitments* (USITC publication 2940, Dec. 1995), *General Agreement on Trade in Services: Examination of South American Trading Partners' Schedules of Commitments* (USITC publication 3007, Dec. 1996), *General Agreement on Trade in Services: Examination of the Schedules of Commitments Submitted by Asia/Pacific Trading Partners* (USITC publication 3053, Aug. 1997), *General Agreement on Trade in Services: Examination of the Schedules of Commitments Submitted by Eastern Europe, the European Free Trade Association, and Turkey* (USITC publication 3127, Sept. 1998), and *General Agreement on Trade in*

¹ Starting with the 1997 issue, the title of the report on services was changed from *U.S. Trade Shifts in Selected Industries: Services* to *Recent Trends in U.S. Services Trade*.

Services: Examination of the Schedules of Commitments Submitted by African Trading Partners (forthcoming, 1999).

The information and analysis in this report are for the purpose of this report only. Nothing in this report should be construed to indicate how the Commission would find in an investigation conducted under other statutory authority.

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CHAPTER 1

INTRODUCTION

Scope and Purpose

The U.S. International Trade Commission (USITC) routinely monitors trade developments in the service, agricultural, and manufacturing sectors. This report, prepared annually, analyzes significant trends in services trade as a whole, assesses trade in selected service industries, and identifies major U.S. trading partners. Since a considerable share of service transactions takes place through affiliates established abroad, data for both cross-border and affiliate transactions are presented to provide a comprehensive analysis of the international activities of U.S. service industries.

Methodological Approach and Organization

The data presented herein are drawn primarily from the most recent annual data available for U.S. trade in services, which are estimated and published by the U.S. Department of Commerce (USDOC), Bureau of Economic Analysis (BEA).¹ With the exception of energy services and environmental services, comparable annual BEA data regarding cross-border services trade are available for the period 1987-97, whereas comparable data pertaining to affiliate transactions are available for the period 1987-96. Since BEA does not report on trade in energy services or environmental services, trade data regarding these services were drawn from reports published by the U.S. Department of Energy,² the *Environmental Business Journal*,³ and industry sources.

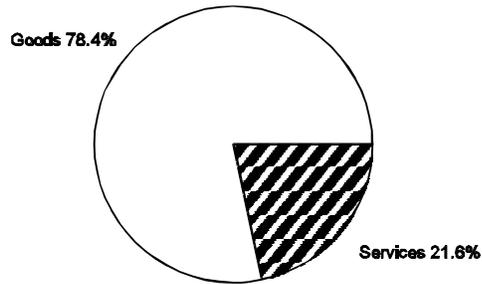
Chapter 2 of this report describes the nature of cross-border trade and affiliate transactions in services and provides an overview of U.S. services trade by industry and by trading partner. Chapters 3 through 20 discuss U.S. international trade in intangible intellectual property and selected service industries, including accounting and management consulting; advertising; architectural, engineering, and construction; audiovisual; banking and securities; computer and data processing; education; energy; environmental; health care; insurance; legal; retail; telecommunication; transportation; travel and tourism; and

¹ Periodically, BEA changes its methodology to enhance annual reporting. Although BEA made no changes to surveys used to report affiliate trade this year, it made several modifications in its survey used to estimate cross-border trade in services, incorporating industry reclassifications and improvements in source data. For more information, see U.S. Department of Commerce (USDOC), Bureau of Economic Analysis (BEA), *Survey of Current Business*, Oct. 1998, p. 76.

² U.S. Department of Energy, Office of Fossil Energy, Office of Coal and Energy Systems, "Electricity Transactions Across International Borders 1996," found at Internet address <http://www.fe.doe.gov/>, retrieved June 30, 1998.

³ *Environmental Business Journal*, Environmental Business International (EBI).

Figure 1-1
U.S. cross-border trade volume, by sector, 1997



Total trade volume: \$2 trillion

Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1998, p. 42.

wholesale services. Each discussion compares cross-border trade performance in 1997 with trends evident during 1992-96, and/or affiliate transactions in 1996 with trends during 1992-95. These chapters also review the principal factors underlying the volume and direction of recent trade, and identify factors likely to influence future trade performance. Outlooks regarding the subject service industries are based on USITC staff interviews with industry representatives and reviews of secondary sources, such as industry journals. Chapter 21 of the report examines the U.S. professional services sector, by discussing the sector's importance and reviewing recent efforts to liberalize trade in professional services.

U.S. merchandise trade is not discussed in this report. As noted in the *Preface*, it is the subject of a separate USITC annual report. However, to put U.S. services trade in perspective with merchandise trade, cross-border services trade accounted for 22 percent of total U.S. cross-border trade volume in 1997 (figure 1-1).⁴ U.S. cross-border trade in services generated an \$88-billion surplus in 1997, in contrast to a U.S. merchandise trade deficit of \$198 billion.⁵ Further, the service sector accounted for 77 percent of U.S. private-sector gross domestic product (GDP) in 1997 (figure 1-2).⁶ By comparison, manufacturing accounted for 19 percent of GDP, and mining and agriculture together accounted for 4 percent. In 1997, the service sector provided 79 percent of total private-sector employment, compared with manufacturing with 19 percent, and mining and agriculture together with 2 percent (figure 1-3).⁷

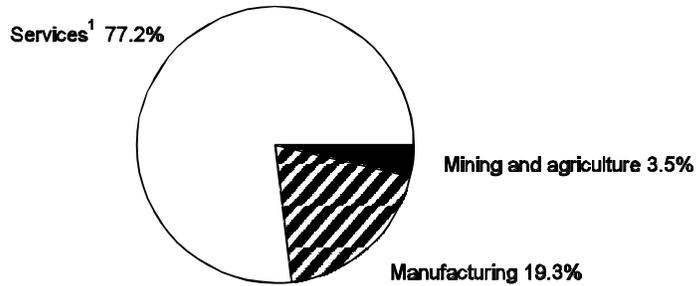
⁴ Total trade volume is the sum of imports and exports.

⁵ USDOC, BEA, *Survey of Current Business*, Oct. 1998, p. 42.

⁶ USDOC, BEA, *Survey of Current Business*, Nov. 1998, p. 23.

⁷ USDOC, BEA, *Survey of Current Business*, Aug. 1998, p. 80.

Figure 1-2
U.S. private-sector gross domestic product, by sector, 1997

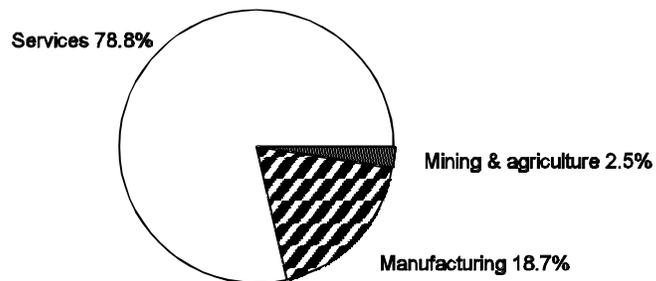


Total private-sector GDP: \$7.1 trillion

¹ The services sector consists of distribution, education, financial, transportation, telecommunication, public utility, travel, and a broad range of business, professional, and technical services.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Nov. 1998, p. 23.

Figure 1-3
U.S. private-sector employment, by sector, 1997



Total full-time equivalent employees: 98.1 million workers

Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Aug. 1998, p. 80.

CHAPTER 2

U.S. TRADE IN SERVICES

Nature of Trade in Services

Nations trade services through two principal channels. One channel, cross-border trade, entails sending individuals, information, or money across national borders. The current account of the United States¹ explicitly delineates cross-border exports and imports of services. The other channel, affiliate transactions, entails selling services through affiliates established by multinational companies in foreign markets. The current account does not list such transactions among exports and imports, but does report direct investors' shares of the profits generated by these affiliates as investment income.

Cross-Border Trade

The analysis of cross-border trade in this report examines private-sector transactions only. Part of cross-border services trade reported in the current account reflects U.S. public-sector transactions (e.g., expenditures related to the operations of the military and U.S. embassies). Public-sector transactions are not considered to reflect U.S. service industries' competitiveness, and introduce anomalies due to such events as international peace-keeping missions and humanitarian relief operations.

The value of U.S. cross-border service exports, including both public- and private-sector transactions, has consistently exceeded that of imports in recent years, yielding a services trade surplus that grew to \$88 billion in 1997 (figure 2-1) and offsetting 44 percent of the merchandise trade deficit (figure 2-2).² When public-sector transactions are removed from the 1997 data, the value of service exports still exceeds that of imports, but the services trade surplus totals \$83 billion (table 2-1).³

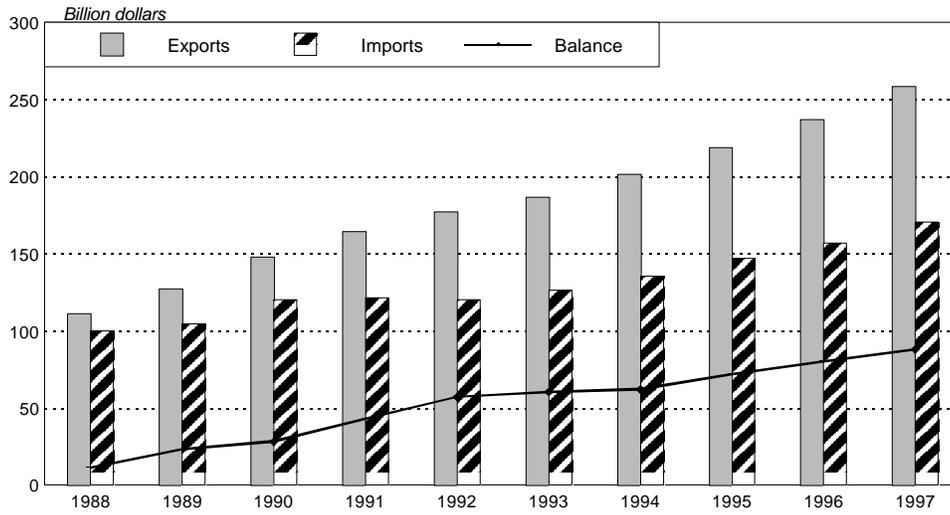
In 1997, private-sector, cross-border service exports grew more slowly than cross-border imports. Exports increased by 7 percent, to \$239 billion, slower than the average annual export growth rate of 10 percent experienced during 1988-96. In comparison, private-sector, cross-border service imports increased by 10 percent in 1997, to \$156 billion, exceeding the 7-percent average annual increase during 1988-96. Consequently, the rate

¹ The current account of the balance of payments reports trade in goods and services, flows of investment income, and unilateral transfers of funds (e.g., U.S. Government grants, pensions, and other funds).

² Values are reported before deductions for expenses and taxes, as gross values are most directly comparable across countries, industries, and firms. U.S. Department of Commerce (USDOC), Bureau of Economic Analysis (BEA), *Survey of Current Business*, June 1992, pp. 68-70.

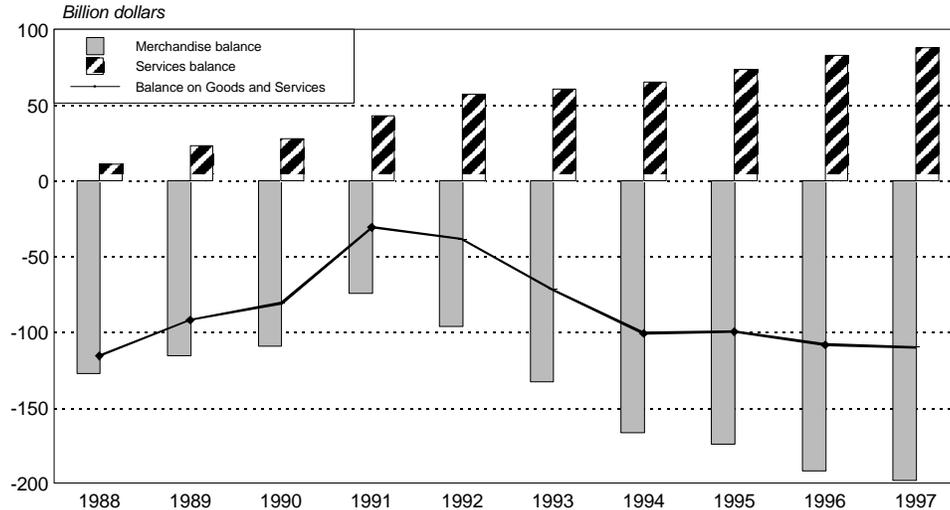
³ USDOC, BEA, *Survey of Current Business*, July 1998, pp. 82-86.

Figure 2-1
U.S. cross-border trade in services: Exports, imports, and trade balance, 1988-97¹



¹ Data are represented as they appear in the current account of the U.S. balance of payments. Consequently, the services trade balance includes public-sector trade in addition to private-sector trade.
 Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, July 1998, pp. 68-69.

Figure 2-2
U.S. merchandise and services trade balances, 1988-97¹



¹ Data are presented as they appear in the current account of the U.S. balance of payments. Consequently, the services trade balance includes public-sector trade in addition to private-sector trade.
 Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, July 1998, pp. 68-69.

Table 2-1
Derivation of U.S. private-sector, cross-border services trade balance, 1988-97

(Million dollars)

	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
Total exports	111,068	127,233	147,922	164,333	176,982	186,385	201,434	219,802	238,792	258,268
Public-sector exports . . .	(9,948)	(9,152)	(10,600)	(11,823)	(13,228)	(14,354)	(13,674)	(15,573)	(14,579)	(19,053)
Private-sector exports . . .	101,120	118,081	137,322	152,510	163,754	172,031	187,760	204,229	224,213	239,215
Total imports	(99,965)	(104,185)	(120,021)	(121,196)	(119,561)	(125,715)	(136,155)	(145,964)	(156,029)	(170,520)
Public-sector imports . . .	17,524	17,184	19,450	18,524	16,097	14,456	12,852	12,609	13,768	14,284
Private-sector imports . . .	(82,441)	(87,001)	(100,571)	(102,672)	(103,464)	(111,259)	(123,303)	(133,355)	(142,261)	(156,236)
Private-sector trade balance	18,679	31,080	36,751	49,838	60,290	60,772	64,457	70,874	81,952	82,979

Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, July 1998, pp. 68-69, and Oct. 1998, pp. 86-87.

of growth in the services trade surplus, which averaged 20 percent annually during 1988-96, fell to only a 1-percent increase in 1997.⁴

Cross-Border Trade by Industry

In 1997, travel and tourism services accounted for 31 percent of U.S. service exports, the largest share of total service exports by a single industry. Travel and tourism exports reflect inbound travelers' total expenditures (e.g., food, lodging, recreation, local transportation, and gifts) while in the United States, and have consistently accounted for a large part of U.S. service exports. Other services accounting for large shares of total U.S. exports were services related to intangible intellectual property, representing 14 percent; freight transportation services (including port services), representing 11 percent; and both passenger fares (airline and maritime), and business, professional, and technical services (hereinafter, professional services), each representing 9 percent (figure 2-3). By comparison, travel and tourism, freight transportation, and passenger fares also figured prominently among U.S. service imports in 1997, accounting for 33 percent, 19 percent, and 12 percent of total service imports, respectively.⁵ Table 2-2 delineates, where applicable, the activities reflected in official cross-border services trade data.

In 1997, as in most other years, all U.S. service industries registered trade surpluses, except those providing advertising, freight transportation, telecommunication, and insurance services. The trade deficits posted by these few service industries, however, largely reflect accounting conventions and trade estimation methodologies, rather than unfavorable competitive positions. For instance, the shortfall in freight transportation services mirrors the deficit in U.S. merchandise trade in large part, as payments for freight transportation are typically made by importers to carriers of exporting countries. Because the United States imports more merchandise than it exports, U.S. importers are likely to pay foreign freight carriers more than U.S. freight carriers receive from foreign importers of U.S. goods. The deficit in telecommunication services reflects the relatively high volume of international calls originating in the United States, and an international accounting convention whereby carriers providing outbound international calls compensate the carriers handling inbound calls. Last, the surplus of premiums received by U.S. insurers over claims paid to foreign policyholders (i.e., net exports by accounting convention) was less than the surplus of premiums collected by foreign insurers over claims paid to U.S. policyholders (i.e., net imports by accounting convention), resulting in a cross-border deficit.

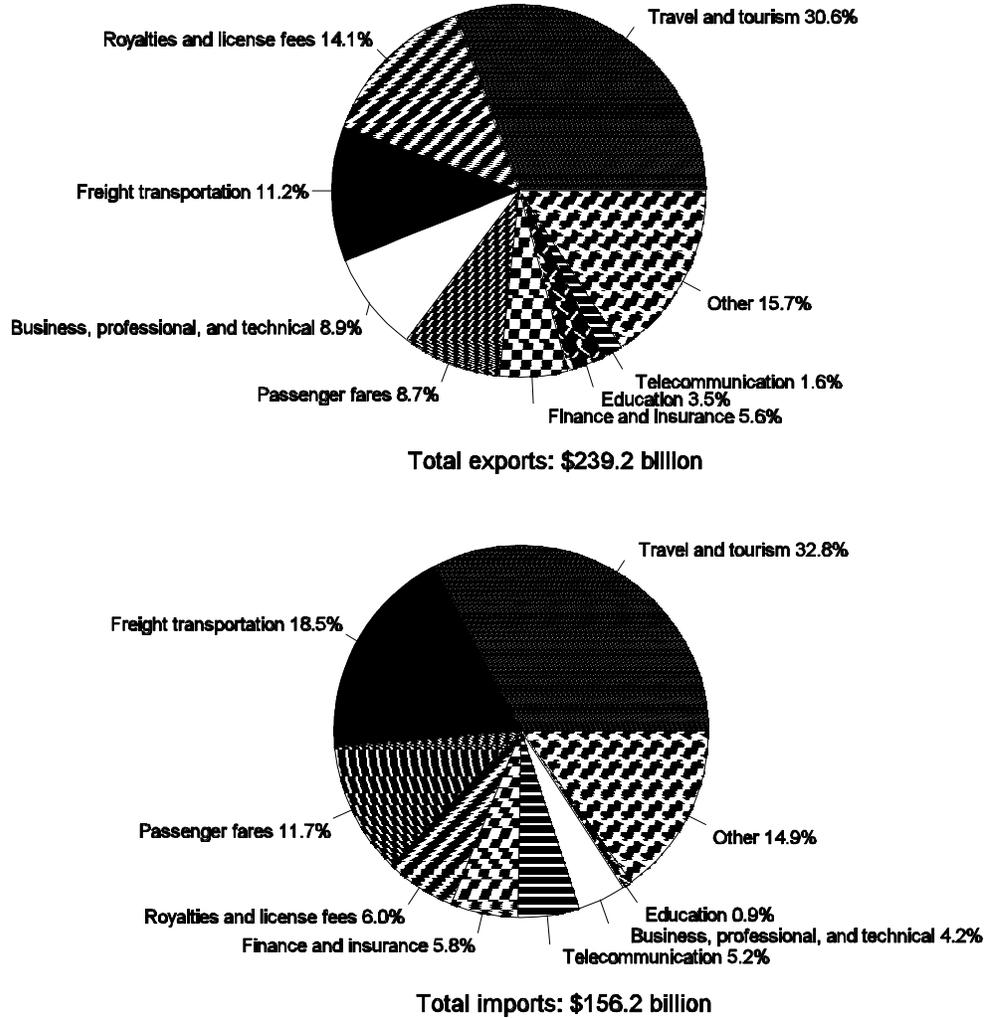
Royalties and license fees, stemming from sales of intangible intellectual property, accounted for 29 percent of the overall services trade surplus in 1997, followed by travel and tourism with 27 percent, and professional services, such as architectural, engineering, and construction services, with 18 percent.⁶ Payments of royalties and license fees reflect a vast array of transactions involving proprietary rights over manufacturing processes, copyrights, broadcast rights, trademarks, and other intangible

⁴ USDOC, BEA, *Survey of Current Business*, Oct. 1998, pp. 86-87.

⁵ Ibid.

⁶ Ibid.

Figure 2-3
U.S. cross-border service exports and imports,¹ by industry, 1997²



¹ Trade data exclude public-sector trade.

² Totals may not equal 100 percent due to rounding.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1998, pp. 86-87.

Table 2-2
Activities captured in official U.S. data on cross-border trade in services, by industry

Service	U.S. Exports	U.S. Imports
Accounting and management consulting	Includes accounting, auditing, bookkeeping, management, consulting, and public relations services to foreign clients. Excludes management of health care facilities, consulting engineering services related to actual or proposed construction or mining services projects, computer consulting, data processing and tabulating services, and public relations services integral to an advertising campaign.	Same.
Advertising	Includes U.S. advertising firms' preparation and placement of advertising in media on behalf of foreign clients, and U.S. media firms' provision of media space and time for foreign firms' advertisements.	Includes foreign advertising firms' preparation and placement of advertising in media on behalf of U.S. clients, and foreign media firms' provision of media space and time for U.S. firms' advertisements.
Architectural, engineering, and construction	Includes construction, engineering, architectural, and mining services, including oil and gas field services. Architectural services include services mainly for businesses, but exclude landscape architecture and graphic design services. Engineering services relate to construction and mining services projects only, and exclude industrial engineering services, such as product design services. Land-surveying services are included, as are services of general contractors in the fields of building and heavy construction, and construction work by special trade contractors, such as erection of structural steel for bridges and buildings and on-site electrical work. Data are reported for services purchased in connection with proposed projects (i.e., feasibility studies) as well as projects contracted or underway, but exclude contractors' expenditures on merchandise and labor.	Same, except data include contractors' expenditures on merchandise and labor.
Audiovisual	Includes nonresidents' rentals of films and tapes from U.S. residents.	Includes U.S. residents' rentals of films and tapes from nonresidents.

Table 2-2--Continued
Activities captured in official U.S. data on cross-border trade in services, by industry

Service	U.S. Exports	U.S. Imports
Banking and securities	Includes brokerage services, private placement services, underwriting services, financial management services, credit card services, credit-related services, financial advisory and custody services, securities lending services, and other financial services.	Same.
Computer and data processing	Includes data entry, processing (both batch and remote), and tabulation; computer systems analysis services, design, and engineering services; custom software and programming services; systems integration services; and other computer services (e.g., timesharing, maintenance, and repair). Excludes general use computer software royalties and license fees.	Same.
Education	Includes tuition and living expenses of foreign students enrolled in U.S. colleges, universities, and other institutions of higher education.	Includes tuition and living expenses of U.S. students studying in foreign colleges, universities, and other institutions of higher education through "study abroad" programs sponsored by U.S. institutions.
Energy	Not available.	Not available.
Environmental	Not available. ¹	Not available. ¹
Health care	Includes services provided by U.S. hospitals, clinics, doctors, and other health care service providers to foreign residents in the United States.	Not available.
Insurance	Includes primary and reinsurance premiums (net of claims paid) purchased by foreign persons from U.S. carriers operating in the U.S. market.	Includes primary and reinsurance premiums (net of claims receipts) purchased by U.S. persons from foreign carriers operating in their home markets.

See footnotes at end of table.

Table 2-2--Continued
Activities captured in official U.S. data on cross-border trade in services, by industry

Service	U.S. Exports	U.S. Imports
Intangible intellectual property	Includes management services and intangible intellectual property to foreign-based entities. Management services essentially include administrative, professional, and managerial services rendered by parent companies to their foreign affiliates. Intangible intellectual property consists of four primary elements: (1) the right to use patented and unpatented processes and formulas used in the production of goods; (2) the right to use copyrights, trademarks, franchises, and broadcast rights; (3) the right to distribute, use, and reproduce computer software; and (4) the right to sell products under a particular trademark, brand name, or signature.	Same.
Legal	Includes legal advice or other legal services.	Same.
Retail	Not available.	Not available.
Telecommunication	Predominantly includes net settlement receipts of U.S. carriers for terminating inbound foreign calls. Also includes telex, telegram, and other basic telecommunication services; value-added services, such as electronic mail, management of data networks, enhanced facsimile, and electronic funds transfer; telecommunication support services, such as repair, ground station services; and the launching of communications satellites.	Same, except predominantly includes net settlement payments by U.S. carriers to compensate foreign carriers for terminating outbound U.S. calls.
Transportation <i>Passenger fares</i>	Includes receipts by U.S. ocean and air carriers from foreign residents traveling between the United States and foreign countries and between two foreign points.	Includes payments to foreign ocean and air carriers by U.S. residents traveling between the United States and foreign countries.

See footnotes at end of table.

Table 2-2--Continued
Activities captured in official U.S. data on cross-border trade in services, by industry

Service	U.S. Exports	U.S. Imports
Transportation--Continued <i>Freight</i>	Includes receipts of U.S.-operated ocean, air, and other carriers for the international transportation of U.S. exports; and receipts of U.S.-operated carriers transporting foreign freight between foreign points. "Other" freight services include transportation of U.S. merchandise exports to Canada by truck. Also includes operational leasing of transportation equipment with crew. ²	Includes payments to foreign-operated ocean, air, and other carriers for international transportation of U.S. imports. "Other" freight services include transportation of U.S. goods imports from Canada by truck. Also includes payments for the operational leasing of equipment with crew.
<i>Port</i>	Includes goods and services purchased in U.S. ports by foreign-operated carriers.	Includes goods and services purchased in foreign ports by U.S.-operated carriers.
Travel and tourism	Includes expenditures in the United States by foreign travelers (except foreign government personnel and their dependents, and other foreign citizens residing in the United States) for lodging, food, and transportation within the United States, and recreation and entertainment, personal purchases, gifts, and other outlays associated with travel in the United States. ³	Includes expenditures abroad by U.S. travelers (excluding U.S. Government personnel and their dependents, and other U.S. citizens residing abroad) for lodging, food, and transportation within foreign countries, and recreation and entertainment, personal purchases, gifts, and other outlays associated with travel abroad. ⁴
Wholesale	Not available.	Not available.

¹ Data reported in ch. 11 are from industry sources. Activities included hazardous and solid waste management services, environmental consulting and engineering services, remediation and industrial services, analytical services, and water treatment works.

² With regard to "other transportation" services, the October 1998 *Survey of Current Business* states that the estimates for operational leasing of transportation equipment without crew were reclassified from the "other transportation" accounts to "other private services" accounts. At the same time, operational leasing of transportation equipment with crew was retained in the "other transportation" account, but was reclassified to the freight component. Consequently, "other transportation" receipts and payments each now have only two components, freight services and port services. USDOC, BEA, *Survey of Current Business*, Oct. 1998, p. 76.

³ Expenditures are estimated by the USDOC, BEA, based on data principally supplied by the USDOC, International Trade Administration, Tourism Industries, in conjunction with the U.S. Department of Justice, Immigration and Naturalization Service, and by Statistics Canada and the Banco de Mexico. Officials of BEA and Tourism Industries, telephone interviews with USITC staff, Oct. 22 and 23, 1998.

⁴ Ibid.

Sources: USDOC, BEA, *U.S. International Transactions in Private Services: A Guide to the Surveys Conducted by the Bureau of Economic Analysis*, Mar. 1998; Environmental Business International (EBI); USDOC, International Trade Administration, Tourism Industries, in conjunction with the U.S. Department of Justice, Immigration and Naturalization Service, and Statistics Canada and the Banco de Mexico; and OECD, *Services Statistics on International Transactions*, p. 119.

property. U.S. trade in proprietary rights takes place principally between U.S. parent companies and their foreign affiliates, reflecting the large volume of U.S. direct investment abroad, and the strength of U.S. firms as innovators. This trade has consistently generated large U.S. surpluses, as U.S. parent firms have licensed foreign affiliates to sell intellectual property abroad, and collected license fees in return, with these fees registering as exports in the U.S. balance of payments. During 1992-97, the surplus on trade in proprietary rights accounted for between 26 percent and 33 percent of the overall cross-border surplus in services trade (figure 2-4).

Since 1989, the surplus on trade in travel and tourism services has increased every year, with the exception of 1994 (figure 2-5). This surplus is sensitive to exchange rate fluctuation. This sensitivity was demonstrated in 1994-95, when the depreciation of the Mexican peso severely curtailed tourism to the United States from Mexico. As a result of the peso's devaluation, U.S. cross-border tourism exports to Mexico dropped from \$5.1 billion in 1993 to \$2.9 billion in 1995, while a stronger dollar encouraged more U.S. outbound tourism to Mexico. Consequently, the U.S. deficit in cross-border tourism trade with Mexico widened from \$43 million in 1993 to \$2.5 billion in 1995. This deficit increased to \$3 billion in 1996, and remained at that level in 1997. In this light, it is reasonable to expect that the currency crisis in Southeast Asia in 1997 and 1998 will continue to have an adverse impact on the overall U.S. tourism trade surplus in the near term. Recent trade data suggest that inbound tourism from Asia declined by about 40 percent between the third quarter of 1997, when the crisis erupted, and the fourth quarter. Inbound tourism from the region appeared to fall by another 12 percent in the first quarter of 1998, before rebounding in the second quarter as summer bookings increased.⁷

Cross-Border Trade by Trading Partner

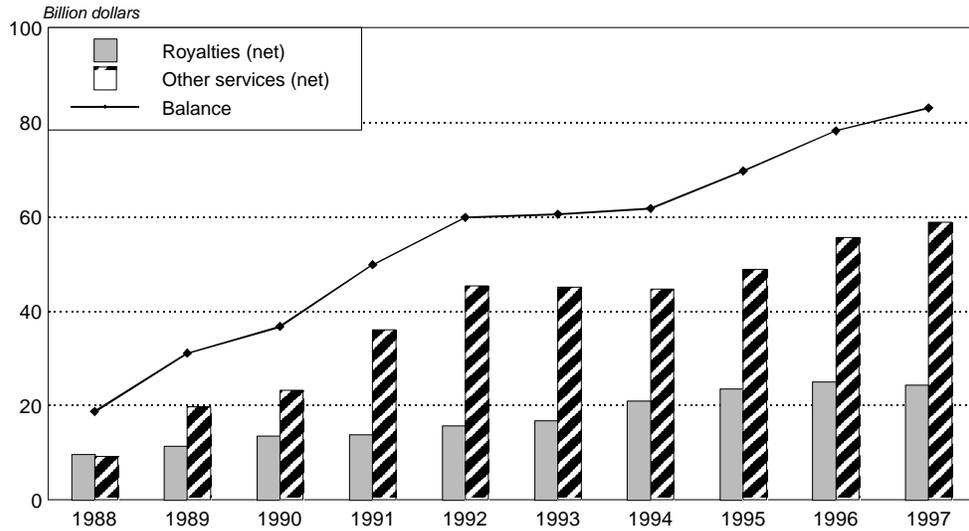
In 1997, the European Union (EU) was the largest U.S. partner with respect to cross-border trade in services, accounting for 31 percent of U.S. exports and 34 percent of imports (figure 2-6). Japan was second, accounting for 14 percent of exports and 9 percent of imports. Canada was third, with 9 percent of both exports and imports, and Mexico fourth, with 4 percent of exports and 8 percent of imports. Jointly, these four major trading partners accounted for 58 percent of U.S. cross-border service exports and 61 percent of imports.

In 1997, the United States registered cross-border trade surpluses in services with all major trading partners except Mexico. Surpluses measured \$21.6 billion with the EU, \$19.7 billion with Japan, and \$6.4 billion with Canada.⁸ For the third consecutive year, the United States recorded a deficit on cross-border services trade with Mexico, which amounted to \$3.8 billion in 1997. Much of the U.S. services trade deficit with Mexico stems from lower inbound travel from Mexico since the peso depreciation.

⁷ Data reflect inbound tourism from Asia (minus Japan and Australia) and Africa, with the former accounting for \$34.6 billion in tourism receipts in 1997, and the latter for \$3.6 billion. USDOC, BEA, *Survey of Current Business*, Oct. 1997, p. 93; and Oct. 1998, pp. 69 and 88.

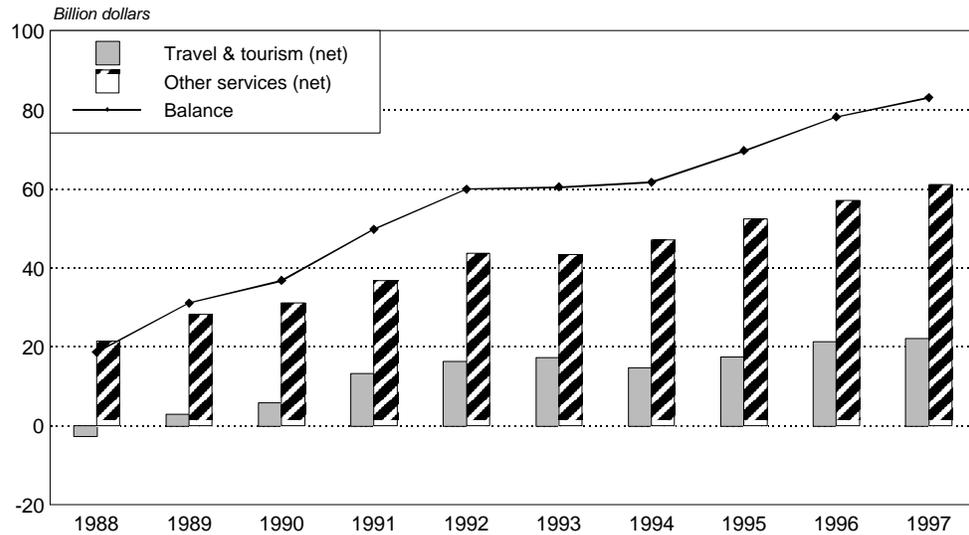
⁸ Ibid.

Figure 2-4
Royalties and license fees in the U.S. cross-border services trade balance,¹ 1988-97



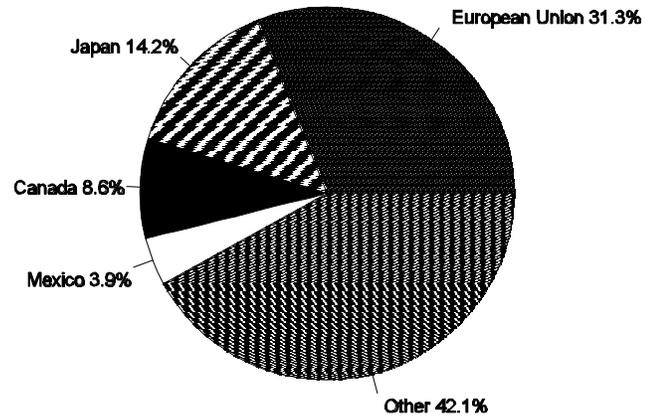
¹ Trade data exclude public-sector trade.
 Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1998, pp. 86-87.

Figure 2-5
Travel and tourism in the U.S. cross-border services trade balance,¹ 1988-97

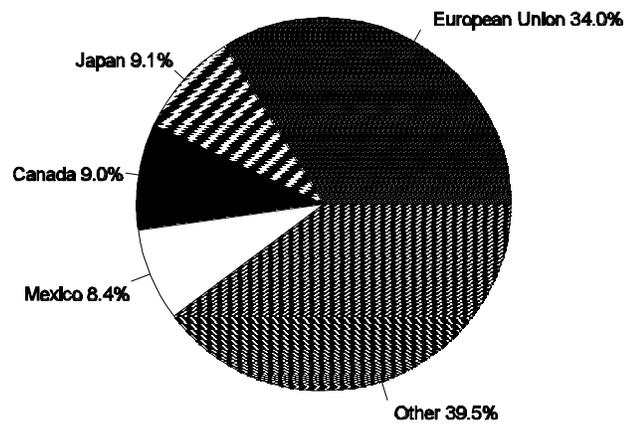


¹ Trade data exclude public-sector trade.
 Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1998, pp. 86-87.

Figure 2-6
U.S. cross-border service exports and imports,¹ by selected trading partners, 1997²



Total exports: \$239.2 billion



Total imports: \$156.2 billion

¹ Trade data exclude public-sector trade.

² Totals may not equal 100 percent due to rounding.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1998, pp. 88-89.

Affiliate Transactions

Data on affiliate transactions track majority-owned affiliates' sales to unaffiliated foreigners in the host market.⁹ The provision of many services requires that the service provider be proximate to the consumer for practical and regulatory reasons. For example, the delivery of certain travel and tourism services, such as lodging and restaurant services, is not feasible across borders. Accounting firms prefer to provide services to overseas clients through foreign affiliates, in part, because regulations may restrict, or render uneconomic, cross-border transmission of financial data. Similarly, architectural and engineering firms find that establishment of a commercial presence in foreign markets is often a necessary prerequisite for obtaining contracts. Consequently, many firms establish a commercial presence abroad by means of foreign direct investment. As noted earlier, direct investors' shares of profits from sales through affiliates are reported as investment income in the balance of payments.¹⁰

In 1996, sales by foreign-based affiliates of U.S. companies increased by 16 percent, almost double the 9-percent average annual growth posted during 1990-95 (figure 2-7). Sales grew by 21 percent in the EU, principally in the United Kingdom, Germany, and the Netherlands. By comparison, purchases from U.S.-based affiliates of foreign firms increased by 8 percent, slightly faster than the 7-percent average annual rate of growth during 1990-95. Purchases from affiliates of EU firms increased by 5 percent, in large part due to increased sales by German-owned insurance companies in the United States. Overall, sales by foreign-based affiliates of U.S. firms exceeded purchases from U.S.-based affiliates of foreign firms by \$60 billion, about one and one-half times the previous year's level.

Affiliate Transactions by Industry

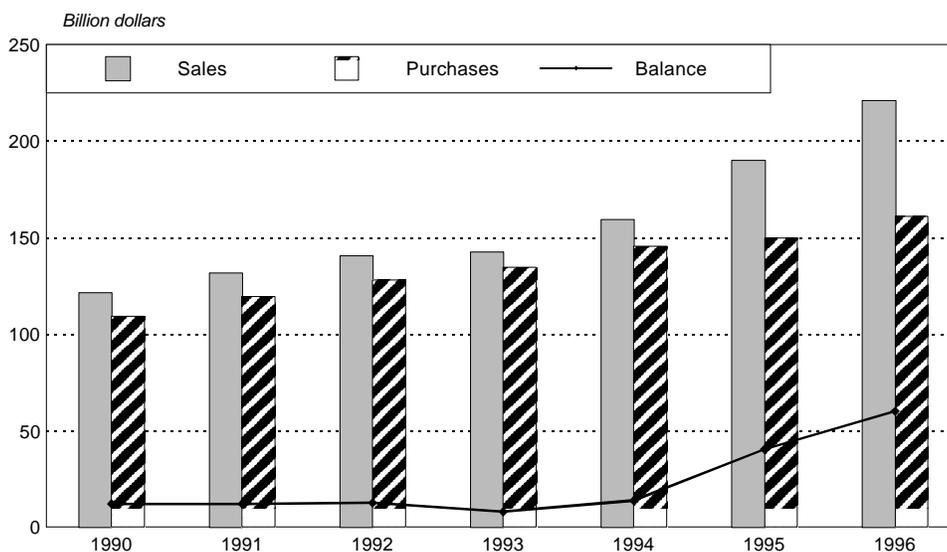
In 1996, sales by U.S.-owned insurance affiliates in foreign countries accounted for 19 percent of total sales by foreign affiliates of U.S. firms, the largest share represented by any single industry (figure 2-8). The computer and data processing services industry placed second, accounting for 13 percent of foreign affiliates' sales.¹¹ By comparison, purchases of insurance services from U.S.-based affiliates of foreign parents accounted for 35 percent of total U.S. purchases from affiliates, reflecting the large presence of foreign insurance companies in the U.S. market. Purchases of banking and securities

⁹ Majority-owned foreign affiliates of U.S. firms are defined as foreign affiliates for which the combined direct and indirect ownership interest of all U.S. parents exceeds 50 percent. Majority-owned U.S. affiliates of foreign firms are U.S.-based affiliates for which the combined direct and indirect ownership interest of all foreign parents exceeds 50 percent. For reporting purposes, the country in which the U.S.-based affiliate's "ultimate beneficial owner" resides receives credit for sales to U.S. persons. An ultimate beneficial owner of a U.S. affiliate is the entity, proceeding up the affiliate's ownership chain, that is not owned more than 50 percent by another person.

¹⁰ Sales receipts are reported before deductions for expenses and taxes, as gross sales figures are more directly comparable across countries, industries, and firms. USDOC, BEA, *U.S. Direct Investment Abroad: 1994 Benchmark Survey, Final Results*, May 1998, p. M-17.

¹¹ *Ibid.*, p. 115.

Figure 2-7
Affiliate service transactions: U.S. sales, purchases, and balance, 1990-96



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1998, p. 114.

services from U.S. affiliates of foreign firms represented 7 percent of total purchases.¹² Table 2-3 delineates, where applicable, the activities reflected in official data regarding affiliate transactions.

Affiliate Transactions by Trading Partner

The great majority of U.S. affiliate sales and purchases are transacted with the EU, Japan, and Canada, reflecting substantial past flows of direct investment between the United States and these trading partners. In 1996, U.S.-owned affiliates located in the EU accounted for 54 percent of sales, while those in Japan and Canada accounted for 10 and 9 percent, respectively (figure 2-9). Growth in foreign affiliates' sales resulted principally from strong demand for computer services, favorable economic conditions in Europe, and acquisitions of foreign providers of electricity and telecommunication services in the wake of the deregulation and privatization of government-owned entities abroad.¹³ By comparison, affiliates owned by EU-parent companies accounted for 50 percent of total U.S. purchases from foreign-owned affiliates, followed by affiliates of Canadian and Japanese firms, with 17 percent and 13 percent, respectively.¹⁴ The increase in purchases from foreign-owned affiliates mainly resulted from a number of new direct investments in the United States by foreign firms, rather than from a net increase in sales by preexisting affiliates.¹⁵

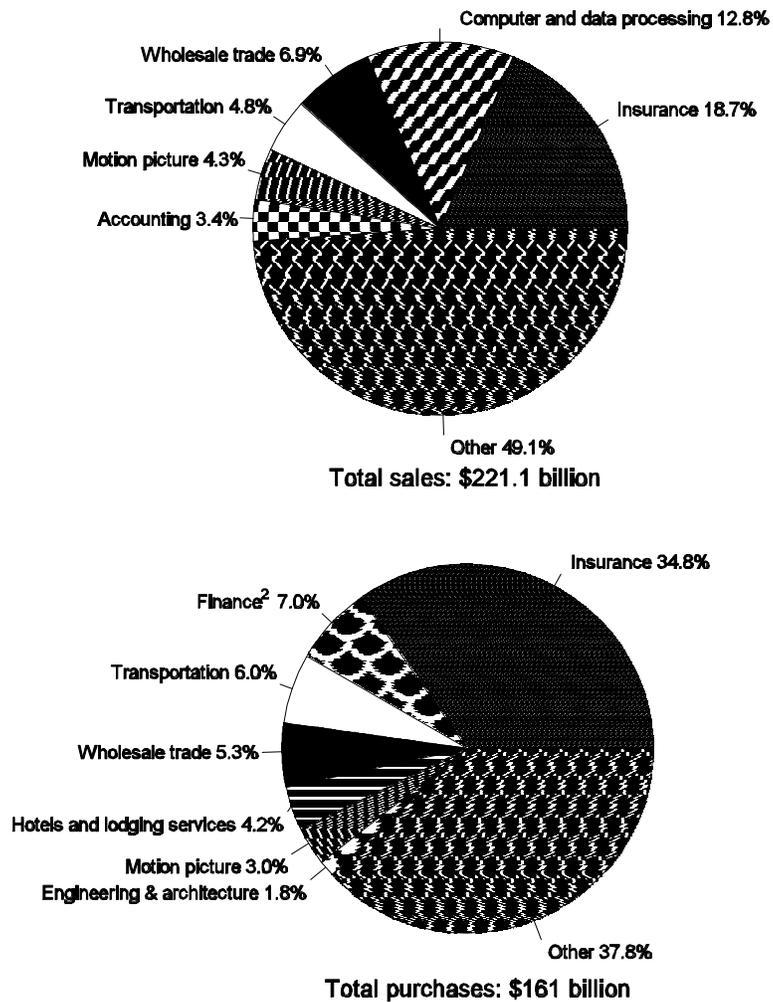
¹² Ibid., p. 116.

¹³ Ibid., p. 84.

¹⁴ Ibid., pp. 136-138.

¹⁵ Ibid., p. 85.

Figure 2-8
Affiliate service transactions: U.S. sales and purchases, by industry, 1996¹



¹ Due to rounding, figures may not equal 100 percent.

² Does not include depository institutions.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1998, pp. 115-116.

In 1996, U.S.-owned affiliates' sales to the EU exceeded purchases from EU-owned affiliates by \$39.9 billion, almost twice that of the previous year. By comparison, U.S. affiliate sales surpassed purchases from Japanese affiliates by \$1.5 billion, about one-half that of the previous year. Nevertheless, this contrasted sharply with transactions during 1991-94, when purchases exceeded sales. In affiliate transactions with Canada, U.S. purchases surpassed U.S. sales in 1996 by \$6.6 billion, a narrower margin than the \$8.1-billion margin in 1995, but wider than those recorded during 1990-94.

Table 2-3
Activities captured in official U.S. data on affiliate transactions, by industry

Service	Activities
Accounting and management consulting	Accounting, bookkeeping, and related auditing services; performing day-to-day management activities; providing operating counsel and assistance, including strategic, financial, information systems, and personnel planning; public relations services; facilities support management activities; and other business consulting.
Advertising	Advertising preparation and placement services, including outdoor advertising services, advertising solicitation, and other miscellaneous advertising activities.
Architectural, engineering, and construction	Architectural and engineering services, such as civil, electrical, industrial, mechanical, petroleum, marine, and design engineering; land, water, and aerial surveying; and construction services, such as building construction, heavy construction, and construction by specialized trade contractors.
Audiovisual	Motion picture, television tape, and film production, distribution and associated services; operating motion picture theaters; and video tape and disk rentals.
Banking and securities	Non-deposit-taking financial services, such as financial leasing; mortgage banking and broking; securities and commodity broking and dealing; originating, underwriting, and distributing securities; buying and selling commodity contracts; operating security and commodity exchanges; providing clearinghouse services; operating management investment companies, unit investment trusts, and face-amount certificate offices; and miscellaneous investment activities.
Computer and data processing	Computer and data processing services, such as processing and preparing reports using consumer supplied data; providing data entry and processing services; and providing time-sharing services.
Education	Not available.
Energy	
<i>Petroleum¹</i>	Producing, transporting, and distributing petroleum products, such as oil and gas field service activities; petroleum wholesaling; operating petroleum tankers; operating petroleum and natural gas pipelines; storing petroleum for hire; and operating gasoline service stations.
<i>Electricity</i>	Generating, transmitting, and/or distributing electrical energy.
<i>Gas</i>	Distributing natural gas for sale, except for pipeline transportation of natural gas from the extracting site, which is captured under petroleum services.
<i>Sanitary</i>	Distributing water for sale, including irrigation systems.
Environmental	Not available. ²
Health care	Services by hospitals, nursing, and personal care facilities, medical and dental laboratories, offices of physicians, etc.; miscellaneous health services, such as home health care, kidney dialysis, and specialty outpatient services; and management of hospitals and nursing homes.

See footnotes at end of table.

Table 2-3--Continued
Activities captured in official U.S. data on affiliate transactions, by industry

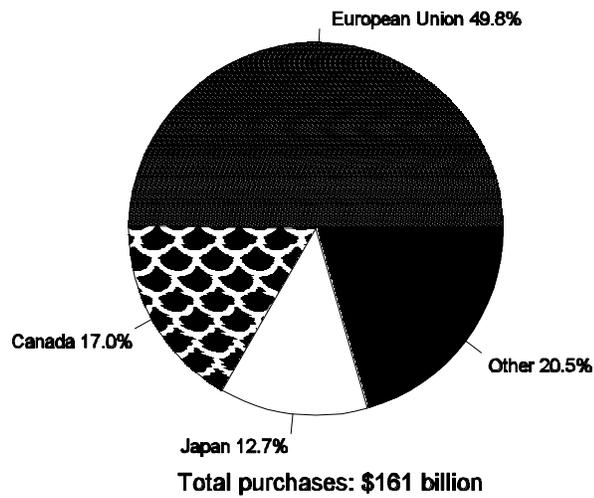
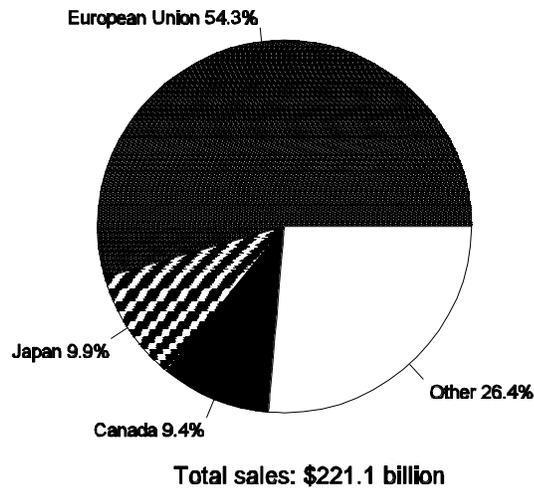
Service	Activities
Insurance	Insurance services, such as providing life, accident, health, fire, marine, casualty, surety, title, deposit, and share insurance; managing pension, health, and welfare funds; providing hospital and medical services plans; and providing other insurance services through brokers, insurance agents, and independent organizations.
Legal	Legal advice or legal services.
Retail	Retailing services include selling merchandise to the general public for personal or household consumption, such as the retailing of general merchandise; food products; apparel and accessories; prepared food and drink; and miscellaneous goods, including building materials, mobile homes, new and used automobiles, boats, and recreational vehicles, computers and computer software.
Telecommunication	Radiotelephone communication services, including cellular telephone, paging and beeper services; local and long-distance telephone services; message communication services, including telegraph, cablegram, electronic mail, and facsimile transmissions; radio and television broadcasting; and other communication services activities.
Transportation	Transportation services, such as providing line-haul railroad operations, furnishing terminal facilities for rail passenger or freight traffic, and engaging in the movement of railroad cars; operating vessels for the transportation of freight or passengers; towing and tugboat services, and other water transport services, providing air transportation and air courier services, operating airports and flying fields, and providing terminal services; arranging passenger tours and transportation, ticketing, and travel information services; and other transportation services, such as highway passenger transportation activities, transporting and warehousing freight, public warehousing and storing, freight forwarding and arrangement services for freight and cargo.
Travel and tourism	Commercial lodging services, including the operation of restaurants, as provided by hotels and motels, rooming and boarding houses, camps and recreational vehicle parks, and membership hotels and lodging houses.
Wholesale	Wholesale services include selling merchandise to retailers, businesses or other wholesalers, such as the wholesaling of new and used motor vehicles and equipment; lumber and construction materials; professional equipment and supplies; ferrous and nonferrous metal semifinished products, coal and other minerals and ores; electrical goods; hardware, and plumbing and heating equipment and supplies; machinery, equipment, and supplies; other durable goods, including sporting and recreational goods and supplies, toys and hobby goods and supplies; and scrap and waste materials, jewelry, watches, and precious stones.

¹ Petroleum services do not exist as a separate ISI category, but rather incorporate elements of Transportation, Communication, and Public Utilities (Petroleum tanker operations - ISI 441, Pipelines, petroleum and natural gas - ISI 461, Petroleum storage for hire - ISI 470); Wholesale Trade (Petroleum and petroleum products - ISI 517); and Retail Trade (Gasoline Services Stations - ISI 554).

² Data reported in Ch. 11 are from industry sources. Activities include hazardous and solid waste management services; environmental consulting and engineering services; remediation and industrial services; analytical services; and water treatment works.

Source: USDOC, BEA, *U.S. Direct Investment Abroad: 1989 Benchmark Survey, Final Results*, "Guide to Industry and Foreign Trade Classifications for International Surveys," Oct. 1992, pp. 1-20.

Figure 2-9
Affiliate service transactions: U.S. sales and purchases, by selected trading partners, 1996¹



¹ Due to rounding, figures may not equal 100 percent.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1998, p. 114.

CHAPTER 3

ACCOUNTING AND MANAGEMENT CONSULTING SERVICES

Introduction

Trade data on accounting and management consulting services include data for closely related services such as auditing, bookkeeping, and public relations, as well as for accounting and management consulting.¹ International trade in accounting and management consulting services takes place on both a cross-border and an affiliate basis. Affiliate transactions in accounting and management consulting services far exceed cross-border transactions due to the difficulty of providing such services across borders,² and the purported advantage of establishing permanent overseas operations in order to better evaluate local market conditions and to provide services directly to clients.

Recent Trends

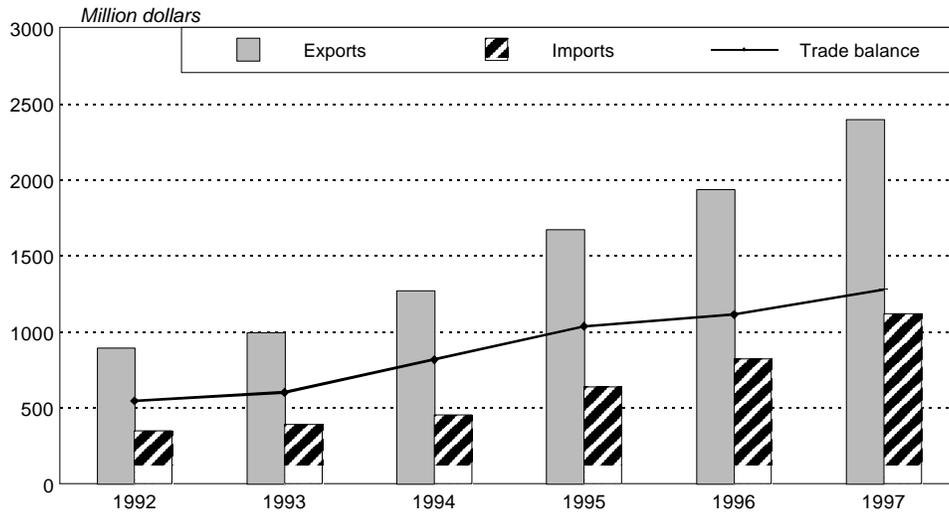
Cross-Border Trade, 1992-97

U.S. cross-border exports of accounting and management consulting services totaled \$2.4 billion in 1997, while imports amounted to \$1.1 billion (figure 3-1). Exports grew by 24 percent in 1997, slightly faster than the 21-percent average annual rate of increase during 1992-96, driven by high worldwide demand for management consulting and a broader array of professional services from accounting firms. Imports increased by 36 percent in 1997, in line with accelerated annual import growth rates recorded since 1995 and faster than the 24-percent average annual increase during 1992-96. Overall, cross-border trade of such services generated a U.S. surplus of \$1.3 billion in 1997. This was 15 percent higher than the \$1.1-billion surplus recorded in 1996, but nonetheless evidenced slower growth than that recorded during 1992-96, when the surplus increased by 19 percent per annum, on average.

¹ For this analysis, cross-border trade data on accounting and management consulting services are the sum of two categories of data reported by the Bureau of Economic Analysis (BEA), namely on accounting, auditing, and bookkeeping services, and on management, consulting, and public relations services. Affiliate transaction data reported by BEA comprise accounting, research, management, and related services.

² Usually, there are fewer legal restrictions on servicing clients once an affiliate is established, than providing such services across borders.

Figure 3-1
Accounting and management consulting services: U.S. cross-border exports, imports, and trade balance, 1992-97



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1998, pp. 86-87.

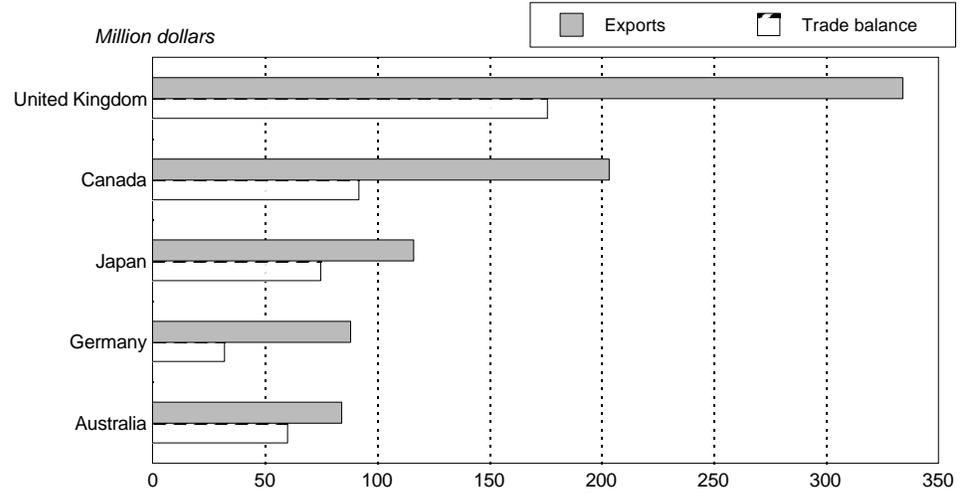
In 1997, the United Kingdom appeared to be the largest single U.S. export market for accounting and management consulting services, accounting for 16 percent of exports (figure 3-2).³ Other major U.S. export markets for such services included Canada and Japan, with 9 percent and 5 percent of exports, respectively. As with its preeminence as a U.S. export market, the United Kingdom appeared to lead in supplying accounting and management consulting services to the U.S. market in 1997, accounting for 20 percent of U.S. imports. Other significant foreign suppliers of such imports included Canada (14 percent), Germany (7 percent), and Japan (5 percent). The United States generated a surplus on trade in such services with each of these trading partners in 1997.

Affiliate Transactions, 1992-96

In 1996, U.S.-owned foreign affiliates in accounting and management consulting services generated sales of \$7.5 billion to foreign consumers, while foreign-owned affiliates in the United States sold services totaling \$1.9 billion to U.S. consumers (figure 3-3). Sales of accounting and management consulting services by foreign-based affiliates of U.S. companies rose by 19 percent in 1996, up from the average increase of 5 percent per year during 1992-95 (despite a 5-percent decline in 1993). Meanwhile, purchases from U.S.-based affiliates of foreign companies declined by 20 percent in 1996, reversing a 23-percent average annual rate of increase during 1992-95. The drop

³ Although cross-border export data by individual foreign markets are not available for accounting services, the data reported for management consulting services are believed to identify principal export markets for the combined accounting and management consulting service industry.

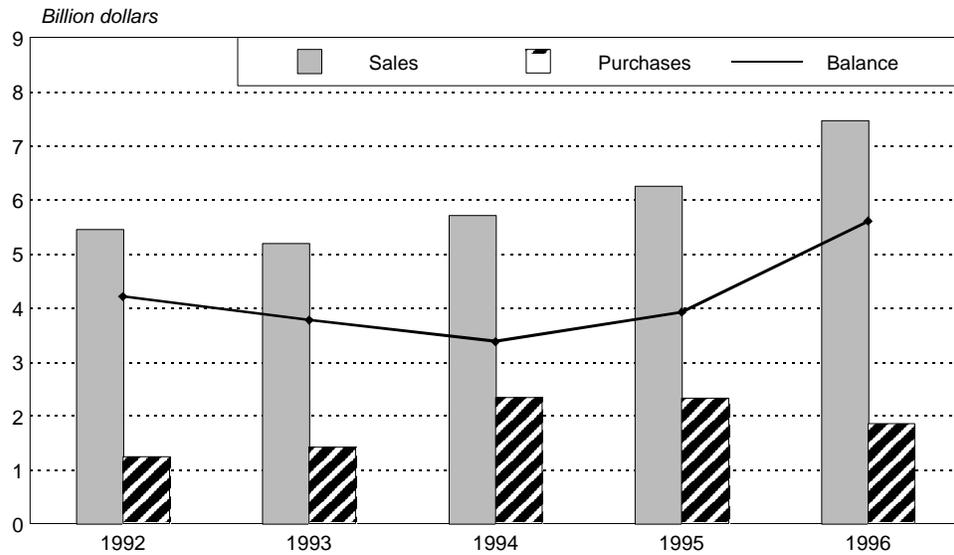
Figure 3-2
Accounting and management consulting services: U.S. cross-border exports and trade balance, by major trading partners, 1997¹



¹ Country-specific trade data are unavailable for accounting services. Data in this figure represent management, consulting, and public relations services only, and consequently, understate trade volume in the accounting and management consulting industry overall.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1998, pp. 113.

Figure 3-3
Accounting and management consulting service transactions by majority-owned affiliates: U.S. sales, purchases, and balance, 1992-96



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Sept. 1995, pp. 104-105; Nov. 1996, pp. 111-112; Oct. 1997, pp. 137-138; and Oct. 1998, pp. 115-116.

in U.S. purchases in 1996 appears, in part, to reflect consolidation in U.S. affiliate operations directed by their foreign parents in the highly competitive U.S. market.

Among foreign-owned affiliates in the accounting and management consulting industries, assets in the United States fell by 8 percent and employment declined by 14 percent in 1996.⁴ Moreover, investment outlays fell by 35 percent in 1996, as both acquisitions of U.S. businesses and the creation of new establishments in the U.S. market declined.⁵ As a consequence of increased sales and decreased purchases in 1996, the amount by which sales exceeded purchases rose by 43 percent, from \$3.9 billion in 1995 to \$5.6 billion in 1996. Such a rapid increase in the excess of sales over purchases in 1996 sharply contrasted with the trend during 1992-94, when U.S. purchases increased more rapidly than sales.

With respect to sales by U.S.-owned affiliates, leading foreign markets in 1996 included the United Kingdom (18 percent), Germany (15 percent), Canada (10 percent), and Switzerland (8 percent) (figure 3-4). As for U.S. purchases in 1996, U.S.-based affiliates owned by British firms supplied the dominant share, 63 percent, followed by affiliates of Japanese firms, with 11 percent.

Summary and Outlook

U.S. accounting and management consulting firms remained highly competitive in 1997, accounting for nearly 60 percent of the global industry's worldwide revenue.⁶ Total revenue at the 100 leading U.S. firms⁷ rose by 20 percent to \$25.5 billion in 1997, following a 14-percent increase in 1996.⁸ Management consulting reflected not only the largest revenue source, but also an increasing share of total revenue, among accounting and management consulting firms in 1997. Management consulting revenues accounted for 43 percent of total revenue in 1997, up from 39 percent in 1996. By comparison, accounting and auditing services and tax services accounted for 33 percent and 24 percent of revenue, respectively.⁹ Among the 100 leading accounting firms, management consulting revenue rose by 30 percent in 1997, to \$10.9 billion, more than double the 11-percent increase for accounting and auditing, to \$8.4 billion, and also notably faster than the 19-percent increase for tax services, to \$6.1 billion.¹⁰

The strength of the U.S. industry is based on traditional tax and auditing expertise, and on its expertise in a number of new and fast-growing market segments, such as corporate

⁴ U.S. Department of Commerce (USDOC), BEA, "Foreign Direct Investment in the United States," *Survey of Current Business*, June 1998, pp. 60-61.

⁵ USDOC, BEA, "Foreign Direct Investment in the United States," *Survey of Current Business*, June 1997, p. 59, and June 1998, p. 57.

⁶ Rick Telberg, "The Top 100: Scorching Growth, But For How Long?" *Accounting Today*, Mar. 23-Apr. 5, 1998, p. 4.

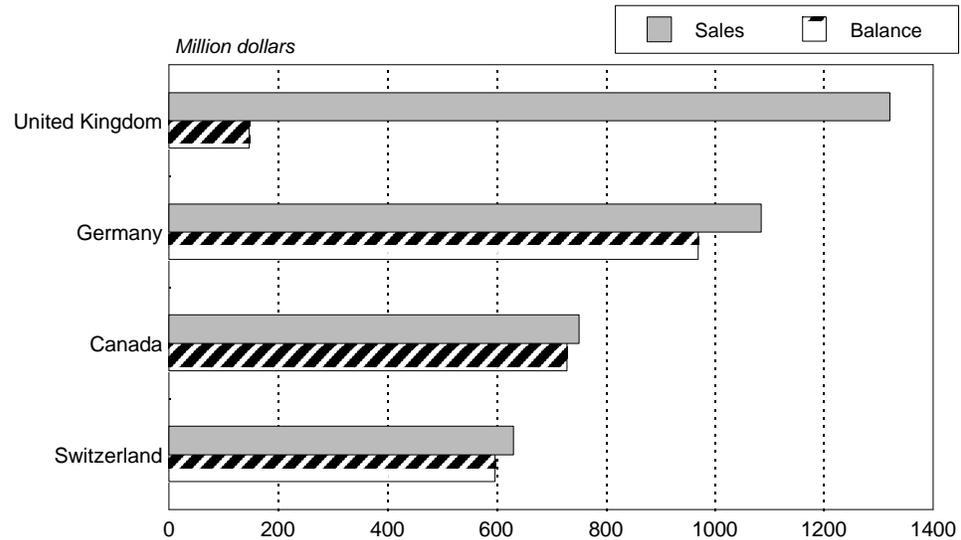
⁷ Rankings for these firms are based on total revenue.

⁸ Rick Telberg, "The Top 100: Scorching Growth, But For How Long?," p. 4.

⁹ Ibid.

¹⁰ Ibid.

Figure 3-4
Accounting and management consulting service transactions by majority-owned affiliates: U.S. sales and balance, by major trading partners, 1996



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1998, pp. 115-116.

valuations essential to assessing potential mergers and acquisitions, restructuring, and applying and managing innovations in information technology.¹¹ This expertise continues to contribute to large cross-border trade surpluses and high sales volumes among U.S.-owned affiliates abroad.

The trends toward industry restructuring amid strong growth in management consulting revenue continued in 1997, as accounting and management consulting firms redefined operations to adapt to changing circumstances in the business environment. Increasing privatization of State-owned industries in foreign markets has created demand by clients for strategies tailored to nascent free-market competition, as well as comprehensive tax and audit services. Increasing demand by large multinational clients for one-stop, integrated business services has encouraged larger accounting firms to diversify operations by also providing management consulting and legal services. For example, U.S. accounting firms have begun to move aggressively to set up corporate law practices in many foreign countries, either by hiring lawyers directly or by merging with law firms.¹² Such combinations, common to local practice in certain foreign countries (but not in the United States because of historical codes of professional ethics adopted by State bar associations), are likely to proliferate.

¹¹ John Covaleski, "The Hottest Niches: Valuations, Info Tech," *Accounting Today: The Top 100 Tax and Accounting Firms*, p. 8.

¹² In France, KPMG Peat Marwick became the country's largest law firm after hiring a number of lawyers, while Arthur Andersen and PricewaterhouseCoopers have moved aggressively to acquire European law firms. "A Glimpse of Our Future: Lawyers, Accountants, and Management Consultants?" *Journal of Management Consulting*, found at Internet address <http://proquest.umi.com/>, retrieved Nov. 10, 1998.

The principal means used to diversify the operations of the major accounting firms has been through mergers and acquisitions to combine specific strengths of various firms. The latest such combination, namely the union of Coopers & Lybrand and Price Waterhouse completed in 1998, reduced the number of megafirms to the “Big Five,”¹³ which together accounted for 84 percent of total worldwide revenue reported by the 100 leading firms.¹⁴

Numerous growing markets for accounting and management consulting services in Asia, Eastern Europe, and Latin America have been adversely affected by recent currency, stock market, and foreign investment fluctuations, and economic turmoil. Slower economic growth and recessions in diverse and widely separated foreign markets are likely to lead to a near-term slowdown in revenue growth for U.S. accounting and management consulting firms.¹⁵

The outlook for near-term accounting and management services trade is far from clear and will depend partly on the rate of recovery of Asian economies. The turmoil of late 1997 that extended and broadened in 1998 appears to have affected industry revenue at least for the first three quarters of 1998, particularly among firms that are not heavily involved in projects related to top-echelon globalization, corporate restructuring, and information technology.¹⁶ Long-term growth prospects for the industry still appear positive, given continued client emphasis on corporate restructuring, mergers and acquisition advice, and adoption of the latest information technology systems.¹⁷

¹³ The “Big Five” accounting firms are Arthur Andersen, Ernst & Young, Deloitte & Touche, KPMG Peat Marwick, and PricewaterhouseCoopers.

¹⁴ Rick Telberg, “The Top 100: Scorching Growth, But For How Long?,” p. 4.

¹⁵ Timothy D. Schellhardt, Elizabeth MacDonald, and Raju Narisetti, “Consulting Firms Get an Unexpected Taste of Their Own Medicine,” *Wall Street Journal*, Oct. 20, 1998, p. 1.

¹⁶ *Ibid.*

¹⁷ DRI/McGraw-Hill, Standard & Poor’s, USDOC, “Professional Business Services: Management Consulting and Public Relations,” *U.S. Industry and Trade Outlook 98* (New York: McGraw-Hill, 1998), p. 49-4.

CHAPTER 4

ADVERTISING SERVICES

Introduction

Advertising services include the preparation of advertisements¹ and their placement in various media. While preparatory services encompass the development of advertising plans and the production of creative work, placement services involve the negotiation and purchase of space or time in either print or broadcast media.² The advertising industry consists of three parties: advertisers, who produce branded products or services; the media, through which such products and services are advertised; and advertising firms. The U.S. advertising industry accounts for nearly 48 percent³ of all expenditures on advertising services⁴ worldwide. U.S. firms reportedly are the most competitive participants in the international advertising market, given the breadth and caliber of their creative skills, media relations expertise, and flexibility in tailoring advertising campaigns to targeted audiences.

Trade in this sector comprises both cross-border trade and affiliate transactions. Of these two delivery channels, affiliate transactions are the predominant mode of trade in advertising services. This is because firms with a local presence cultivate knowledge critical to the successful administration of advertising services, including an understanding of the local media environment, as well as familiarity with consumer tastes, language, and culture. Consequently, affiliated firms tend to develop a competitive advantage over agencies attempting to export advertising services from home offices. In 1996, sales by U.S.-owned advertising affiliates abroad equaled no less than \$5.0 billion,⁵ compared to \$551 million earned through cross-border exports of advertising services.⁶

Recent Trends

¹ An advertisement is a paid announcement, delivered through a public medium, that promotes a particular product, service, or idea.

² Traditional media comprise printed matter, such as newspapers and magazines, as well as broadcast media, including television and radio. Added to these are cable and satellite television, direct mail, outdoor advertising (e.g., billboards), the yellow pages, and the Internet.

³ *Insider's Report*, McCann-Erickson, June 1998.

⁴ Advertising expenditures comprise the money that advertisers spend to promote their goods and services.

⁵ Sales by foreign affiliates of U.S. advertising firms exclude sales by Canadian affiliates because the Bureau of Economic Analysis (BEA) suppressed such data to avoid disclosing the operation of individual firms.

⁶ U.S. Department of Commerce (USDOC), BEA, *Survey of Current Business*, Oct. 1998, p. 115.

Cross-Border Trade, 1992-97

In 1997, U.S. cross-border exports of advertising services reached \$581 million, a 5-percent increase from the previous year (figure 4-1). Such growth was approximately one-third of the 15-percent average annual rate of growth recorded during 1992-96. The slower growth in U.S. exports of advertising services may be due, in part, to a decline in the demand for such services by countries in Asia.⁷ Imports decreased by 12 percent in 1997 to \$863 million, a marked contrast to the 21-percent average annual rate of growth recorded during 1992-96. As a result, the cross-border trade deficit in advertising services declined by roughly one-third, from \$425 million in 1996 to \$282 million in 1997. By comparison, during 1992-96, the U.S. trade deficit in advertising services grew at an average annual rate of roughly 33 percent (despite narrowing slightly in 1994). Available country-specific data indicate that the five largest U.S. export markets for advertising services in 1997 were, in descending order, Canada, the United Kingdom, Japan, Germany, and Hong Kong. Of these countries, Canada and the United Kingdom each comprised 17 percent of total U.S. advertising service exports, while Japan accounted for 9 percent. Conversely, U.S. imports of advertising services were highest from Japan, accounting for 33 percent; the United Kingdom, 14 percent; Germany, 9 percent; Canada, 6 percent; and France, 5 percent.

The United States posted its largest cross-border trade deficit in advertising services with Japan, where U.S. imports surpassed exports by \$226 million in 1997 (figure 4-2). The U.S. trade deficit with Japan represented 80 percent of the total U.S. trade deficit in advertising services. By comparison, trade deficits with Germany equaled \$41 million, with the United Kingdom, \$27 million, and with France, \$15 million. U.S. trade deficits in advertising services with each of those countries decreased in 1997. In particular, the U.S. trade deficit in advertising services with Japan declined by 14 percent; with Germany, by 36 percent; with France, by 44 percent, and with the United Kingdom, by 43 percent. At the same time, the United States posted its largest trade surplus in advertising services with Canada, which reached \$49 million.

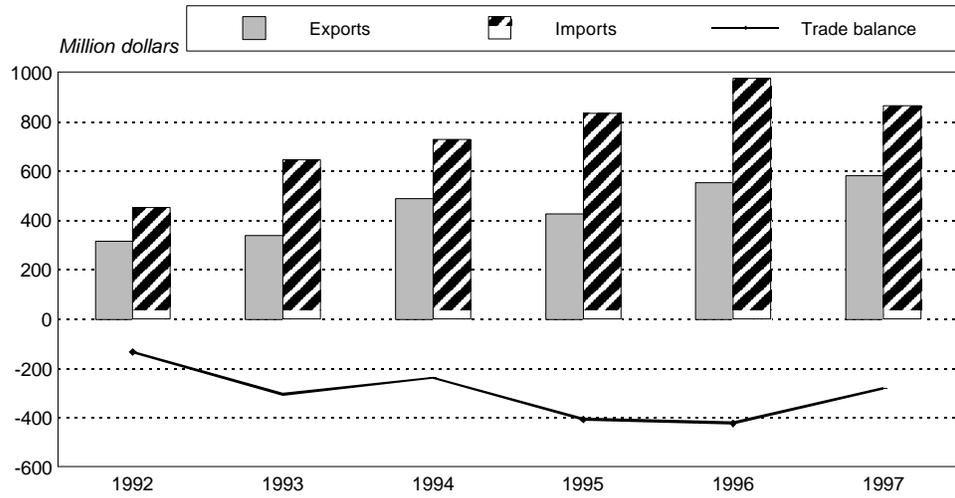
Affiliate Transactions, 1992-96

Complete data in 1996 pertaining to total sales by foreign-based advertising affiliates of U.S. firms are not available, but sales excluding only Canada amounted to about \$5 billion. In 1996, sales by European-based affiliates are believed to account for the majority of such transactions.⁸ European affiliates of U.S. firms generated \$3.8 billion in sales in 1996, up 11 percent from 1995. This growth exceeded the 3-percent average annual rate of growth of advertising sales by European affiliates of U.S. firms during 1992-95. Affiliates in the United Kingdom and Germany generated the most sales, accounting for \$881 million and \$856 million, respectively (figure 4-3). By

⁷ *Insider's Report*, McCann-Erickson, Dec. 1997.

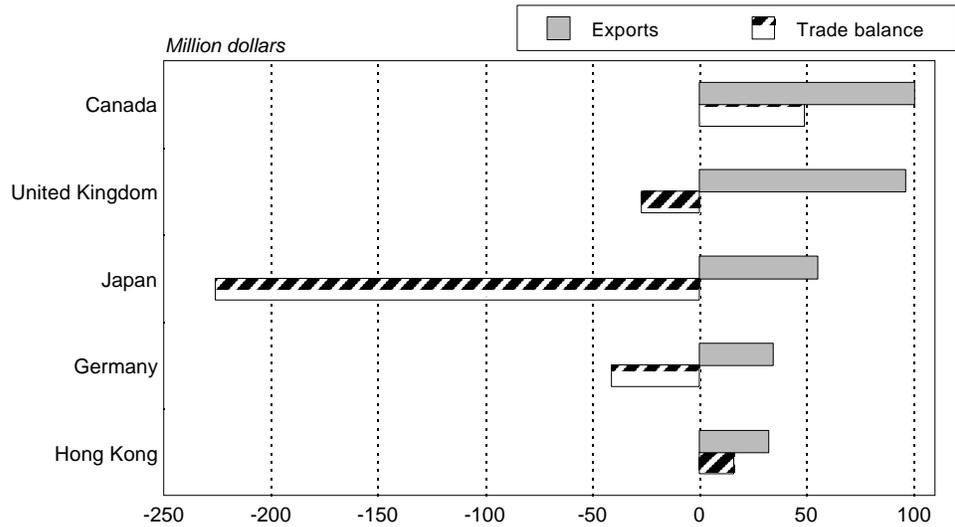
⁸ European-based advertising affiliates accounted for 71 percent of all advertising affiliate sales in 1995. USDOC, BEA, *Survey of Current Business*, Oct. 1998, p. 115.

Figure 4-1
Advertising services: U.S. cross-border exports, imports, and trade balance, 1992-97



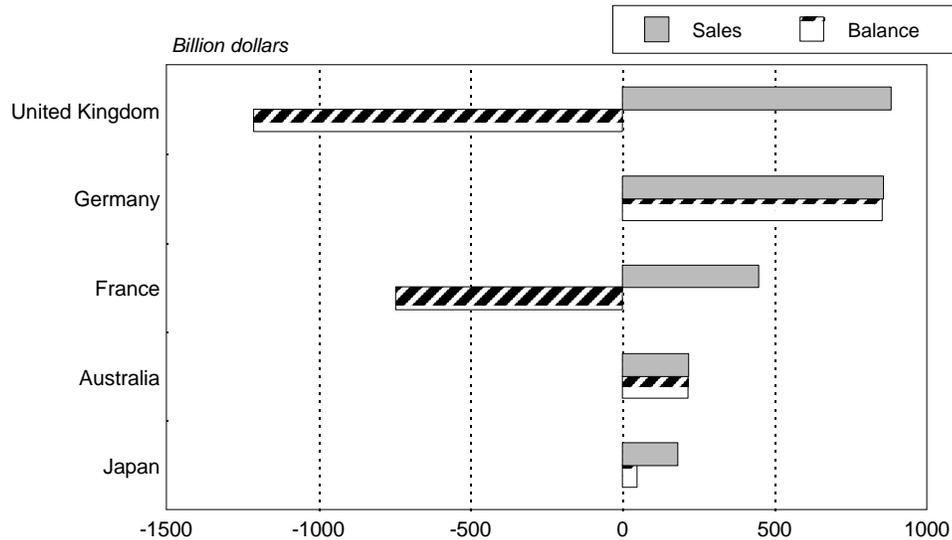
Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1998, pp. 86-87.

Figure 4-2
Advertising services: U.S. cross-border exports and trade balance, by major trading partners, 1997



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1998, p. 113.

Figure 4-3
Advertising service transactions by majority-owned affiliates: U.S. sales and balance, by major trading partners, 1996



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1998, pp. 115-116.

comparison, sales of all affiliates based in the Asia-Pacific region totaled \$873 million. Among these affiliates, those in Australia, with sales of \$215 million, and Japan, with \$179 million, appear to have predominated.

Purchases of advertising services from foreign-owned affiliates based in the United States increased by 16 percent to \$3.5 billion in 1996. This was higher than the average annual growth rate of 6 percent during 1992-95. By region, U.S. purchases from advertising affiliates of European firms were largest, reaching \$3.3 billion, or 94 percent of the total. In particular, U.S. purchases from affiliates with parent companies in the United Kingdom and France were the most prominent, with the former amounting to \$2.1 billion, or 60 percent of total purchases, and the latter equaling \$1.2 billion, or 34 percent of such purchases. The higher proportion of purchases made by U.S. companies from British- and French-owned advertising affiliates is most likely due to the presence of such firms among the top advertising organizations⁹ worldwide. For example, 4 of the top 20 international advertising organizations are based in the United Kingdom, whereas 2 such companies are French-owned.¹⁰ Overall, the United States posted its greatest surplus in affiliate transactions with Germany, which reached \$853 million in 1996, and its largest deficit with the United Kingdom, which stood at \$1.2 billion.

⁹ An advertising organization consists of a holding company and its subsidiaries. Subsidiaries include individual advertising firms or advertising networks, as well as direct marketing, sales promotion, and other advertising service firms.

¹⁰ "World's Top 50 Advertising Organizations," *Advertising Age*, Apr. 27, 1998, p. s10.

Summary and Outlook

In 1997, cross-border trade in advertising services was marked by the first decline in U.S. imports recorded during the period under review. The decline occurred despite 7-percent overall growth in U.S. advertising expenditures in 1997.¹¹ U.S. cross-border exports of advertising services increased in 1997, as did U.S. sales through affiliates in 1996.¹²

In general, forecasts through the year 2002 indicate that growth in U.S. imports of advertising services could outpace a moderate increase in U.S. advertising exports. Sales by foreign advertising affiliates of U.S. firms are anticipated to rise steadily and are likely to contribute to the advertising revenue growth of U.S. parent firms.¹³

Economic Indicators

Because advertising is used to stimulate the purchase of new products and services, growth in advertising expenditures reflects the overall health of the economy. As such, spending on advertisements tends to rise in times of economic expansion and shrink during recessionary periods. Additionally, advertising expenditures are positively correlated with income; expenditures tend to be greatest in countries with high per capita income and smallest in economies with low per capita income.¹⁴ Moreover, advertising expenditures typically increase at a faster rate than does growth in national income, a phenomenon that appears more pronounced in developing than in developed economies.¹⁵

The tendency of advertising expenditures to fluctuate with changes in the economic climate and to reflect a country's per capita income, explain recent occurrences in the advertising sector. For example, the recessionary effects of the Asian financial crisis have prompted a significant decline in ad spending in the economies of Southeast Asia, as well as in markets such as China, Korea, and Japan. Korean advertising expenditures in the

¹¹ *Insider's Report*, McCann-Erickson.

¹² In 1996, sales by foreign affiliates of U.S. advertising firms, *excluding* those by Canadian affiliates, amounted to \$5.0 billion. In 1995, such sales, *including* by Canadian affiliates, totaled \$4.9 billion. USDOC, BEA, *Survey of Current Business*, Oct. 1998, p. 115, and Oct. 1997, p. 137.

¹³ "Professional Business Services," *U.S. Industry & Trade Outlook '98*, pp. 49-7 and 49-8.

¹⁴ For instance, in 1996, per capita ad spending in the United States was \$380, or roughly 1 percent of GNP. By comparison, per capita expenditures on advertising in China were \$2.00, or approximately 0.2 percent of the country's GNP. It should be noted, however, that countries at relatively the same level of economic development may differ significantly in their per capita advertising expenditures. Juliana Koranteng, "Top Global Ad Markets," *Ad Age International*, May 11, 1998, pp. 15 and 19, and "Advertising Services: Background Note by the Secretariat," World Trade Organization (WTO), Council for Trade in Services, July 9, 1998.

¹⁵ In developing economies, this phenomenon may stem, in part, from the unleashing of pent-up consumer demand for previously unavailable or unaffordable goods and services.

major media,¹⁶ which accounted for about 2 percent of worldwide advertising spending in 1997, are forecasted to decline by over 12 percent in 1998.¹⁷ Moreover, advertising expenditures in Japan, which comprised nearly 13 percent of all major-media ad spending in 1997,¹⁸ are expected to fall by at least 3 percent in 1998¹⁹ and to further decrease through the year 2000.²⁰ As a result, U. S. advertising agencies, in particular, have experienced a reduction in revenues from their Asian operations. This decline has been exacerbated by the relative strength of the U.S. dollar against Asian currencies.²¹ Conversely, advertising expenditures will likely experience a moderate increase in countries such as the United Kingdom, Germany, and France, where GDP was anticipated to grow by roughly 5 percent in 1998.²² Furthermore, expenditures on advertising will likely rise in emerging markets, such as the Czech Republic, where ad spending grew at more than three times the rate of GDP in 1997.²³

Industry-wide Phenomena

Apart from economic factors, industry-wide phenomena have impacted the advertising industry. These phenomena include account consolidation; the clustering of advertising agencies into multinational organizations; and the growing use of the Internet to carry advertisements.

Global Branding and Account Consolidation

Increasingly, companies have elected to develop products with international brand identities, or global brands. Global brands are products which provide the same benefits to consumers and use similar advertising concepts in each of the geographic markets in which they are sold. In some cases, such products may also be adapted to suit local tastes.²⁴ The trend towards global branding, in turn, has led advertisers to consolidate their advertising accounts among a handful of international agency networks.²⁵ By doing so, advertisers gain leverage in negotiating advertising fees and can ensure that their global brands are marketed consistently worldwide. In 1994, IBM became one of the first U.S. companies to consolidate its advertising under one agency network, Ogilvy & Mather, which replaced the more than 40 agencies that had originally handled IBM's

¹⁶ Here, the major media include the press, television, radio, cinema, and outdoor advertising.

¹⁷ "Advertising Expenditure Forecasts," news release, *Zenith Media Publications*, July 9, 1998, found at Internet address <http://www.zenithmedia.com/>, retrieved Nov. 3, 1998.

¹⁸ Ibid.

¹⁹ *Insider's Report*, McCann-Erickson.

²⁰ "Advertising Expenditure Forecasts," news release, *Zenith Media Publications*.

²¹ Industry representative, interview by USITC staff, Nov. 4, 1998.

²² One estimate places 1998 GDP growth in the United Kingdom, Germany, and France at 5.4 percent, 4.7 percent, and 4.1 percent, respectively. The corresponding figures for 1998 growth in advertising are 7 percent for the United Kingdom, 5.5 percent for Germany, and 5 percent for France. *Insider's Report*, McCann-Erickson.

²³ *Insider's Report*, McCann-Erickson.

²⁴ Robert L. Wehling, "Even at P&G, Only 3 Brands Make Truly Global Grade So Far," *Ad Age International*, Jan. 1998, p. 8.

²⁵ Here, an agency network refers to a parent advertising firm and its foreign subsidiaries.

global accounts. Shortly thereafter, companies such as Nestle, Kellogg,²⁶ and Colgate-Palmolive followed suit.²⁷ Global branding and account consolidation have also altered the nature of the client-agency relationship. Previously, advertising agencies played an auxiliary role in the marketing of their clients' new products; now agencies partner globally with advertisers to oversee every aspect of a brand's management.²⁸ The latter may include, for example, the execution of brand mapping exercises²⁹ and the development of product-positioning strategies.³⁰

The Advent of Advertising Agency Organizations and Expansion Abroad

Advertising organizations, which comprise a holding company and a collection of direct marketing, sales, promotion, and other specialty agencies, are replacing the independently owned advertising "shops" that have traditionally characterized the industry. Such organizations have the financial capital to be publicly traded and to acquire individual agencies and associated firms. In 1997, advertising organizations purchased over 200 independent ad agencies.³¹ In the same year, gross revenues of the top 10 global advertising organizations, 6 of which were U.S.-based, increased by 13 percent compared to 1996.³²

Advertising organizations have increased their activity abroad by acquiring equity stakes in overseas firms and/or by establishing foreign affiliates. In particular, advertising organizations have established equity interests in foreign firms to expand geographically, access foreign clients, and better navigate foreign media regulations.³³ For example, in 1998, Omnicom Group, a U.S. advertising organization, acquired an equity stake in a local Japanese advertising agency, Nippo. The acquisition was reportedly intended to provide Omnicom with a direct link to Japanese clients and the local media.³⁴ Japan's Dentsu, the world's fourth-largest advertising organization, has considered the purchase of a 20-percent equity stake in the U.S.-based advertising group, Leo Burnett. The

²⁶ "So What Is All the Fuss About?" *The Economist*, June 22, 1996, found at Internet address <http://www.economist.com/>, retrieved Dec. 17, 1998.

²⁷ Non-U.S. advertisers that have consolidated their worldwide accounts under a few international agency networks include Honda, L'Oreal, Nestle, and Shell Oil. "Advertising: A Passion for Variety," *The Economist*, Nov. 30, 1996, found at Internet address <http://www.economist.com/>, retrieved Dec. 17, 1998; and Laurel Wentz, "World Brands," *Ad Age International*, Sept. 1997, p. ill.

²⁸ Industry representative, interview by USITC staff, Nov. 11, 1998.

²⁹ Brand mapping is an exercise used to determine how consumers rate competing brands across a variety of product attributes (e.g., quality, price, package design).

³⁰ Joe Reif and Janet Whittle, *Services—The Export of the 21st Century: A Guidebook for US Service Exporters*, A Joint Publication of The Northern California Export Council and the World Trade Press, 1997, p. 51.

³¹ R. Craig Endicott, "Independent Networks Are Giving Multinationals Run for Their Money," *Ad Age International*, June 8, 1998, p. 22.

³² This percentage was calculated using advertising organizations' gross income figures reported in "World's Top 50 Advertising Organizations," *Advertising Age*, p. s10.

³³ Industry representative, interview by USITC staff, Nov. 4, 1998.

³⁴ Alexandra Harney, "Japan: A Hard Sell for Arriviste Admen," *Financial Times*, Oct. 6, 1998, found at <http://www.ft.com/>, retrieved Nov. 3, 1998.

investment could provide Dentsu with a broader presence in both the United States and Europe.³⁵ Separately, Young & Rubicam, one of the top five U.S.-based advertising organizations, has established majority-owned affiliates in many of the leading markets of Africa, Asia, Europe, and Latin America. In 1997, this advertising organization derived 43 percent of its worldwide revenues from overseas operations.³⁶

The Internet

Growth in Internet usage³⁷ is making online advertising a popular means of advertising goods and services. Consequently, the Internet is becoming a new source of revenue for the advertising industry. Although U.S. advertising expenditures on the Internet comprised less than 1 percent of all consumers advertising spending in the United States in 1997, industry analysts predict rapid growth of the Internet as a new advertising medium.³⁸ In 1998, U.S. advertising expenditures on the Internet were forecasted to increase by 50 percent over 1997 expenditures,³⁹ compared to a 7-percent growth rate for advertising in the traditional media.⁴⁰ In foreign markets, Internet advertising revenues were anticipated to grow with similar vigor, given ongoing telecommunications deregulation and a subsequent increase in the number of online users. For instance, Internet advertising expenditures in Canada, which were roughly \$7 million in 1997, were expected to more than double in 1998, and to reach \$42 million by 1999.⁴¹ In the United Kingdom, Internet ad spending in 1998 was estimated to equal \$10 million, and is forecasted to increase to nearly \$170 million by

³⁵ Sally Beatty, "Japan's Dentsu Considers Buying a Minority Stake in Leo Burnett," *Wall Street Journal Interactive Edition*, found at Internet address <http://www.wsj.com/>, posted and retrieved Dec. 9, 1998, and Julie Steenhuysen, "Burnett Says a Dentsu Alliance Three Months Away," *Reuters*, found on the PointCast Network, posted and retrieved Dec. 9, 1998.

³⁶ On average, the top 10 U.S. advertising agencies by gross income earned approximately 42 percent of their 1997 revenues from foreign operations. "World's Top 50 Advertising Organizations," *Advertising Age*, pp. s14 and s26.

³⁷ In June 1998, more than 70 million adults used the Internet in the United States compared to 35 million at the end of 1996. The United States reportedly accounts for roughly half of the total number of global Internet users. Mark Cavallone, "Computers: Consumer Services & the Internet," *Standard & Poor's Industry Surveys*, Oct. 15, 1998, found at Internet address <http://www.netadvantage.standardpoor.com/>, retrieved Nov. 17, 1998.

³⁸ Kate Maddox, "Online Advertising Reaches \$544.8 mil, New Report Says," *Advertising Age*, Aug. 3, 1998, p. 28.

³⁹ Kate Maddox, "IAB: Ad Revenue Online Projected to Hit \$2 billion in '98," *Advertising Age*, Nov. 2, 1998, p. 38.

⁴⁰ Internet advertising expenditures were estimated to be approximately \$264 million in 1996, \$545 million in 1997, and \$2 billion in 1998. Mary Meeker, *The Internet Advertising Report*, Morgan Stanley Dean-Witter, Dec. 1996, p. iii; "Online Advertising Reaches \$554.8 million, New Report Says," *Advertising Age*; "IAB: Ad Revenue Online Projected to Hit \$2 billion in '98," *Advertising Age*; and *Insider's Report*, McCann-Erickson.

⁴¹ USDOC, International Trade Administration, National Trade Data Bank, "Canada-Internet: A Growing Advertising Medium," Market Research Reports, STAT-USA Database, found at Internet address <http://www.stat-usa.gov/>, retrieved Nov. 3, 1998.

2001.⁴² The United States is poised to benefit from global growth in Internet advertising, given the competitive advantage of U.S. Internet firms and their commercial entry into markets abroad. For example, Yahoo!, a U.S. Internet media provider, and DoubleClick, a U.S. advertising network, both have established a commercial presence in Asia and Europe.⁴³ Further, Omnicom, the largest U.S. advertising organization, has equity stakes in 4 of the top 15 interactive advertising agencies⁴⁴ worldwide.⁴⁵

⁴² James McIntosh, "Internet: UK Advertising Predicted to Rise," *Financial Times*, Oct. 28, 1998, found at Internet address <http://www.ft.com/>, retrieved Nov. 3, 1998. Internet expenditures, which were expressed as British pounds in this article, were converted to \$US values using exchange rates found at Internet address <http://www.stat-usa.gov/>.

⁴³ U.S. International Trade Commission, "Internet Advertising," *Industry, Trade, and Technology Review*, USITC publication 3134, Sept. 1998, p. 15.

⁴⁴ Interactive advertising agencies help advertisers set up their own sites on the Internet and aid them in placing advertisements on websites operated by other companies.

⁴⁵ Saul Hansell, "Deal to Create the Largest Interactive Ad Agency," *The New York Times*, Aug. 3, 1998.

CHAPTER 5

ARCHITECTURAL, ENGINEERING, AND CONSTRUCTION SERVICES

Introduction

Architectural, engineering, and construction (AEC) services comprise interrelated service activities. Architectural firms provide blueprint designs for buildings and public works and may oversee the construction of projects.¹ Engineering firms provide planning, design, construction, and management services for projects such as civil engineering works and residential, commercial, industrial, and institutional buildings.² Construction services include pre-erection work; new construction and repair; and alteration, restoration, and maintenance work. Such services may be provided by general contractors, who oversee all construction work for those awarding the contract, or specialty subcontractors who perform discrete sections of the construction.

Trade in architectural, engineering, and construction services is predominantly undertaken by affiliates in foreign markets.³ U.S. firms that engage in international trade in architectural, engineering, and construction services generally establish some type of subsidiary, joint venture, or representative office in important foreign markets as local presence is often a determining factor in contract awards. Cross-border trade in AEC services is generally limited to transporting across national boundaries items such as blueprints and designs via mail, telecommunication networks, or other means.

¹ Architectural services also include preliminary site study, schematic design, design development, final design, contract administration, and post-construction services.

² Engineering services also include undertaking preparatory technical feasibility studies and project impact studies; preparing preliminary and final plans, specifications, and cost estimates; and delivering various services during the construction phase.

³ Bureau of Economic Analysis (BEA) data on transactions between majority-owned affiliates of U.S. architectural, engineering, and construction (AEC) firms and nonaffiliated firms are limited in order to avoid disclosing confidential, proprietary information pertaining to individual firms. Nevertheless, in 1996, BEA estimated that total sales of architectural, engineering, and surveying services by foreign affiliates of U.S. parents amounted to \$8.6 billion, while purchases from U.S. affiliates of foreign firms totaled \$3 billion. U.S. Department of Commerce (USDOC), BEA, *Survey of Current Business*, Oct. 1998, pp. 115-116.

Recent Trends in Cross-Border Trade, 1992-97

In 1997, U.S. cross-border exports of architectural, engineering, and construction services totaled nearly \$4.1 billion, up 15 percent from 1996.⁴ This growth rate, which was slightly below the 16-percent average annual growth rate recorded during 1992-96 (figure 5-1) due to a decline in exports to certain primary markets in Asia, reflected significant increases in exports to both Canada and Indonesia.⁵ By comparison, U.S. cross-border imports of AEC services dropped by 29 percent to \$346 million in 1997, despite strong domestic demand for such services.⁶ Such demand was increasingly met by domestic firms. In 1997, revenues received by U.S. contractors and designers for projects in the United States grew by 3 percent and 8 percent, respectively.⁷ By comparison, foreign firms' billings from projects in the United States declined by 6 percent, due largely to a 26-percent drop in revenues secured by Japanese contractors from construction work in the United States.⁸ The decrease in U.S. imports in 1997 was in sharp contrast to the 17-percent average annual growth rate registered during 1992-96 (despite dropping by 12 percent in 1994). As a result, the United States strengthened its consistent surplus in cross-border AEC services trade. In 1997, the surplus on cross-border trade totaled \$3.7 billion, up 22 percent from 1996. This rate of increase was notably higher than the 16-percent average annual growth rate experienced during 1992-96.

Despite economic difficulties in the region, Asia-Pacific nations remained key export markets for U.S. cross-border architectural, engineering, and construction services in 1997 (figure 5-2). Indonesia remained the top market for U.S. architectural, engineering, and construction services, accounting for exports of \$424 million in 1997, up 71 percent from 1996. Indonesia's total construction expenditures grew slightly in

⁴ Data pertaining to cross-border trade in architectural, engineering, and construction services reflect certain limitations. Data on U.S. exports are reported on a net basis (i.e., U.S. contractors' expenditures on merchandise and labor are excluded), whereas data on U.S. imports are reported on a gross basis. As a result, the U.S. surplus on the architectural, engineering, and construction services account is understated. In addition, data pertaining to architectural, engineering, and construction services also reflect trade in mining and surveying services, which inflates estimated trade volumes.

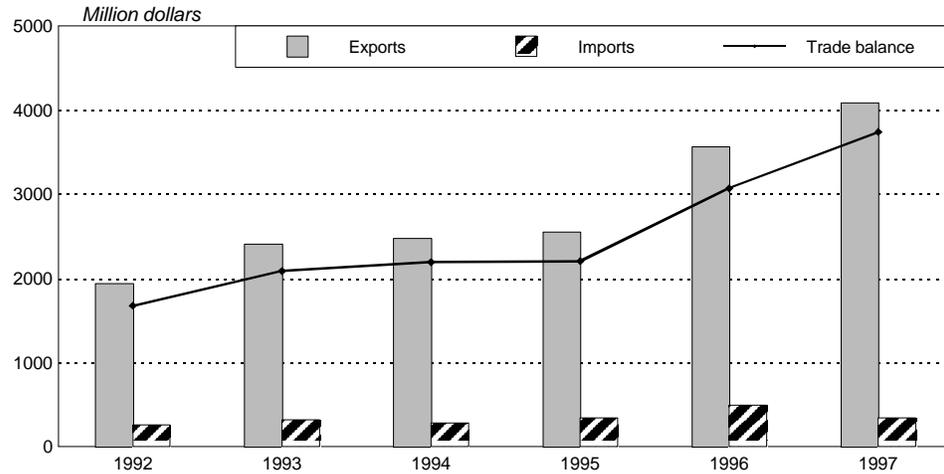
⁵ The combined increase in exports of \$360 million to Canada and Indonesia accounted for roughly 70 percent of the total rise in U.S. cross-border exports of AEC services in 1997.

⁶ The U.S. construction market grew by approximately 7 percent in 1997. This increase represents the sixth straight year of positive growth in the industry, which has been aided by a strong U.S. economy and low interest rates. "Construction at a Crossroad," *Engineering News-Record*, Nov. 2, 1998, p. 10.

⁷ "The Top 400 Contractors: Markets are Mixed but Advancing Overall," *Engineering News-Record*, May 25, 1998, p. 57; and "The Top 500 Design Firms: Struggling to Retain Talent," *Engineering News-Record*, Apr. 20, 1998, p. 46.

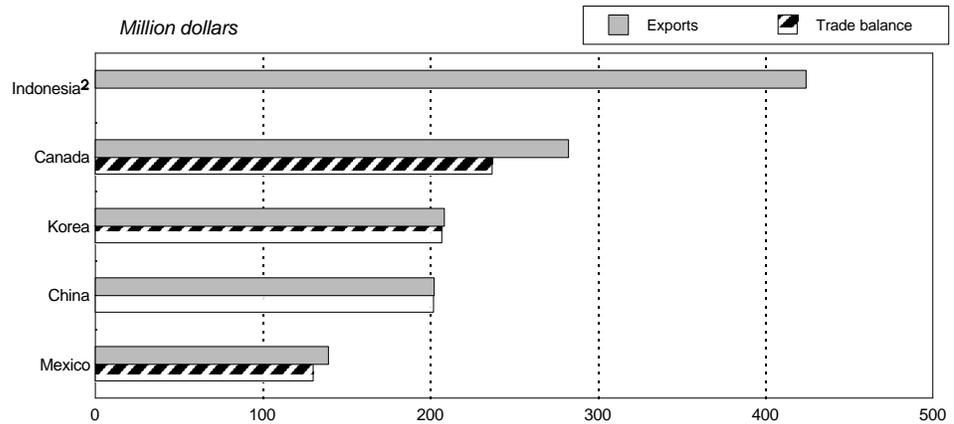
⁸ "The Top 225 International Contractors: Financing is a Key to Shaky Market," *Engineering News-Record*, Aug. 17, 1998, p. 43; and "The Top 225 International Contractors: Financing Becomes the Key to Jobs," *Engineering News-Record*, Aug. 25, 1997, p. 39.

Figure 5-1
Architectural, engineering, and construction services: U.S. cross-border exports, imports, and trade balance, 1992-97



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1998, pp. 86-87.

Figure 5-2
Architectural, engineering, and construction services: U.S. cross-border exports and trade balance, by major trading partners, 1997¹



¹ Data on U.S. exports are reported on a net basis (i.e., U.S. contractors' expenditures on merchandise and labor are excluded), whereas data on U.S. imports are reported on a gross basis. In addition, data pertaining to architectural, engineering, and construction services also reflect trade in mining and surveying services.

² The AEC services trade balance with Indonesia is not shown, because data on U.S. imports from Indonesia were suppressed in order to avoid disclosing information about the operations of individual firms. Nevertheless, it is believed that such trade with Indonesia resulted in a substantial U.S. surplus in 1997.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1998, p. 113.

1997,⁹ and certain construction sectors, including the oil and gas sector, remained comparatively strong throughout the year. The substantial increase in exports to Indonesia may also reflect revenues collected from projects completed in 1997 but initiated well before the nation's economic crisis, and the continuation of projects financed through private sources, international lending institutions, and multinational interests. Exports to Korea grew by 52 percent to \$208 million in 1997, reflecting a 6-percent increase in total construction spending in 1997 and the relatively late downturn of the Korean economy.¹⁰ Similarly, insulation from the region's financial crisis combined with extensive public works projects and strong foreign direct investment¹¹ kept China among the principal markets for AEC services in 1997. U.S. cross-border exports of AEC services to China grew by 22 percent to \$202 million in 1997. At the same time, the Asian economic crisis had a significant adverse effect on foreign demand for U.S. architectural, engineering, and construction services in certain other Asian countries. For example, exports to Malaysia and Japan, which were among the top U.S. export markets for AEC services in 1996, fell sharply by 70 percent and 59 percent, respectively, in 1997.

Canada and Mexico were other key markets for U.S. cross-border exports of architectural, engineering, and construction services. U.S. exports to Canada rose by 188 percent to \$282 million in 1997, reflecting strong growth in the Canadian construction market¹² during the year and U.S. providers' dominance among foreign construction and design firms active in that market.¹³ Exports to Mexico increased by 62 percent to \$139 million, spurred by the country's continued economic recovery. The Mexican construction industry grew by over 10 percent in 1997,¹⁴ and sectors such as infrastructure, power, and housing benefitted from increased private-sector funding and sizeable loans from international development banks. With respect to imports, available data indicate that the United Kingdom and Canada remained the top suppliers of U.S. cross-border imports of AEC services in 1997. Imports of \$76 million and \$45 million from these two countries, respectively, accounted for approximately one-third of all cross-border imports of architectural, engineering, and construction services in 1997.

⁹ "World Market Overview," *Engineering News-Record*, Nov. 30/Dec. 7, 1998, p. 42.

¹⁰ *Ibid.*, p. 44.

¹¹ The vast majority of construction work in China available to foreign AEC firms is derived from foreign direct investment. USDOC, ITA, National Trade Data Base, "China-Construction & Engineering Services," Stat-USA Database, found at Internet address <http://www.stat-usa.gov/>, posted July 1, 1997, retrieved Jan. 6, 1999.

¹² The Canadian construction market grew by 9 percent to approximately \$67 billion in 1997.

¹³ U.S. contractors captured 54 percent of total revenues earned by international contractors in Canada in 1997. Likewise, U.S. design firms accounted for nearly 90 percent of total billings for all foreign design firms active in the Canadian market in 1997. "World Market Overview," *Engineering News-Record*, Nov. 30/Dec. 7, 1998, p. 64.

¹⁴ "The Mexican Economy: An Overview," Embassy of Mexico in Canada, found at Internet address <http://www.embamexcan.com/Economy/econ-over.html>, retrieved Jan. 8, 1999.

Summary and Outlook

The strong U.S. trade performance in architectural, engineering, and construction services is sustained by consistent growth in U.S. firms' activities overseas, coupled with a persistently low level of participation of foreign firms in the U.S. building and design services sector. In 1997, for example, the total value of overseas contracts secured by U.S. AEC firms grew by over 11 percent, from \$28 billion in 1996 to nearly \$32 billion.¹⁵ By comparison, foreign firms' billings from projects in the United States totaled \$15 billion, representing about 2 percent of the total \$626 billion spent on construction in the United States in 1997.¹⁶ Dynamic growth in developing nations, combined with U.S. firms' established reputation and years of experience overseas, resulted in U.S. strength in this service sector. While economic difficulties in several key markets may reduce export opportunities in the near future, U.S. firms expect to maintain a prominent position in the global market for AEC services due to a resurgence of heretofore stagnant markets,¹⁷ a changing competitive environment, and anticipated strong demand for the quality and expertise that U.S. firms can offer.

Currently, the decline in construction activity in Asia as a result of financial crisis is the greatest challenge facing U.S. firms engaged in international trade in architectural, engineering, and construction services. Indonesia, Thailand, and Malaysia, for example, have been forced to cancel or delay major transportation, infrastructure, and power projects, and overall construction in these countries was expected to decline by 35 percent, 18 percent, and 20 percent, respectively, in 1998.¹⁸ Public resources available for construction have declined drastically, and international lending for specific projects has decreased as funding agencies such as the World Bank target general financial restructuring over specific infrastructure works.¹⁹ Further, because of the severe decline in the value of Asian currencies, U.S. services have become extremely costly, and some AEC firms report difficulties in collecting fees or covering expenses with payments received in local currencies.²⁰ Moreover, under encouragement from countries such as Korea, which wants foreign firms to participate in project finance as well as

¹⁵ "The Top 225 International Contractors: Financing is a Key to Shaky Market," *Engineering News-Record*, Aug. 17, 1998, p. 48; and "The Top 200 International Design Firms: Asian Crisis Curtails Growth," *Engineering News-Record*, July 20, 1998, p. 36.

¹⁶ *Ibid.*; and "World Market Overview," *Engineering News-Record*, Nov. 30/Dec. 7, 1998, p. 45.

¹⁷ For example, the construction markets of certain European countries, which registered minimal or no growth in the past few years, are beginning to rebound.

¹⁸ "Indonesia Postpones 15 Projects," *International Construction*, Feb. 1998, p. 6; "Construction Firms Squeezed by Asian Economic Meltdown," *Engineering News-Record*, Oct. 20, 1997, p. 16; and "World Market Overview," *Engineering News-Record*, Nov. 30/Dec. 7, 1998, p. 39.

¹⁹ "World Bank Shifts Emphasis from Projects to Rescue Loans," *Engineering News-Record*, Oct. 5, 1998, p. 11.

²⁰ *Ibid.*; "The Top 225 International Contractors: Financing is a Key to Shaky Market," *Engineering News-Record*, Aug. 17, 1998, pp. 34-35; and Bradford McKee, "Shifting Ground: the Top 50 U.S. Multinational Architects Recover from a Rough Year with Just a Little More Dough to Show for It," *Architecture*, Oct. 1998, pp. 136-137.

construction,²¹ and Malaysia, where “build-operate-transfer” (BOT)²² and similar methods of funding are gaining attention,²³ AEC service providers are finding it increasingly necessary to offer or arrange financing in order to procure work in the region. This increases risk for those firms providing the required capital and excludes companies that cannot or are reluctant to finance large infrastructure projects.

At the same time, many firms anticipate a rebound in Asian construction markets in approximately 2 to 3 years as impacted economies recover and reinstate delayed infrastructure projects.²⁴ In the interim, several projects in the region are proceeding, particularly those driven by overseas investment by multinational firms that tend to employ experienced foreign firms to design and construct their operations abroad. The regional crisis may also alter the competitive environment for AEC services, particularly with respect to key U.S. competitors in the global marketplace. For example, as a result of economic problems in domestic and overseas markets, over 1,900 construction companies in Korea, including approximately 4 of the country’s largest firms, have gone bankrupt,²⁵ and a number of major Japanese contractors have reported heavy losses and a decrease in work from domestic companies invested abroad.²⁶ The weakened state of competition in the global AEC services market could result in greater opportunities for U.S. companies to secure contracts overseas. In addition, it is predicted that Asian design and construction firms unable to invest in advanced technologies and secure financing for domestic projects would turn to U.S. firms for support, expanding prospects for market access.²⁷ In short, while the Asian financial crisis has negatively impacted overall construction activity throughout the region, select opportunities remain. The extended needs of Asian countries in power, transportation, and housing

²¹ “World Bank Shifts Emphasis from Projects to Rescue Loans,” *Engineering News-Record*, Oct. 5, 1998, p. 11.

²² Under such arrangements, a developer builds and operates a project long enough to regain construction costs and turn a profit before transferring the operation to state ownership.

²³ “The Top 225 International Contractors: Financing is a Key to Shaky Market,” *Engineering News-Record*, Aug. 17, 1998, p. 42.

²⁴ *Ibid.*, p. 44; “World Market Overview,” *Engineering News-Record*, Nov. 30/Dec. 7, 1998, p. 50; and “Construction Firms Squeezed by Asian Economic Meltdown,” *Engineering News-Record*, Oct. 20, 1997, p. 16.

²⁵ “South Korea’s Bankrupt Construction Firms Total 1,945,” *Korea Herald*, Nov. 10, 1998, found at Internet address <http://www.cxa.net/>, retrieved Jan. 5, 1999; and “Impact of the Economic Downturn on Major Projects in Korea,” U.S. Department of State telegram, message reference No. 000329, prepared by U.S. Embassy, Seoul, Jan. 21, 1998.

²⁶ “Tough Times for Japan’s Big Firms,” *Engineering News-Record*, Aug. 31, 1998, p. 19.

²⁷ See for example, USDOC, “Korea-Construction Ind. Prospects,” International Market Insights, Stat-USA Database, found at Internet address <http://www.stat-usa.gov/>, posted Dec. 15, 1997, retrieved Jan. 6, 1999.

suggest strong future prospects for U.S. architectural, engineering, and construction firms.²⁸

Contrary to the challenges presented in Asia, Latin American markets offer numerous sector-specific projects along with greater political and economic stability. In Mexico, for example, foreign AEC firms have won a number of contracts in power generation, and approximately 10 additional plants adding 4,600 megawatts of power are expected to be offered for bid by 2000.²⁹ Chile, which has registered strong economic growth for over a decade, promotes outside participation in power and transportation projects through the sale of concessions. The country has awarded over \$1 billion in toll road contracts and announced plans to grant an additional \$500 million in concessions for infrastructure projects in 1999.³⁰ Argentina and Brazil, which are also active in power plant and toll road privatization, support a number of industrial works. One U.S. contractor, for example, is participating in the construction of several automobile manufacturing facilities in these countries.³¹ Though the Brazilian economy has recently experienced serious financial problems, the country boasts the sixth-largest construction market in the world, leading industry officials to believe that most projects, particularly those in the telecommunications and power sectors, will continue.³²

U.S. firms hoping to take advantage of opportunities in Asia, Latin America, and other strong markets such as Canada and the Middle East still face certain constraints. In several countries, foreign AEC firms are required to work with local firms, primarily in joint-venture arrangements where foreign equity levels may be restricted. U.S. firms may also be excluded from bidding on certain projects by both explicit national regulations³³ and established practices favoring domestic firms. Moreover, progress on mutual recognition agreements and multinational accords designed to facilitate international acceptance of U.S. architectural and engineering licenses has been slow. Nonetheless, despite the various challenges involved in trade in architectural, engineering, and construction services, U.S. firms are highly competitive and have

²⁸ See "The Top 200 International Design Firms: Asian Crisis Curtails Growth," *Engineering News-Record*, July 20, 1998, pp. 34-35; "The Top 400 Contractors: Surge in Asian Revenue Makes Firms Vulnerable to Economic Undertow," *Engineering News-Record*, May 25, 1998, p. 110; and "Big Projects Pushing Ahead Despite Asia's Financial Woes," *Engineering News-Record*, Apr. 6, 1998, p. 24.

²⁹ "Mexico's New Generation," *Project Finance*, Sept. 1998, p. 26.

³⁰ "Chile's Sale of the Decade," *International Construction*, Dec. 1998, p. 7; and "World Market Overview," *Engineering News-Record*, Nov. 30/Dec. 7, 1998, p. 55.

³¹ "World Market Overview," *Engineering News-Record*, Nov. 30/Dec. 7, 1998, p. 54.

³² *Ibid.*, pp. 54-55.

³³ For example, a national decree in China prevents foreign firms from bidding on the majority of domestic construction work. According to the decree, foreign firms may only bid on projects funded by foreign investment or international organizations, projects initiated by Chinese-foreign joint ventures that require technologies unavailable locally, and projects initiated by domestic firms for which a suitable domestic contractor cannot be found. USDOC, ITA, National Trade Data Bank, "China-Construction & Engineering Services," Stat-USA Database, found at Internet address <http://www.stat-usa.gov/>, posted July 1, 1997, retrieved Jan. 6, 1999.

demonstrated the ability to procure increasing amounts of work in diverse markets. The overall outlook for U.S. trade in AEC services, while moderated by the difficulties experienced in developing countries, remains positive.

CHAPTER 6

AUDIOVISUAL SERVICES

Introduction

Audiovisual services comprise the production and distribution of motion pictures, television and radio programs, recorded music, music videos, and recorded video tapes. These services are distributed to consumers through rental or sale of prerecorded work, projection in movie theaters, and television, pay television, and radio broadcasting. Audiovisual services transactions take the form of royalties, rentals, license fees, or other funds received or paid, including those from outright sales and purchases, for the rights to display, reproduce, or distribute material prerecorded on motion picture film or television tape.¹ Transactions occur both across borders and through affiliates whose parent firms are based in another country. Cross-border trade data on audiovisual services reflect only film and tape rentals. Data on affiliate transactions reflect the production and distribution of motion pictures, television tapes, and film; the operation of movie theaters; and the rental of video tapes and disks.²

Recent Trends

Cross-Border Trade, 1992-97

As noted above, data on cross-border trade in audiovisual services solely reflect film and tape rentals. In 1997, U.S. cross-border exports of audiovisual services increased by 23 percent, to \$6.2 billion, faster than the 18-percent average annual growth recorded during 1992-96 (figure 6-1).³ This is due to the worldwide popularity of numerous motion pictures released by Hollywood studios in 1997. For example, Sony Pictures recorded 47-percent growth in revenues in the fiscal year ending March 31, 1998, due primarily to strong box office and video sales of movies produced in 1997, including *Men in Black*, *My Best Friend's Wedding*, *Air Force One*, and *As Good as it Gets*.⁴

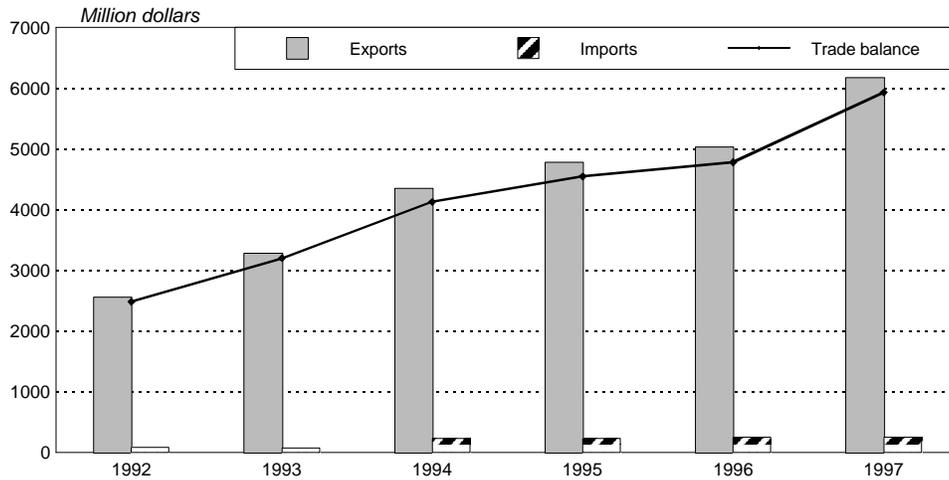
¹ U.S. Department of Commerce (USDOC), Bureau of Economic Analysis (BEA) representative, interview by USITC staff, Washington, D.C., Dec. 10, 1998.

² Ibid.

³ USDOC, BEA, "International Sales and Purchases of Private Services," *Survey of Current Business*, Oct. 1998, pp. 98-105.

⁴ Sony Corporation, *Industry Segment Information*, found at Internet address <http://www.sony.co.jp/>, retrieved Dec. 15, 1998.

Figure 6-1
Audiovisual services: U.S. cross-border exports, imports, and trade balance, 1992-97



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Nov. 1996, pp. 94-95, Oct. 1997, pp. 121-122, and Oct. 1998, pp. 121-122.

Fox Filmed Entertainment, which released *Independence Day* and *Star Wars: Special Edition*, also earned record-setting revenues in international markets in 1997.⁵ In addition, Viacom's entertainment revenues grew by 11 percent in 1997, due partly to higher foreign home video sales by Paramount.⁶ U.S. imports remained unchanged at \$247 million in 1997, in sharp contrast to the 32-percent average annual growth during 1992-96 (despite declining in 1993).⁷ On balance, the United States registered a \$5.9-billion surplus on trade in audiovisual services in 1997, reflecting a 24-percent increase from the previous year. The rate of increase in the surplus was higher than the 18-percent average annual growth during 1992-96.

The major U.S. export markets for cross-border audiovisual services in 1997 were Europe -- notably the Netherlands, Germany, and the United Kingdom -- and Japan (figure 6-2). The Netherlands was the largest single export market at \$991 million, followed by Germany, \$827 million, and the United Kingdom, \$685 million.⁸ Cross-border exports to Japan amounted to \$539 million.

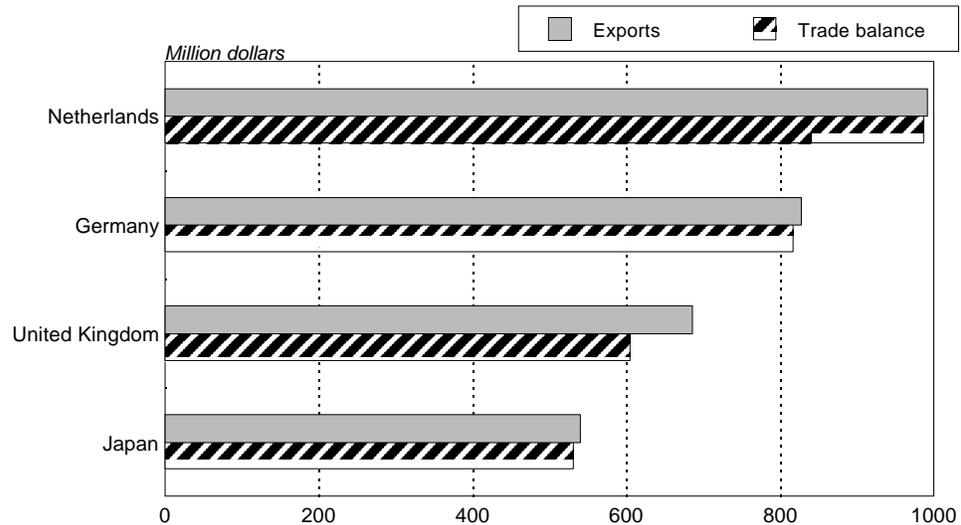
⁵ Fox Entertainment, *1997 Annual Report*, found at Internet address <http://www.newscorp.com/>, retrieved Dec. 15, 1998.

⁶ Viacom News Release, *Viacom Reports 1997 Fourth Quarter and Year End Results*, New York, Feb. 26, 1998, found at Internet address <http://www.viacom.com/qr97q4.tin>, retrieved Dec. 15, 1998.

⁷ USDOC, BEA, "International Sales and Purchases of Private Services," *Survey of Current Business*, Oct. 1998, pp. 98-105.

⁸ *Ibid.*, p. 104.

Figure 6-2
Audiovisual services: U.S. cross-border exports and trade balance, by major trading partners, 1997



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1998, p. 104 and 105.

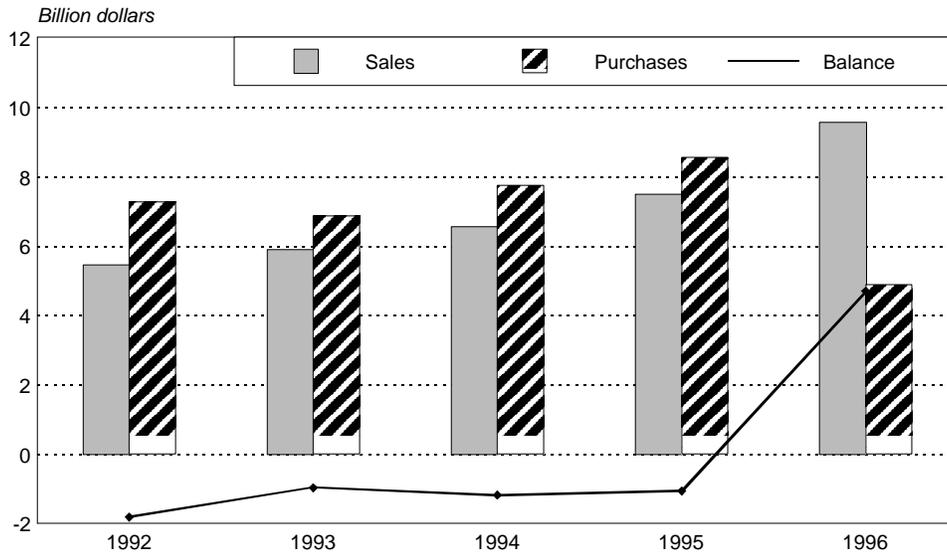
Affiliate Transactions, 1992-96

Data on affiliate transactions in audiovisual services reflect sales of services by affiliates of firms in the motion picture industry. In 1996, foreign-based affiliates of major U.S. motion picture studios generated receipts totaling \$9.6 billion (figure 6-3), a 28-percent increase from 1995, and more than double the 11-percent average annual growth rate during 1992-95. Meanwhile, U.S. purchases of such services from U.S.-based affiliates of foreign firms fell by 43 percent to \$4.9 billion in 1996.⁹ Consequently, U.S.-owned affiliates' sales exceeded foreign-owned affiliates' sales by \$4.7 billion in 1996, whereas the latter exceeded the former by \$1.3 billion, on average, during 1992-95. The change in the balance was principally due to a \$656-million decline in purchases from U.S. affiliates of European-owned motion picture companies. In 1996, a U.S. holding company acquired Metro-Goldwyn-Mayer/United Artists (MGM/UA) from Credit Lyonnais, a French bank.¹⁰

⁹ Ibid.

¹⁰ For more information, see USITC, "U.S. film industry: How mergers and acquisitions are reshaping distribution patterns worldwide," *Industry, Trade, and Technology Review*, Jan. 1997.

Figure 6-3
Audiovisual service transactions by majority-owned affiliates: U.S. sales, purchases, and balance, 1992-96



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Sept. 1995, pp. 104-105; Nov. 1996, pp. 111-112; Oct. 1997, pp. 137-136; and Oct. 1998, pp. 115-116.

Consequently, the proceeds of MGM/UA in the United States were no longer reported as affiliate transactions, causing data on purchases from U.S. affiliates of French parent companies to fall from \$492 million in 1995 to \$34 million in 1996.¹¹ To a lesser degree, the drop in U.S. purchases is attributable to decreased market shares of the major foreign-owned motion picture producers in the United States: Columbia Pictures, TriStar, and Universal Studios. Sony's Columbia and TriStar studios' combined share of the U.S. box-office market dropped from first to fifth place in 1996. *Jerry Maguire*, released in December 1996, was Sony's only movie among the top 15 domestic films for the year, and most of the proceeds from this film were not reported in 1996 transaction data.¹² Universal Studios, majority-owned by Canadian beverage company Seagram, also had a single movie, *The Nutty Professor*, in the top 15 in 1996. Universal's domestic box-office market share slipped from 13 percent in 1995 to 8 percent in 1996.¹³

The United Kingdom continued to provide U.S.-owned foreign affiliates with the largest market for motion pictures, accounting for \$1.3 billion in sales in 1996.¹⁴ Conversely, it appears that U.S. affiliates of Canadian and British parent firms continued to be the largest foreign-owned suppliers of motion pictures to the U.S. market in 1996. British-

¹¹ USDOC, BEA, "International Sales and Purchases of Private Services," *Survey of Current Business*, Oct. 1997, p. 138; and USDOC, BEA, "International Sales and Purchases of Private Services," *Survey of Current Business*, Oct. 1998, p. 116.

¹² Standard & Poor's, *Industry Surveys: Movies & Home Entertainment*, May 21, 1998, p. 1.

¹³ Ibid.

¹⁴ USDOC, BEA, "International Sales and Purchases of Private Services," *Survey of Current Business*, Oct. 1998.

owned firms accounted for 32 percent of U.S. purchases through foreign-owned affiliates.¹⁵

Summary and Outlook

U.S. cross-border exports of audiovisual services increased substantially in 1997, while imports remained unchanged, consequently increasing the U.S. trade surplus in such services to \$5.9 billion. The U.S. purchase of the previously French-owned MGM/UA, and smaller market shares for U.S. affiliates of foreign-owned studios resulted in U.S. sales exceeding purchases by \$4.7 billion in 1996, reversing the pattern experienced during 1992-95.

The U.S. motion picture industry enjoys an immense and growing success around the world, far surpassing the performance of foreign movies in the United States.¹⁶ Widespread use of the English language virtually assures U.S. movies a large international market.¹⁷ In addition, non-English-speaking foreign markets welcome popular U.S. movies that are dubbed or subtitled in local languages. Thus, U.S. motion pictures account for 80 percent of box-office receipts in Europe, and more than 50 percent of box-office receipts in Japan.¹⁸ In contrast, dubbed or subtitled foreign-language films are not popular with U.S. audiences.¹⁹ Consequently, foreign-language movies rarely attain the level of success of domestic productions in the United States.

The U.S. motion picture industry should also reap the benefits of an expanded and improved stock of movie theaters around the world. The number of movie screens in Europe and Asia is increasing rapidly, as theater companies, including U.S. firms, replace old, single-screen movie facilities with modern multiplexes, which have the capacity to show several movies simultaneously. For example, Loews Cineplex International, owned by Sony, formed a joint venture with Yelmo Cineplex de España to build new theaters in Spain. Loews expects the joint venture to build 15 to 20 new multiplexes in the next few years.²⁰ Other companies building multi-screen theaters in Europe include IMAX Theaters of Canada, with a large presence across the continent, and Planet Movies by AMC, newly established by AMC Entertainment and Planet Hollywood International.²¹ Warner Brothers International Theaters, UCI (a joint venture by MCA/Universal and Paramount), Cinemark USA, and United Artists Theater Circuit are also engaged in theater building in Asia.²² Consequently, the ratio of inhabitants per movie screen fell by

¹⁵ Ibid.; BEA data on U.S. purchases from U.S. affiliates of Canadian audiovisual firms were suppressed to avoid disclosure of data of individual companies.

¹⁶ Standard & Poor's, *Industry Surveys: Movies & Home Entertainment*, p. 10.

¹⁷ Ibid.

¹⁸ Jonathan Bing, Maria Simson, and Jeff Zaleski, "Movies and Money," *Publishers Weekly*, Aug. 17, 1998.

¹⁹ Robert J Guttman, "Going to the Movies with Jack Valenti," *Europe*, Sept. 1998.

²⁰ Melanie D. Goldman, "Invasion of the Cineplexes," *Europe*, Sept. 1998.

²¹ Ibid.

²² Andrew Tanzer and Robert LaFranco, "Luring Asians from Their TV Sets," *Forbes*, June 3, 1996.

4 percent in Europe, and by 3 percent in Japan in 1997.²³

U.S. audiovisual companies are also poised to benefit from innovations in video distribution. Cable television and direct-to-home satellite services offering multiple channels are expanding worldwide. In addition to multiplying the distribution channels for audiovisual products, these technologies enable customers to view movies of their choice on demand, and will likely increase the demand for U.S. motion pictures. In the United States, pay television already generates two-thirds, on average, of Hollywood movie revenue.²⁴ Receipts from broadcasting rights more than tripled from \$1.4 billion in 1990 to \$4.8 billion in 1996 and are reportedly set to increase exponentially as Europe launched digital television in 1998.²⁵ The Internet also adds to the ways audiovisual products are distributed.

Although digital television and the Internet constitute new and better ways to distribute entertainment products, their extensive use in the future for the distribution of audiovisual services is contingent upon the provision of a secure broadcasting environment protected from piracy. The U.S. audiovisual industry, with more than \$2.5 billion in estimated annual losses from piracy,²⁶ does not feel adequately protected by current copyright laws. The industry advocates stronger measures against unauthorized video reproduction, such as the World Intellectual Property Organization treaties that extend the protection of intellectual property rights to the digital environment.²⁷

The movie industry currently faces economic downturns in some of its export markets, notably in Asia, which could affect future sales of U.S. audiovisual products. The Asia-Pacific region accounted for 20 percent of U.S. cross-border exports in 1997, and 12 percent of affiliate sales in 1996.²⁸ However, motion picture ticket sales have not historically demonstrated vulnerability to economic recession, evidently because expenditures for movie theater tickets may be maintained at normal levels due to their relatively low cost.²⁹ On the other hand, cable and satellite television firms have already been adversely affected. For example, the economic crisis curtailed the growth in multi-channel television households in Southeast Asian countries, and slowed penetration in India and China, causing MGM to terminate operations of MGM Gold (Asia) in April

²³ MEDIA Salles, "Cinema Exhibition in Western Europe and Other Continents," 1998 *European Cinema Yearbook, advance edition*, found at Internet address <http://www.mediasalles.it/usa.htm>, retrieved Dec. 9, 1998.

²⁴ Bruce Barnard, "Hollywood invests in Europe: New studios, joint ventures, & local talent reap profits," *Europe*, Sept. 1998.

²⁵ *Ibid.*, and Bhawani Shankar, "Digital TV on home run," *Telecommunications*, Dec. 1997.

²⁶ Motion Picture Association of America, Anti-Piracy, found at Internet address <http://www.mpaa.org/anti-piracy/>, retrieved Nov. 5, 1998.

²⁷ *Ibid.* For further information, see USITC, "Electronic Trade Transforms Delivery of Audiovisual Services," *Industry, Trade, and Technology Review*, Oct. 1997.

²⁸ USDOC, BEA, "International Sales and Purchases of Private Services," *Survey of Current Business*, Oct. 1998, pp. 104 and 115.

²⁹ Harold L. Vogel, *Entertainment Industry Economics* (New York: Cambridge University Press, 1994), pp. 34-36.

1998.³⁰ MGM Gold was a 24-hour satellite and cable television service established in June 1996 to deliver Hollywood entertainment channels featuring primarily movies from the MGM Library to customers in China, Hong Kong, India, and Taiwan.³¹

³⁰ Metro-Goldwyn-Mayer Inc., Quarterly Report 10-Q filed to the Securities and Exchange Commission (SEC), on Aug. 5, 1998; and Annual Report Form 10-K filed to the SEC on Mar. 17, 1998, found at Internet address http://www.mgm.com/corporate/sec_filings/sec.index.html, retrieved Nov. 5, 1998.

³¹ Ibid.

CHAPTER 7

BANKING AND SECURITIES SERVICES

Introduction

For the purposes of this discussion, banking and securities services comprise both fee-based commercial banking services and securities-related services. Fee-based commercial banking services include financial management and transaction services; advisory services; custody services;¹ credit card services; and other credit-related services, such as provision of standby letters of credit for trade financing.² Securities-related services include securities lending services;³ mutual fund services; securities clearance and settlement services; securities trading services; private placements;⁴ and underwriting services.⁵ Insurance and banks' deposit-taking and lending services are excluded from this discussion. Both fee-based commercial banking services and securities-related services can be traded across borders or sold through foreign affiliates.

¹ A custodian holds securities under a written agreement for a client and buys or sells when instructed. Custody services include securities safekeeping as well as collection of dividends and interest. Thomas P. Fitch, *Dictionary of Banking Terms* (New York: Barron's, 1990), p. 172.

² A standby letter of credit represents an obligation by the issuing bank to a designated third party (the beneficiary) that is contingent on the failure of the bank's customer to perform under the terms of the contract with the beneficiary. A standby letter of credit is most often used as a credit enhancement, with the understanding that, in most cases, it will never be drawn against or funded. *Ibid.*, p. 591.

³ A securities loan is a loan made by broker-dealers, banks, or other organizations to finance the purchase of securities. *Ibid.*, p. 552.

⁴ A private placement is the sale of an entire issue of securities to a small group of investors. *Ibid.*, pp. 481-482.

⁵ Data on transactions of finance affiliates reflect the operations of financial holding companies, franchises, and other financial companies, including securities and commodities brokers. These other financial companies account for nearly 100 percent of sales and purchases. U.S. Department of Commerce (USDOC), Bureau of Economic Analysis (BEA), *U.S. Direct Investment Abroad*, preliminary 1995 estimates, table II.A.2.; and *Foreign Direct Investment in the United States*, preliminary 1995 estimates, table A.1.

Recent Trends

Cross-Border Trade, 1992-97

In 1997, U.S. banking and securities service firms recorded cross-border exports of \$11.1 billion and cross-border imports of \$3.9 billion, resulting in a \$7.2-billion surplus (figure 7-1). U.S. exports increased by 32 percent in 1997, faster than the 20-percent average annual increase recorded during 1992-96. By contrast, imports grew somewhat more slowly in 1997, by 30 percent, than they had during 1992-96, when annual increases averaged 32 percent. As a consequence of faster-than-usual export growth and slower-than-usual import growth, the surplus on trade in banking and securities services increased significantly faster in 1997, by 33 percent, than it had during 1992-96, when increases averaged 15 percent per year.⁶

Strong foreign demand for U.S. securities fueled the rapid growth of banking and securities service exports. Foreign demand was strong due to 11-percent appreciation of the U.S. dollar;⁷ rising U.S. stock prices, as reflected in the 32-percent increase in the Standard and Poor's 500 stock index; and the "flight to quality" that began in the fourth quarter of 1997, as foreign investors shed Asian securities in favor of dollar-denominated assets.⁸ Net foreign purchases of U.S. securities totaled \$352.4 billion in 1997, reflecting 22-percent growth over 1996. Net foreign purchases of U.S. Treasury securities increased by 5 percent in 1997, to a record \$163.1 billion; net foreign purchases of U.S. stocks increased more than fivefold, to \$66.9 billion; and net foreign purchases of U.S. bonds increased by 1 percent, to \$122.4 billion.⁹ U.S. exports of banking and securities services also increased as U.S. banks met growing foreign demand for custody services. U.S. banks' custody holdings grew almost tenfold, from \$2.7 billion in 1996 to \$26.6 billion in 1997. U.S. banks principally performed custody services for investors in the United Kingdom and the Caribbean.¹⁰

Net U.S. purchases of foreign securities declined in 1997, but the immense volume of transactions undertaken to increase stakes in West European stocks, where price gains averaged more than 40 percent,¹¹ and to decrease holdings in Asia as the financial crisis in that region unfolded, resulted in higher U.S. imports, or fees and commissions paid to foreign brokers. Trading activity in foreign stocks increased by 53 percent in 1997, while trading activity in foreign bonds increased by 33 percent.¹² Nonetheless, net U.S. purchases of foreign stocks decreased by 35 percent, from \$58.8 billion in 1996 to \$38 billion in 1997, while net U.S. purchases of foreign bonds decreased by 16 percent, from

⁶ USDOC, BEA, *Survey of Current Business*, Oct. 1998, pp. 103-104.

⁷ Eleven percent appreciation of the U.S. dollar was measured against the currencies of 10 industrial countries. USDOC, BEA, *Survey of Current Business*, Apr. 1998, p. 59.

⁸ *Ibid.*, p. 76.

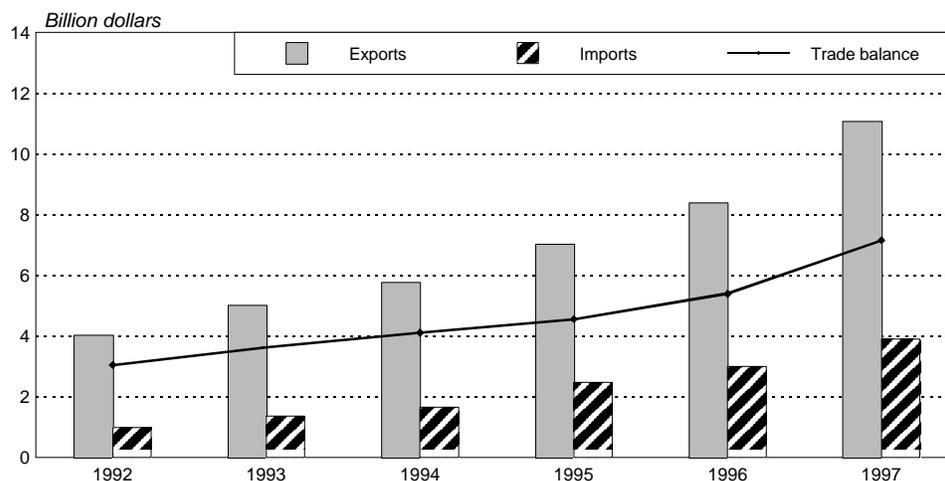
⁹ *Ibid.*, pp. 75-78.

¹⁰ Caribbean investors included U.S. nonbanking firms, such as auto-financing companies, consumer finance companies, commercial finance companies, and insurance companies. *Ibid.*, p. 75.

¹¹ *Ibid.*, p. 72.

¹² *Ibid.*, pp. 73-74.

Figure 7-1
Banking and securities services: U.S. cross-border exports, imports, and trade balance, 1992-97



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1998, pp. 86-87.

\$49.4 billion to \$41.3 billion.¹³ Highlighting the impact of the Asian financial crisis, net U.S. purchases of foreign stocks measuring \$15.6 billion in the third quarter of 1997 abruptly shifted to net U.S. sales of \$2.6 billion in the fourth quarter, as U.S. investors shed stocks in emerging markets.¹⁴

Among U.S. trading partners in banking and securities services, the United Kingdom continued its longstanding preeminence (figure 7-2). In 1997, the United Kingdom accounted for cross-border exports of \$2.2 billion, or 20 percent of total banking and securities service exports, and cross-border imports of \$1.6 billion, or 40 percent of total banking and securities service imports. British preeminence reflects London's entrenched position among leading global financial centers. Other significant export markets included Japan, another leading financial center; Canada; Bermuda; and France.¹⁵ Among these, Bermuda was the only trading partner to make its first appearance among the top five U.S. export markets for banking and securities services. This likely reflects the continuing establishment of financial firms, especially nonbanks, in Bermuda as a means to benefit from favorable corporate, personal income, and capital gains tax rates.¹⁶

¹³ Ibid., pp. 72-73.

¹⁴ Ibid., pp. 71 and 73.

¹⁵ USDOC, BEA, *Survey of Current Business*, Oct. 1998, p. 104.

¹⁶ See USITC, *Industry, Trade, and Technology Review*, May 1993, p. 17.

Affiliate Transactions, 1992-96

In 1996, sales of foreign affiliates of U.S. firms exceeded purchases from U.S. affiliates of foreign firms by no less than \$6.9 billion (figure 7-3).¹⁷ Sales by foreign affiliates of U.S. firms amounted to no less than \$18.2 billion, whereas purchases from U.S. affiliates of foreign firms totaled \$11.3 billion. Sales through foreign affiliates of U.S. firms appeared to grow by 12 percent in 1996, which was slower than the average annual growth rate of 26 percent recorded during 1992-95 (despite the decrease in 1994).¹⁸ By contrast, purchases from U.S. affiliates of foreign firms grew by 59 percent in 1996, much faster than the average annual growth rate of 10 percent recorded during 1992-95. Principally a consequence of the exceptionally rapid growth in U.S. purchases from foreign-owned affiliates, as discussed below, the U.S. balance on affiliate transactions decreased by 25 percent in 1996, a stark contrast to 48-percent average annual growth during 1992-95.¹⁹

On a bilateral basis, the largest trading partners were those countries where U.S. firms have established a substantial commercial presence in order to participate in the local market. These include the United Kingdom and Japan (figure 7-4), which host the largest financial markets outside the United States. In the United Kingdom, sales through foreign affiliates of U.S. firms totaled \$7.9 billion in 1996, representing 43 percent of total U.S. sales of banking and securities services through affiliates. Corresponding purchases from British affiliates operating in the United States measured \$2.2 billion, or 19 percent of total U.S. purchases. Japan ranks second to the United Kingdom in terms of the volume of financial-service transactions. U.S. affiliates recorded sales of \$2.7 billion in the Japanese market, representing 15 percent of total sales of banking and securities services through affiliates, and Japanese affiliates accounted for \$4.4 billion in purchases, representing 39 percent of all U.S. purchases from foreign financial service affiliates. Japan's increasing share of sales stems from several acquisitions of financial institutions in recent years. These acquisitions were reportedly motivated by Japanese firms' interest in broadening their range of services and improving access to U.S. technology and the large U.S. capital market.²⁰ However, Japan's recent economic difficulties have led Japanese banks to sell off significant U.S. banking assets, as European and Canadian banks have expanded their U.S. holdings. Japanese bank assets in the United States fell 24 percent to \$291 billion in the year

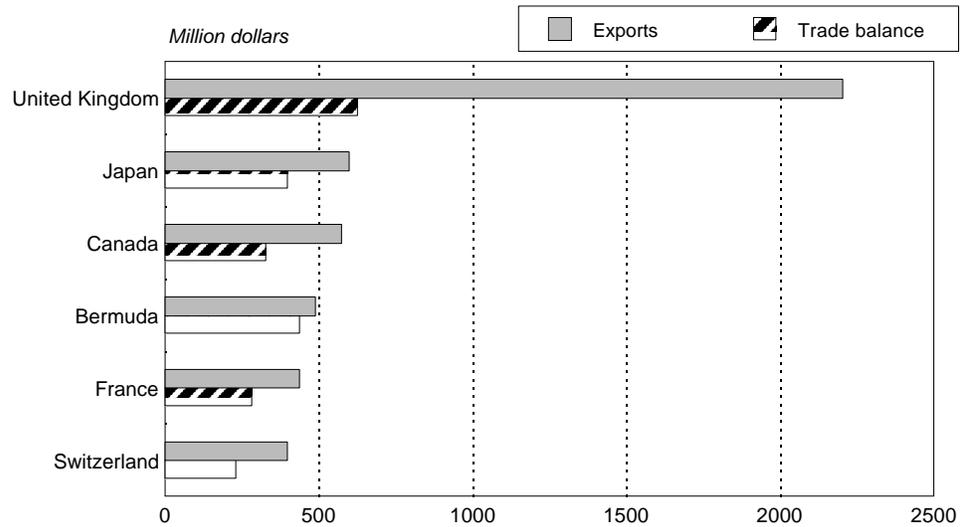
¹⁷ BEA data on sales by foreign affiliates of U.S. companies are somewhat limited in order to avoid disclosing confidential information pertaining to individual firms. Consequently, the data reported for U.S. sales and the U.S. surplus are believed to understate U.S. sales and surpluses during 1992-96. Growth rates have been estimated by USITC staff on the basis of publicly available information. USDOC, BEA, *Survey of Current Business*, Oct. 1998, p. 115.

¹⁸ Ibid.

¹⁹ Ibid., p. 116.

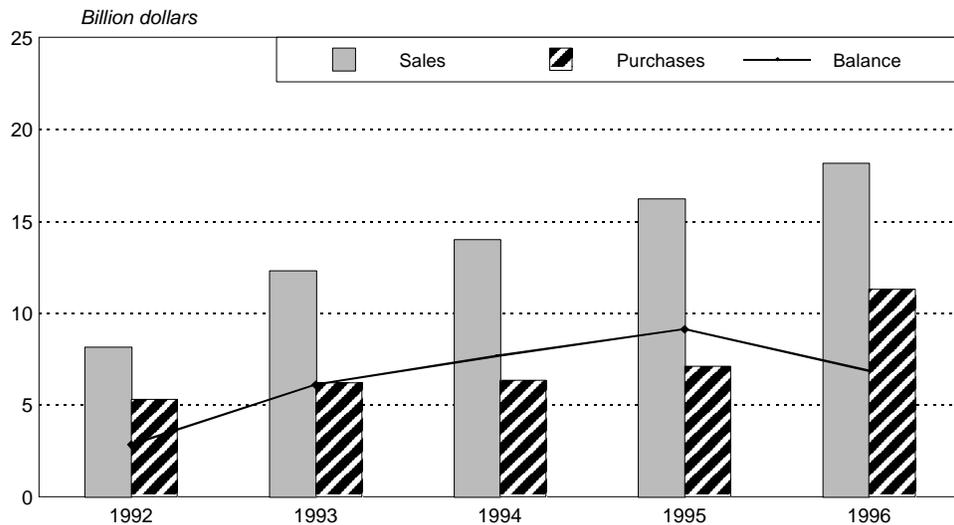
²⁰ Ibid., p. 85.

Figure 7-2
Banking and securities services: U.S. cross-border exports and trade balance, by major trading partners, 1997



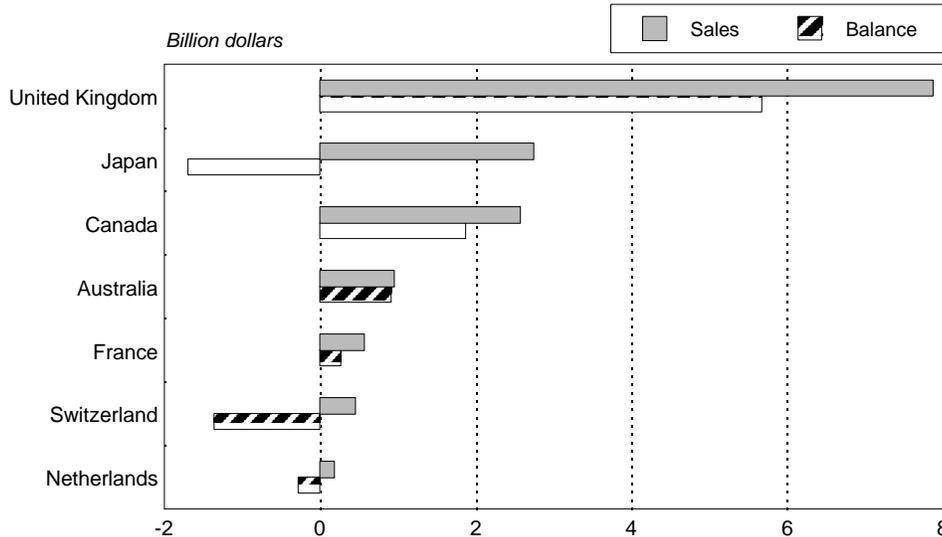
Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1998, pp. 104-105.

Figure 7-3
Banking and securities service transactions by majority-owned affiliates: U.S. sales, purchases, and balance, 1992-96



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Sept. 1995, pp. 104-105; Nov. 1996, pp. 111-112; Oct. 1997, pp. 137-136; and Oct. 1998, pp. 115-116.

Figure 7-4
Banking and securities service transactions by majority-owned affiliates: U.S. sales and balance, by major trading partners, 1996



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1998, pp. 115-116.

ended June 30, 1998. Japan accounted for 25 percent of foreign bank assets in the United States as of that date, down from 47 percent 3 years earlier.²¹

Summary and Outlook

The growth of trade in banking and securities services continued unabated during 1996-97. With respect to cross-border trade in 1997, exports and imports increased by 32 percent and 30 percent, respectively, resulting in 33-percent growth in the surplus on trade in banking and securities services, which totaled \$7.2 billion. With respect to affiliate transactions in 1996, purchases of financial services from foreign-owned brokers and dealers in the United States increased rapidly, by 59 percent in 1996, far outstripping 12-percent growth in U.S. banking and securities affiliates' sales in foreign markets. Nonetheless, U.S. sales exceeded U.S. purchases by \$6.9 billion, though this was down by 25 percent from the year before.

The competitive position of U.S. banking and securities service providers appears to be improving. In part, this stems from mergers and acquisitions in the U.S. financial industry. Mergers and acquisitions have left U.S. firms larger, thereby able to draw on more resources and benefit from greater economies of scale. U.S. firms are also more diversified, with risks spread over multiple products and regional markets. After the

²¹ "As Japan's Banks Trim U.S. Assets, Europe, Canada Institutions Gain," *American Banker*, Feb. 18, 1999, found at Internet address <http://www.americanbanker.com/>, retrieved Mar. 3, 1999.

Citicorp/Travelers Group and NationsBank Corp./BankAmerica Corp. mergers, 3 U.S. banking and securities service firms ranked among the largest 10 such firms in the world, as ranked by assets (table 7-1). The merger of Deutsche Bank (Germany) and Bankers' Trust (United States), scheduled for completion in 1999, will place a fourth company with considerable U.S. participation in the top ten.²²

U.S. banking and securities service firms also may benefit from the reduced lending capacity of competing foreign firms, especially Japanese banks. Japanese banks currently hold ¥29 trillion (\$228 billion) of nonperforming and restructured loans, and have recently reported holding another ¥65 trillion (\$511 billion) of potential problem loans, which could become nonperforming loans if borrowers and creditors mismanage the debt, or if Japan's economic recession worsens.²³ Given the need to hold reserves against potential defaults of this magnitude, Japanese banks have been hesitant to extend new loans, creating a liquidity crisis. In July 1998, Japan announced the Comprehensive Plan for Financial System Revitalization, a framework intended to reduce debt burdens and illiquidity. However, most believed the plan was too conservative and was insufficiently funded, at ¥30 trillion (\$214 billion), to rescue ailing banks and restore vitality to those banks that remain healthy in relative terms.²⁴ Additional steps have been taken since October 1998, including the nationalization of two insolvent banks²⁵ and the extension of ¥43 trillion (\$362 billion) in recapitalization funds, plus ¥17 trillion (\$143 billion) to deal with failed banks. Banking sector improvement is proceeding slowly, however. Fifteen of Japan's 18 leading banks have applied to borrow approximately ¥5.7 trillion (\$48 billion) in public funds, but further capital injections will probably be needed. Banks are reluctant to apply for the bailout funding because the conditions attached to these funds are unclear, and the banks are concerned that acceptance of public funds may adversely affect stock prices, placing the banks in further jeopardy.²⁶

It has also become clear that Japanese banks are the most vulnerable foreign banks to the economic crisis that continues to play out in the Asian mainland. At yearend 1997, Japan held outstanding loans of \$114.7 billion in Asia, accounting for 30 percent of all

²² "The Banker Top 1000," *The Banker*, July 1998, p. 131, found at Internet address <http://proquest.umi.com/>, retrieved Nov. 30, 1998; Kathleen Day, "Bankers Trust, Deutsche Bank to Announce Merger," Los Angeles Times-Washington Post News Service, found at Internet address <http://newsedge/>, posted Nov. 30, 1998, retrieved Nov. 30, 1998; and "Global Rank of Top Financial Services Companies," Reuters, found at Internet address <http://www.foxmarketwire.com/>, posted Apr. 6, 1998, retrieved Nov. 30, 1998.

²³ "Japan's Bad News on Bad Debts: ¥65 Trillion of Potential Problems," *The Banker*, Feb. 1998, found at Internet address <http://proquest.umi.com/>, retrieved Nov. 25, 1998.

²⁴ See, for instance, Anthony Rowley, "Bridge Plan to Nowhere," *The Banker*, Aug. 1998, found at Internet address <http://proquest.umi.com/>, retrieved Nov. 30, 1998.

²⁵ The Long-Term Credit Bank of Japan and Nippon Credit Bank. See Oxford Analytica Briefs, "Japan: LTCB Nationalisation," Oct. 26, 1998, and "Japan: NCB Takeover," Dec. 15, 1998, found at Internet address <http://www.oxan.com/ixbin/>, retrieved Mar. 2, 1999.

²⁶ Oxford Analytica Briefs, "Japan: Bank Rescue Package," Oct. 15, 1998, and "Japan: Bank Provisioning," Dec. 1, 1998, found at Internet address <http://www.oxan.com/ixbin/>, retrieved Mar. 2, 1999.

Table 7-1
Ten largest financial service companies, by assets

Company	Country	Assets (Billion dollars)	Net Income (Million dollars)
Deutsche Bank/Bankers Trust	Germany/United States	830	(¹)
Citigroup ²	United States	698	7,506
Tokyo Mitsubishi	Japan	691	326
UBS	Switzerland	663	3,290
NationsBank ³	United States	525	6,287
Sumitomo Bank	Japan	482	272
Sanwa Bank	Japan	444	207
HSBC	United Kingdom	401	5,273
Chase Manhattan	United States	336	2,461
ING	Netherlands	278	8,333

¹ Not available.

² Reflects combined assets and income of Citicorp and Travelers Group.

³ Reflects combined assets and income of NationsBank and BankAmerica.

Source: "The Banker Top 1,000," *The Banker*, July 1998, p. 131, found at Internet address <http://proquest.umi.com>, retrieved Nov. 30, 1998; Kathleen Day, "Bankers Trust Deutsche Bank to announce Merger," Los Angeles Times-Washington Post News Service, found at Internet address: <http://newsedge>, posted Nov. 30, 1998, retrieved Nov. 30, 1998; and "Global Rank of Top Financial Services Companies," Reuters, found at Internet address: <http://www.foxmarketwire.com>, posted Apr. 6, 1998, retrieved Nov. 30, 1998.

loans to Asia extended by banks reporting to the Bank for International Settlements (BIS).²⁷ By contrast, German banks accounted for about 13 percent of outstanding loans; French banks, for 11 percent; British banks, for 9 percent; and U.S. banks, for 8 percent.²⁸ In the countries most severely affected by the Asian crisis--Thailand, South Korea, and Indonesia--Japan accounted for 36 percent of outstanding loans; Germany and France, 10 percent apiece; the United States, 8 percent; and the United Kingdom, 7 percent.²⁹

U.S. banks may also benefit from recent and ongoing liberalization of foreign financial markets, especially that which facilitates the acquisition or establishment of foreign financial affiliates. For instance, Japan's liberalization facilitated Citigroup's acquisition of a stake in Nikko Securities³⁰ and Merrill Lynch's establishment of a new retail brokerage company that will take possession of the assets formerly held by the failed Yamaichi Securities.³¹ Financial liberalization is also a key part of the IMF agreements

²⁷ Banks reporting to BIS include those of Austria, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Italy, Japan, Luxembourg, Netherlands, Norway, Spain, Sweden, the United Kingdom, and the United States.

²⁸ BIS, Monetary and Economic Department, "Consolidated international banking statistics for end-1997," press release, table 2, May 25, 1998.

²⁹ Ibid.

³⁰ David Weidner, "Citigroup Partners Still Eager Acquirers, Nikko Deal Shows," *American Banker*, June 2, 1998, p. 1.

³¹ "Merrill Lynch Outlines Retail Network Using Yamaichi Outlets," *Nikkei Daily News*, (continued...)

signed by Indonesia, South Korea, and Thailand. Restructuring authorities in these countries are auctioning off the assets of closed financial institutions, although this has proved to be a slow process due to the difficulty of assessing the value of ailing institutions.³² Nonetheless, U.S. firms have proved to be active bidders in the auctions held to date. In the first half of 1998, for instance, GE Capital purchased more than 50 percent of the assets auctioned in Thailand.³³

A potential obstacle to growing U.S. competitiveness is the possible spread of the Asian financial crisis to other emerging markets. In particular, U.S. financial institutions could be adversely affected if Latin America were to become deeply embroiled in the same type of crisis that currently plagues Asia. In Latin America, U.S. banks hold 22 percent of outstanding debt.³⁴ It seems clear that a crisis was narrowly averted by Brazil when its currency, the real, came under pressure in October 1997. Brazilian authorities averted the crisis by quickly doubling the Central Bank's intervention interest rates, to pull in foreign capital, and adopting a fiscal package intended to bring government accounts into surplus in short order. In November 1998, Brazilian authorities and the International Monetary Fund agreed on a program that is intended to end the chronic public-sector deficit. In its effort, Brazil will be able to draw upon more than \$41 billion in funds provided by the IMF, the World Bank, the Inter-American Development Bank, and several industrial countries channeling funds through the Bank for International Settlements.³⁵ On January 15, 1999, the Brazilian Government abandoned the value of the real in relation to the U.S. dollar, allowing the Brazilian currency to float freely on foreign exchange markets. This led to a sharp devaluation of the real, which in turn has made it much more difficult for Brazil to meet its debt service obligations. In consequence, Brazil and the IMF announced a revised agreement in March 1999. Brazil agreed to new cuts in federal spending and civil service reform, and a new program to fight inflation. The real will remain on a floating exchange rate regime and the Brazilian Government has committed to accelerating its privatization program.³⁶

The Russian banking sector is in disarray following the currency crisis in August 1998, with an estimated one-half of the country's banks insolvent as of February 1999. Net assets of the banking sector fell by over 60 percent to an estimated \$40 billion in 1998. The Russian Government unveiled a bank restructuring plan in October 1998, but implementation is only beginning. A long-awaited law covering the bankruptcy of banks, passed in February 1999, should greatly facilitate restructuring of the sector. However,

³¹ (...continued)

Feb. 13, 1997, found at Internet address <http://www.nikkei.co.jp/>, retrieved Oct. 20, 1998.

³² In one noteworthy purchase, the Dutch bank ABN Armo acquired a 75-percent stake in Thailand's Bank of Asia for a price to be determined by an independent auditor at yearend 1999 based on the average price-to-book value of six other Thai banks. David Lanchner, "Buy Now, Price it Later," *Global Finance*, May 1998, p. 17.

³³ "GE Capital Emerges as the Biggest Buyer of Thai Assets in FRA sell-off," *The Banker*, Aug. 1998, p. 63.

³⁴ BIS, Monetary and Economic Department, "Consolidated international banking statistics for end-1997."

³⁵ IMF, External Relations Department, "Camdessus Welcomes Conclusion of Talks on Brazil's Program," News Brief No. 98/43, Nov. 13, 1998.

³⁶ Oxford Analytica Brief, "Brazil: IMF Agreement," Mar. 11, 1999, found at Internet address <http://www.oxan.com/ixbin/>, retrieved Apr. 30, 1999.

foreign banks completed a debt restructuring deal with the Russian Government in November 1998, and remain highly unlikely to make significant new investments. Support from the international financial institutions has not been forthcoming, either. Necessary financing for the bank restructuring process must therefore come almost entirely from the Russian Government.³⁷

In the long term, U.S. and foreign banking and securities firms are expected to benefit from countries' implementation of trade-liberalizing commitments in the WTO Financial Services Agreement which entered into force as scheduled on March 1, 1999.³⁸

³⁷ Oxford Analytica Briefs, "Russia: Debt Deal," Nov. 17, 1998, "Russia: Bank Restructuring," Jan. 29, 1999, and "Russia: Bank Bankruptcy," Feb. 23, 1999, found at Internet address <http://www.oxan.com/ixbin/>, retrieved Mar. 3, 1999.

³⁸ The WTO Financial Services Agreement, the fifth Protocol to the General Agreement on Trade in Services (GATS) was signed by 70 countries on December 12, 1997. It was ratified by 52 of those countries by the January 1999 deadline. The majority of the remaining 18 countries are expected to ratify the agreement by June 1999. The agreement covers multilateral trade commitments in the banking, securities, and insurance services, and brings to 104 the total number of countries that have made some kind of financial services commitments in the GATS process. World Trade Organization, "The Results of the Financial Services Negotiations Under the General Agreement on Trade in Services," found at Internet address http://www.wto.org/wto/services/finance_background.htm, retrieved Mar. 3, 1999.

CHAPTER 8

COMPUTER AND DATA PROCESSING SERVICES

Introduction

Computer and data processing services¹ include computer systems analysis, design, and engineering; custom software and programming services; computer leasing;² systems integration services; data entry, processing, and tabulation; and other computer-related services such as computer timesharing, maintenance, and repair.³ U.S. firms sell computer and data processing services in foreign markets primarily through foreign-based affiliates. However, cross-border trade continues to increase as advances in electronic transmission technologies better enable firms to provide computer and data processing services from remote locations. Computer and data processing services most often delivered to foreign clients include systems integration,⁴ outsourcing,⁵ and custom programming.⁶

¹ In 1998, the Bureau of Economic Analysis (BEA) revised downward its estimates for 1992-97 of cross-border trade in computer and data processing services, by reclassifying computer software royalties and license fees. The reclassification transferred such fees to other, similar royalty and license fee transactions. BEA held that the reclassification better reflects the acquisition and sales of rights to use or reproduce computer software as transactions involving intangible, nonproduced, nonfinancial assets and proprietary rights, such as patents, copyrights, trademarks, industrial processes, and franchises. As a result of the reclassification, BEA's estimates published in October 1998 for computer and data processing services trade during 1992-96 are lower than such estimates published previously. See U.S. Department of Commerce (USDOC), BEA, *Survey of Current Business*, July 1998, p. 54, and October 1998, p. 76.

² Data pertaining to computer leasing do not reflect financing fees.

³ This service category excludes prepackaged software shipped to or from the United States and included in U.S. merchandise trade statistics. USDOC, BEA, *Instructions to BE-22 Survey*, OMB form No. 0608-0060, July 20, 1995.

⁴ Systems integration comprises the development, operation, and maintenance of computer networks. Tasks involve all phases of systems design, including planning, coordinating, testing, and scheduling of projects; analysis and recommendation of hardware and software; system installation; software customization; and end-user training.

⁵ Outsourcing describes the practice of contracting out internal functions, ranging from low-skill services such as data entry to more complex functions such as managing a company's telecommunication and computer networks.

⁶ Custom programmers create or modify software to perform tasks that are unique to client companies.

Recent Trends

Cross-Border Trade, 1992-97

In 1997, U.S. cross-border exports of computer and data processing services decreased by approximately 1 percent to \$1.6 billion, reversing the 21-percent average annual growth rate experienced during 1992-96 (figure 8-1). By contrast, U.S. imports jumped by 94 percent to \$270 million, far above the 22-percent average annual increase achieved during 1992-96 (despite an 18-percent decline in 1994). The decline in exports and the rise in imports reduced the computer and data processing services trade surplus to \$1.3 billion, or by 10 percent.

The United Kingdom and Canada remained the leading cross-border recipients of U.S. computer and data processing services in 1997 (figure 8-2). Exports to these countries accounted for \$378 million or 23 percent of total U.S. exports of such services. Australia, with purchases of \$132 million, surpassed Japan and Germany to rank as the third-largest market for U.S. computer and data processing services. Canada, the United Kingdom, Germany, and Japan remained the predominant suppliers of such services to the United States in 1997, accounting for 58 percent of all such imports.

Affiliate Transactions, 1992-96

In 1996, U.S. sales of computer and data processing services through foreign-based affiliates totaled \$28.3 billion, accounting for 13 percent of total U.S. sales transacted by foreign affiliates. Affiliate sales rose by approximately 25 percent in 1996,⁷ which was the same average annual growth rate experienced during 1992-95 (figure 8-3). In 1996, U.S. purchases of such services from U.S.-based affiliates of foreign firms fell for the first time during the period under review. The 2-percent drop, from \$3.9 to \$3.8 billion, sharply contrasts with the average annual growth rate of 20 percent experienced during 1992-95. The large increase in U.S. sales coupled with marginally lower purchases increased the U.S. balance on affiliate transactions to \$24.5 billion. Data limitations preclude a meaningful discussion of country-specific affiliate activity.⁸

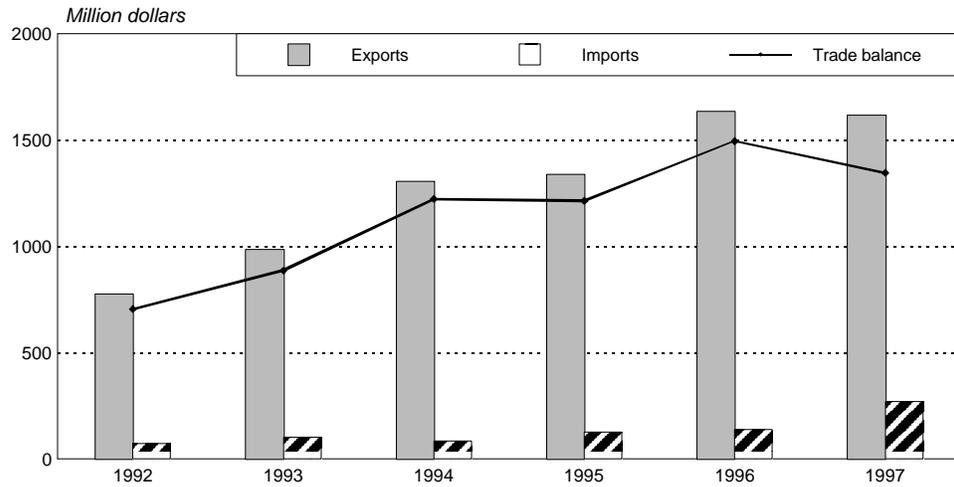
Summary and Outlook

Growth in U.S. exports of computer and data processing services through affiliates remained strong in 1996, with the yearly increase matching the average annual growth rate achieved during 1992-95. Affiliate sales continued to account for the vast majority

⁷ In October 1997 *Survey of Current Business*, BEA reported total U.S. sales amounting to \$22.7 billion in 1995 by foreign affiliates of U.S. computer and data processing firms. This report of *Recent Trends in U.S. Services Trade* includes these estimates, because such data for 1995 were not disclosed in the October 1998 *Survey of Current Business*.

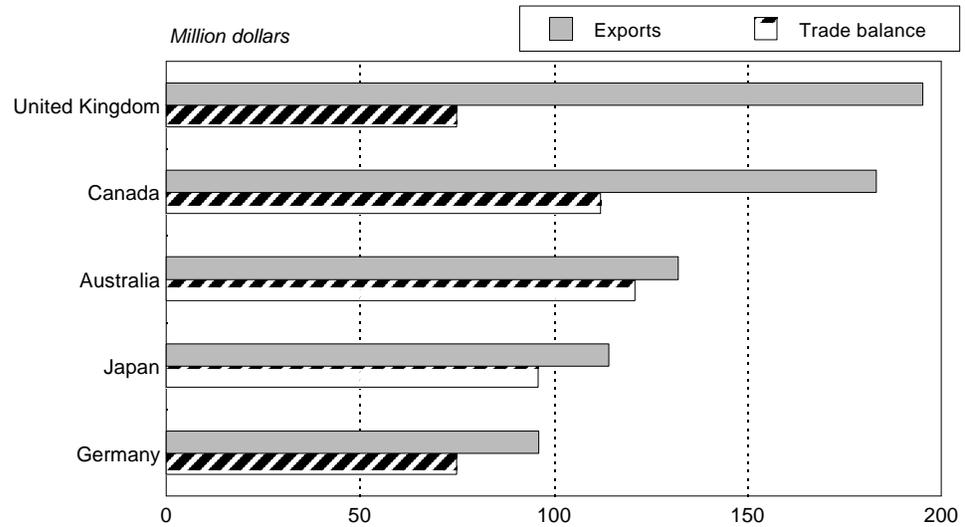
⁸ To avoid disclosing the operations of individual companies, BEA suppressed much of the country-specific data regarding affiliate transactions.

Figure 8-1
Computer and data processing services: U.S. cross-border exports, imports, and trade balance, 1992-97



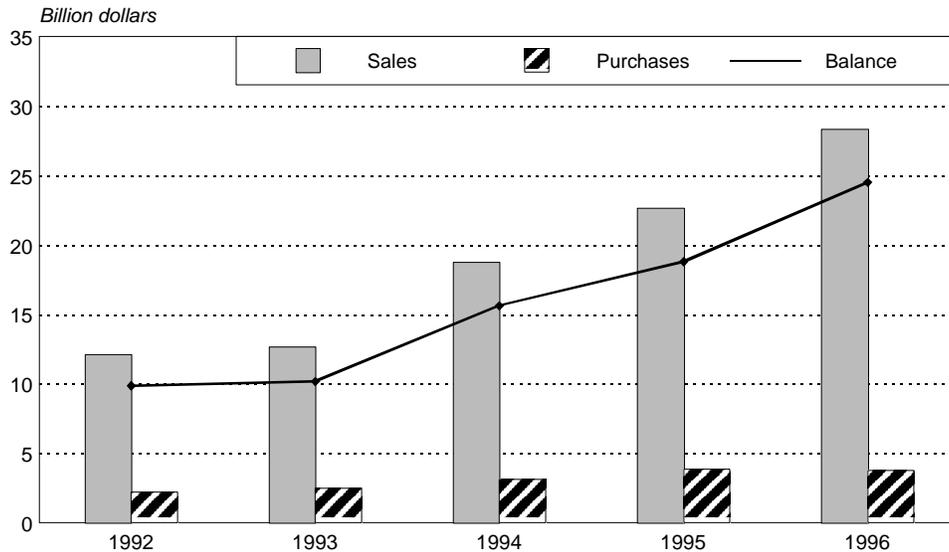
Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1998, pp. 86-87.

Figure 8-2
Computer and data processing services: U.S. cross-border exports and trade balance, by major trading partners, 1997



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1998, p. 113.

Figure 8-3
Computer and data processing service transactions by majority-owned affiliates: U.S. sales, purchases, and balance, 1992-96



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Sept. 1995, pp. 104-105; Nov. 1996, pp. 111-112; Oct. 1997, pp. 137-136; and Oct. 1998, pp. 115-116.

of trade in such services, leading cross-border exports by more than 17-fold. With regard to cross-border trade, the United Kingdom, Canada, and Japan remained the most significant trading partners, joined by Australia.

Growth in this sector is expected to remain strong. Important industry issues and opportunities include electronic commerce, the “Year 2000 Problem” (Y2K),⁹ the high demand for computer networks of all sizes, and the proliferation of the Internet and the World Wide Web. Retail sales over the Internet were approximately \$600 million in 1996, while 1998 sales are projected to exceed \$35 billion. This growth is likely to create significant demand for the computer and data processing services that enable electronic commerce.¹⁰

Industry analysts expect that the global information technology (IT) services market will nearly double over the next 5 years, to \$620 billion. These figures reflect revenue from sectors including custom programming, consulting, systems integration, and

⁹ Many date-dependent computer applications use only the last two digits of the year and therefore will not be able to distinguish between, for example, the year 2001 and 1901. Although a potentially massive problem for computer users, the Y2K presents computer software and services vendors with significant opportunity as worldwide repair estimates range from \$200 billion to more than \$500 billion.

¹⁰ For a more in-depth analysis of Internet retailing, see: USITC, “Nonstore Retailing: Alternative Retail Venues Attract Customers,” *Industry, Trade, and Technology Review*, publication No. 3153, Dec. 1998.

outsourcing.¹¹ According to International Data Corporation (IDC), worldwide spending on outsourcing services grew by nearly 20 percent in 1997, to \$44 billion, and is likely to grow by 12 percent annually through 2001. One of the newer, fast-growth areas of the outsourcing industry is business process outsourcing (BPO).¹² This segment comprised 27 percent of total outsourcing revenues in 1997, and is expected to grow by more than 15 percent per year through 2001. The worldwide systems integration market also experienced healthy growth in 1997. Industry analysts estimate the market grew by 12 percent to \$39.4 billion. The market is expected to grow by 11 percent annually through 2001, as the manufacturing and financial sectors continue integrating their worldwide operations. Data-processing-service providers also continued to experience robust growth in 1997. Industry analysts estimate this market topped \$62 billion, up by 9 percent from 1996.¹³

The European market for computer and data processing services is strong. Leading applications include solving Y2K problems and adjusting computer systems to recognize the single European currency, the euro, introduced at the beginning of 1999.¹⁴ Opportunities are also likely to develop in Asia as businesses restructure their financially troubled operations. Industry analysts believe that outsourcing may become an attractive strategy to Asian companies striving to reduce costs.¹⁵ Growth is also reaching Latin America. Mexico is currently overtaking English-speaking rivals such as Ireland, India, and several Caribbean Islands as the leading foreign destination for U.S. data processing.¹⁶

U.S. firms play a major role in meeting the worldwide demand for computer and data processing services. For example, Andersen Consulting reported strong growth in Europe and the Asia-Pacific markets in 1997.¹⁷ Automatic Data Processing¹⁸ (ADP) has operations in every major European country and believes that the continued increase in multinational companies and a strong demand for outsourcing will create additional

¹¹ Bruce Caldwell, "Technology Services: Genesis of a New Services Era," *Information Week*, Apr. 6, 1998, found at Internet address <http://www.informationweek.com/>, retrieved Nov. 5, 1998.

¹² BPO involves outsourcing an entire business function of a company, such as human resources operations.

¹³ Standard & Poor's, "Industry Surveys - Computers: Computer Services," June 25, 1998, p. 2.

¹⁴ To prepare for the currency conversion, most European businesses, particularly banks and financial services providers, will require extensive modifications to their computer hardware and software. The updates are likely to be expensive -- estimates range from two to six times as costly as Y2K conversions. Anne Knowles, "Euro: Creation of a new currency," *Datamation*, Nov. 1997.

¹⁵ "Top Analysts Review Computer Services," *The Wall Street Transcript*, found at Internet address <http://www.twst.com/>, retrieved Nov. 5, 1998.

¹⁶ Mexico's strengths include its proximity to the United States, a large bilingual work force, inexpensive labor, and a high-capacity telecommunications infrastructure. Joel Millman, "U.S. Offshore Data Processing Firms Flourish in Mexican Border Cities," *Wall Street Journal*, Dec. 1, 1998.

¹⁷ "1997 Annual Report," Andersen Consulting, found at Internet address <http://www.ac.com/>, retrieved Oct. 21, 1998.

¹⁸ ADP specializes in employer services such as payroll and human resource management.

opportunities in the region. In 1997, ADP expanded its presence in the Canadian and South American computer services markets through several acquisitions.¹⁹ Foreign clients accounted for 39 percent of Electronic Data Systems' (EDS)²⁰ total revenues in 1997, up from 35 percent in 1996. European revenue for EDS increased \$461 million, or 17 percent, to \$3.1 billion in 1997. Other foreign revenues grew \$239 million more than in 1996, to \$1.1 billion, due principally to new contracts signed in the Asia-Pacific region.²¹ First Data Corporation also reported continued international success in 1997. The firm expanded its presence in Europe through a joint venture in Spain, new clients in Germany, and improved relationships with British-based clients. Operations in Australia also enjoyed strong growth.²²

A trend that continues to reshape the computer services market is the gravitation toward offering services by leading manufacturers of computer hardware. As companies expand worldwide and as technology becomes more complex, clients increasingly value a single source for all their computer needs. One-stop-shopping provides better prices and greater convenience. Compaq Computer, the world's largest PC maker, entered the services market by purchasing Digital Equipment Corporation, a leader in corporate systems and services. The combined company's \$37.5 billion in annual revenue will be second only to IBM's.²³

IBM's services business is the fastest growing sector within the company and is expected to be the largest sector by the end of 1999.²⁴ IBM is optimistic because, among other factors, the firm recently won several outsourcing contracts in Japan, a huge market where companies have historically kept work in-house. Also, the worldwide backlog for IBM services contracts stands at \$44 billion.²⁵ IBM's services revenue increased 22 percent in 1997 and 25 percent in 1996. The increases were driven by continued strong growth in professional services, which includes managed operation of systems, and systems integration design and development.²⁶

¹⁹ Automatic Data Processing, Inc., *Form 10-K*, filed with the U.S. Securities and Exchange Commission, fiscal year ended June 30, 1997.

²⁰ EDS provides professional services such as systems development, systems integration, and business process management to industries including communications, health, energy, travel and transportation, and financial services.

²¹ Electronic Data Systems Corp., *Form 10-K*, filed with the U.S. Securities and Exchange Commission, fiscal year ended December 31, 1997.

²² First Data Corp., *Investor Information*, found at Internet address <http://www.firstdatacorp.com/>, retrieved Oct. 22, 1998.

²³ Paul Davidson, "Compaq to buy Digital in bid for clout," *USA Today*, Apr. 6, 1998.

²⁴ Jeff Bliss, "IBM Increases Reliance On Services Growth," *Computer Reseller News*, May 13, 1998, found at Internet address <http://www.techweb.com/>, retrieved Oct. 22, 1998.

²⁵ "IBM Is in Talks for Services Deal That May Be Worth Over \$2 Billion," Dow Jones Newswires, *Wall Street Journal Interactive*, Aug. 10, 1998.

²⁶ Reportedly, IBM continues to face the adverse effects of weakness in some Asian markets. Also, since approximately 81 percent of IBM's non-U.S. revenue was derived from affiliates operating in local currency environments, the company's results were diminished as many worldwide currencies weakened versus the U.S. dollar in 1997. International Business Machines Corp., *1997 IBM Annual Report*, found at Internet address <http://www.ibm.com/AnnualReport>, retrieved Nov. 5, 1998.

New York-based Computer Associates International (CA), a key developer of software products, is also moving into the international computer services market. CA is expanding its European services business through acquisitions and internal growth.²⁷ However, a severe shortage of qualified professionals is creating staffing problems and is driving up the price of service companies entertaining acquisition offers. Yet, because the European service market is extremely fragmented, CA believes it has an opportunity to become a major participant.²⁸

²⁷ CA-Europe hopes to add 500 employees per quarter to the services group.

²⁸ Steven Burke, "CA Hires Bull France President," *Computer Reseller News*, Sept. 10, 1998.

CHAPTER 9

EDUCATION SERVICES

Introduction

Education services include formal academic instruction in primary, secondary, and higher education institutions such as colleges and universities, as well as instructional services offered by libraries and correspondence, vocational, language, and special education schools. Formal foreign study programs sponsored by colleges and universities account for approximately 90 percent of trade in education services.¹ U.S. cross-border exports reflect the estimated tuition and living expenses of foreign residents enrolled in U.S. colleges and universities.² U.S. cross-border imports of education services represent the estimated tuition and living expenses of U.S. residents who study abroad.³ Affiliate transactions in education services occur when U.S. institutions provide courses overseas using their own faculty and facilities, or when foreign institutions provide courses in the United States using their own faculty and facilities. Because comprehensive data on affiliate transactions are not available, this chapter will focus solely on cross-border trade.

Recent Trends in Cross-Border Trade, 1992-97⁴

In 1997, U.S. exports of education services totaled \$8.3 billion, while U.S. imports measured \$1.3 billion (figure 9-1). Exports increased by 5 percent in 1997, slightly slower than the 6-percent average annual increase during 1992-96. By comparison, U.S. imports grew by 8 percent, also slower than the 13-percent average annual growth rate during 1992-96. Trade in education services generated a \$6.9-billion surplus in 1997, surpassing the previous year by almost \$300 million. The surplus grew by 4 percent, slightly slower than the 5-percent average annual growth rate during 1992-96.

Foreign students studying in the United States numbered 457,984 in the 1996-97 academic year, placing the United States first in the world in terms of foreign student enrollment. However, foreign enrollment grew only slightly, by 1 percent, following

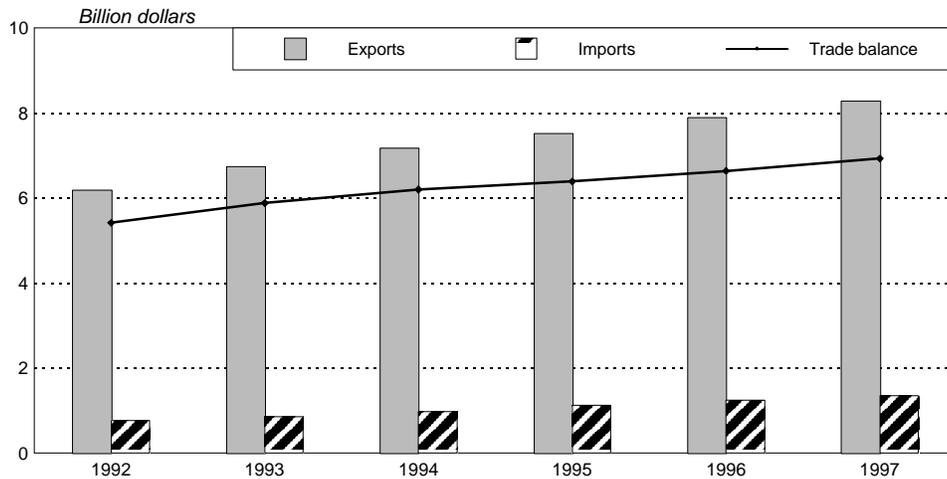
¹ USITC staff estimates based on interviews with U.S. Department of Commerce (USDOC) officials, Mar. 1997.

² Foreign residents do not include U.S. citizens, immigrants, or refugees.

³ U.S. residents must receive credit from accredited U.S. institutions to be included in trade data; those who do not transfer foreign academic credit to U.S. institutions, or who study abroad on an informal basis, are not included.

⁴ The Bureau of Economic Analysis (BEA) reports trade data on education services on an academic-year basis. Accordingly, trade data for 1992 spans the 1991-92 academic year, which began in September 1991 and ended in August 1992. Trade data reported for 1997 include services provided during the 1996-97 academic year.

Figure 9-1
Education services: U.S. cross-border exports, imports, and trade balance, 1992-97



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1998, pp. 86-87.

even smaller increases in the 1994-95 and 1995-96 academic years.⁵ Together, these three academic years represent the smallest consecutive annual increases since the Institute of International Education (IIE) began collecting such statistics in 1919, and continue a 7-year trend of slow growth in foreign-student enrollments in the United States.⁶ The slowdown can be attributed to several factors, perhaps the most important of which is increasing competition from abroad, especially from three other English-speaking countries--Australia, Canada, and the United Kingdom.⁷

These three countries have been particularly aggressive, and successful, in recruiting foreign students, especially from Southeast Asia.⁸ Australia, in particular, has undertaken a determined marketing campaign aimed at prospective students from Asia. Its efforts have focused on promoting Australia and its institutions as a nearby, economical, and safe alternative to an education in the United States.⁹ The recent economic downturn in Asia,

⁵ Todd M. Davis, ed., *Open Doors 1996/97: Report on International Educational Exchange* (New York: Institute of International Education, 1997), p. 1.

⁶ *Ibid.*, pp. 1, 3, 189.

⁷ The U.S. share of the international education market has shrunk from 40 percent in the 1980s to approximately 32 percent today. Paul Desruisseaux, "Intense Competition for Foreign Students Sparks Concerns About U.S. Standing," *Chronicle of Higher Education*, Oct. 9, 1998, p. A55; and industry representatives, telephone interviews by USITC staff, Oct. 28 and Nov. 2, 1998. See also, Paul Desruisseaux, "Competition Intensifies for Asian Students," *Chronicle of Higher Education*, May 29, 1998, pp. A48-A49.

⁸ Desruisseaux, "Intense Competition for Foreign Students," p. A55; "Issues for the 21st Century: the International Student Market, 1997," in Davis, *Open Doors 1996/97*, pp. 4-6; and industry representatives, telephone interviews by USITC staff, Oct. 28 and Nov. 2, 1998.

⁹ Desruisseaux, "Competition Intensifies for Asian Students," pp. A48-A49; Geoffrey

(continued...)

combined with a significant depreciation of the Australian dollar against the U.S. dollar, have added to Australia's allure.¹⁰ Additionally, Australia is expected to pass new immigration laws that would waive current residency requirements and make foreign students who earn Australian degrees immediately eligible for permanent residency in the country. Such a policy could prove to be very attractive to foreign students.¹¹

Steadily improving educational systems and institutions, especially at the undergraduate level, in developing and newly developed countries, especially in Asia, also contributed to the slowdown in the flow of foreign students to the United States.¹²

Despite the above, Asian countries continue to be major U.S. export markets for education services. In 1997, Asia accounted for over 57 percent of U.S. exports of such services. Ranked by values, Japan, Korea, China, Taiwan, Canada, India, and Malaysia led all U.S. export markets (figure 9-2). Exports increased with regard to four of the seven markets, especially the two leading markets, Japan and Korea, although the growth rate of such exports to Korea slowed slightly. Even so, Korea replaced China as the number two U.S. export market in 1997.¹³ Interestingly, although U.S. exports to China declined by 2 percent to \$545 million in 1997, the number of students from China studying in the United States actually rose by 7 percent, from 39,613 in the 1995-96 academic year to 42,503 in the 1996-97 academic year.¹⁴ A closer examination of the numbers reveals that the proportion of Chinese students enrolled in undergraduate programs has declined, while the proportion enrolled in graduate programs has risen.¹⁵ Foreign students generally pay full tuition at the undergraduate level, while special financial aid, especially teaching assistantships, is often available to graduate students.

⁹ (...continued)

Maslen, "Australia Plans Campaign to Promote Its Colleges to Students from Other Nations," *Chronicle of Higher Education*, May 22, 1998, p. A52; and industry representatives, telephone interviews by USITC staff, Oct. 28, 1998.

¹⁰ Desruisseaux, "Intense Competition for Foreign Students," p. A55; and industry representatives, telephone interviews by USITC staff, Oct. 28, 1998.

¹¹ Geoffrey Maslen, "Shift in Immigration Laws May Help Australian Universities Attract Foreign Students," *Chronicle of Higher Education*, Sept. 18, 1998, p. A52; and industry representatives, telephone interviews by USITC staff, Oct. 28, 1998.

¹² Industry representatives, telephone interviews by USITC staff, Oct. 28 and Nov. 2, 1998. However, according to a recent article, the higher education systems in many of the world's poorest countries, especially in Africa, have deteriorated significantly over the past two decades primarily because of soaring enrollments and declining economies. See, Burton Bollag, "International Aid Groups Shift Focus to Higher Education in Developing Nations," *Chronicle of Higher Education*, Oct. 30, 1998, pp. A51-A52.

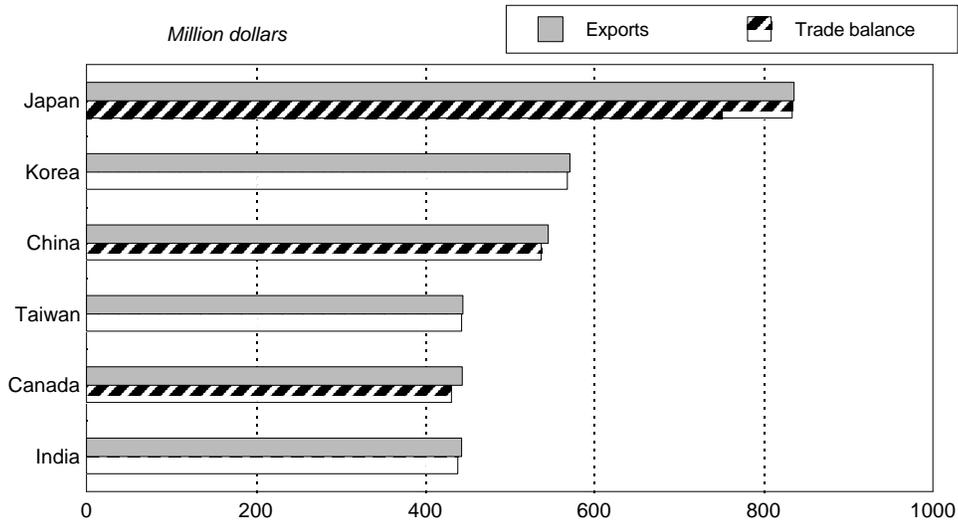
Interestingly, according to *Open Doors*, for the fourth consecutive year, enrollments of African students were up during the 1996/97 academic year. Davis, *Open Doors 1996/97*, p. 7.

¹³ BEA, *Survey of Current Business*, Oct. 1998.

¹⁴ Davis, *Open Doors 1996/97*, p. 30.

¹⁵ *Ibid.*, p. 38.

Figure 9-2
Education services: U.S. cross-border exports and trade balance, by major trading partners, 1997



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1998, pp. 104-105.

This partially explains how more students could result in lower exports. It is also possible that Chinese students in general are attending schools with lower tuition, perhaps community colleges, and budgeting less for living expenses.¹⁶

European markets remained the principal destinations for U.S. residents studying abroad, accounting for approximately 56 percent of all U.S. imports of education services in 1997. The United Kingdom held the largest share of U.S. imports, as in years past, followed by Mexico, Spain, Italy, and France. The United States maintained an education services trade surplus with all of its trading partners except Italy, Mexico, Spain, and the United Kingdom.

Summary and Outlook

Although the United States continued to generate a substantial surplus in education services trade, the rate of growth of the surplus has slowed in recent years. Students from Asia remained the largest foreign consumers of U.S. education services, led by those from Japan, Korea, China, Taiwan, and India.

In recent years, a number of developments have raised concerns about the ability of the United States to continue to attract international students to its institutions. Since 1997, the Asian financial crisis has drawn the most attention. Starting in mid-1997, countries in Southeast Asia succumbed to plummeting currencies and faltering capital markets,

¹⁶ Industry representative, interview via electronic mail by USITC staff, Jan. 20, 1999.

rapidly and severely undercutting Asian employment and savings. U.S. educators and government officials feared that dire economic conditions in Asia would prevent Asian students from pursuing their educations in the United States. Most institutions anticipated a substantial decline in the numbers of both continuing and newly matriculating students.¹⁷ In order to stave off an exodus of Asian students from this country, U.S. educational institutions, private corporations, and State and Federal Governments combined efforts to provide financial aid, including special loans, scholarships, and grants; tuition deferment plans; and part-time employment opportunities. Additionally, the United States Information Agency (USIA), under its Exchange Visitor Program, and the Immigration and Naturalization Service implemented special regulations in order to ease student visa requirements and employment restrictions.¹⁸

In the end, the results appear to be mixed. For the 1996-97 academic year, many institutions reported significantly lower enrollments of Asian students. Indeed, IIE census numbers indicate lower enrollments from Hong Kong, Indonesia, the Philippines, Singapore, and Taiwan. However, enrollments from Malaysia, the Republic of Korea, and Thailand, among the countries hardest hit by the Asian crisis, were actually up by 4, 3, and 11 percent, respectively.¹⁹ More recent enrollment figures paint an even brighter picture. According to the IIE, enrollments from almost all Asian countries for the 1997-98 academic year were up. Most notably, enrollments from the Republic of Korea, Thailand, China, and Indonesia were up 16, 12, 11, and 7 percent, respectively. Enrollments from the Philippines, Malaysia, Singapore, and Taiwan were up as well, but only marginally.²⁰ Even so, there are still some observers who think that 1997-98 enrollment figures, as they were collected in fall 1997, do not accurately reflect the disruption caused by the Asian crisis.²¹ Interviews with administrators at several universities that historically have attracted large numbers of foreign students suggest that

¹⁷ Tony Gillotte, "Financial Crisis in Thailand Disrupts Plans of College Students," *Chronicle of Higher Education*, Nov. 14, 1997, p. A49; Paul Desruisseaux, "In the U.S.: Survey Finds Less Effect Than Officials Had Expected," *Chronicle of Higher Education*, Mar. 27, 1998, pp. A52-A53; Paul Desruisseaux, "U.S. Colleges Widen Foreign Recruiting to Offset Loss of Students from Asia," *Chronicle of Higher Education*, Sept. 25, 1998, pp. A55-A57; and industry representatives, telephone interviews by USITC staff, Oct. 16, 1997 and Oct. 28, 1998.

¹⁸ Desruisseaux, "Survey Finds Less of an Effect on Enrollments Than Expected," p. A52; "Oklahoma Lures Internationals with Low Tuition," *International Educator*, vol. 7, No. 4 (Early Fall 1998), p. 7; "Korean Student Assistance Awards Program Announces Grant Recipients," *NAFSA.news*, Oct. 23, 1998; Eduardo Lachia, "U.S. Benefactors Help Asian Students Remain in School," *Asian Wall Street Journal*, Sept. 7, 1998, p. 16; "NAFSA and ASPIRE Announce ASAAP Grant Recipients: Asian Student Assistance From NAFSA," *NAFSA Newsletter*, vol. 49, No. 6 (Aug./Sept. 1998), p. 15; "Special Student Relief: a NAFSA Practice Advisory," *Government Affairs Bulletin*, vol. 13, No. 8 (May/June 1998), pp. 1, 3-7; "U.S. Agency Eases Visa Rules for Some Asian Students," *Chronicle of Higher Education*, July 3, 1998, p. A33; and industry representatives, telephone interviews by USITC staff, Oct. 28 and Nov. 2, 1998.

¹⁹ Davis, *Open Doors 1996/97*, pp. 30-31.

²⁰ Institute of International Education (IIE), as reported in, "Foreign Students in U.S. Institutions, 1997-98," *Chronicle of Higher Education*, Dec. 11, 1998, p. A67.

²¹ Paul Desruisseaux, "2-Year Colleges at Crest of Wave in U.S. Enrollment by Foreign Students," *Chronicle of Higher Education*, Dec. 11, 1998, p. A66; and industry representatives, telephone interviews by USITC staff, Oct. 28 and Nov. 2, 1998.

fall 1998 enrollments by Asian students may indeed be significantly lower.²² English as a Second Language (ESL) programs were the first and worst hit by a decline in Asian student enrollments, with some programs declining by as much as 50 percent. Although Asian enrollments are off in regular degree programs as well, the effects appear to be largely offset by increases in enrollments from the rest of the world. Several schools report that the numbers of students from China, India, and countries in Eastern Europe and the former Soviet Union are up significantly. It also appears that while undergraduate enrollments may have declined, graduate school admissions, which often include special financial aid, including teaching assistantships, are up. Additionally, institutions with historically large international enrollments and active recruitment programs appear to have been able to maintain total enrollment, even if Asian student enrollments are down.²³

The lessons of the Asian financial crisis, combined with increased competition from abroad, have brought the issue of attracting foreign students to the fore. U.S. institutions and organizations concerned with international education, along with State and Federal Government officials, are engaged in a dialog regarding the possibilities for active recruitment of foreign students and so-called “cooperative marketing”—that is, a unified public-private effort to promote U.S. educational institutions abroad much like other U.S. exports.²⁴ This comes at a time when the U.S. Government has chosen to eliminate the USIA as a distinct entity, for many years the sole promoter abroad of a U.S. education.²⁵ Although most of its programs, including academic and cultural exchange programs, will continue under the Department of State, continued funding for its 450 academic advising centers, which dispense advice and information about U.S. higher education to a minimum of 2 million prospective students each year, has been and continues to be in doubt. Further, interviews with administrators at U.S. educational institutions reveal some scepticism about the prospects for and the efficacy of “cooperative marketing” of such a diverse and varied export as education. It should be noted that much of this scepticism may come from institutions that do not themselves have active recruitment programs, beyond making informational materials available abroad.²⁶

²² Industry representatives, telephone interviews by USITC staff, Oct. 28 and Nov. 2, 1998.

²³ Desruisseaux, “U.S. Colleges Widen Foreign Recruiting,” p. A55; and industry representatives, telephone interviews by USITC staff, Oct. 28 and Nov. 2, 1998.

²⁴ Marlene Johnson, Executive Director and CEO, NAFSA: Association of International Educators, “U.S. Leadership in International Education: the Lost Edge,” remarks at the U.S. Department of State, Sept. 24, 1998, found at Internet address <http://www.nafsa.org/>, retrieved Oct. 13, 1998; Marlene Johnson, “‘Cooperative Marketing’: Can it be Applied to Funding Overseas Advising Centers?” *NAFSA.news*, Oct. 9, 1998; and industry representatives, telephone interviews by USITC staff, Oct. 28 and Nov. 2, 1998.

²⁵ The USIA will officially merge with the Department of State as of October 1, 1999. USIA official, telephone interview by USITC staff, Jan. 19, 1999. See also “U.S. Information Agency is Eliminated, but Its Academic-Exchange Programs Will Live On,” *Chronicle of Higher Education*, Oct. 30, 1998, p. A51.

²⁶ Industry representatives, telephone interviews by USITC staff, Oct. 28 and Nov. 2, 1998.

Despite the challenges, the United States maintains its position as the world's leading exporter of education services. Although 4-year, degree-conferring colleges and universities continue to account for the overwhelming majority of these exports, industry professionals point to other areas that are of increasing interest. In particular, U.S. community colleges continue to attract a larger share of foreign students. Community colleges are increasingly viewed by foreign students as a viable and less expensive entry point into the U.S. system of higher education.²⁷ Indeed, most recent figures for the 1997-98 academic year show that 2-year colleges attracted twice as many foreign students as they did a decade ago. Enrollments of foreign students at 2-year colleges saw a 13-percent increase over the 1996-97 academic year, accounting for 15 percent of all foreign enrollments in the United States during the 1997-98 academic year.²⁸

Other areas that have seen significant increases in the number of foreign students are continuing education and extension programs. In particular, short-term certificate programs, especially for corporate consumers, and intensive ESL programs have become increasingly popular among foreign students.²⁹ As with the community college, the ESL programs often act as conduits to degree programs.³⁰

²⁷ Industry representatives, telephone interviews by USITC staff, Oct. 28 and Nov. 2, 1998.

²⁸ IIE, as reported in Desruisseaux, "2-Year Colleges at Crest of Wave," p. A66.

²⁹ Popularity of these programs is growing despite the recent fall in overall enrollments by Asian students. See, for example, Dr. B. Jane Stanfield, "The 'New' English Language Institute," in Davis, *Open Doors 1996/97*, pp. 164-165; Bill Wallace, "Intensive English Programs: Gateways for International Education on the University Campus," in Davis, *Open Doors 1996/97*, pp. 171-173; Amy Magaro Rubin, "Intensive English Programs Are Lucrative for Universities," *Chronicle of Higher Education*, Dec. 12, 1997, p. A48; and industry representatives, telephone interviews by USITC staff, Oct. 28 and Nov. 2, 1998.

³⁰ Wallace, "Intensive English Programs," pp. 171-173.

CHAPTER 10

ENERGY SERVICES

Introduction

Energy services consist of a wide variety of activities involved with energy exploration, production, and delivery. These services may be broadly divided into two categories: petroleum-related services and utility-related services. Petroleum-related services principally include oil field services, pipeline transportation and storage services, tanker services, and services provided by petroleum wholesalers and retailers. Utility-related services comprise sales of services by firms engaged in the distribution of natural gas and the generation, transmission, and/or distribution of electrical energy.¹ Energy services may include design and engineering; transportation; storage; trading, marketing, and brokerage; commodity and price risk management; demand-side and other customer services; as well as waste management and disposal services.²

As with most industries, energy services may be sold to foreign customers either through cross-border channels or through foreign-based affiliates. Energy services most likely to be traded on a cross-border basis include transportation; design and engineering; and some of the financially oriented activities such as energy trading, marketing, brokerage, and risk management. Services provided through foreign affiliates tend to be those that require a direct presence in foreign markets, such as oil field services, gas pipeline transportation, or electric power generation, transmission, and distribution services. Official data on cross-border energy services transactions are unavailable principally because they are not captured by an individual service category. Instead, cross-border transactions in energy services are reflected in other data on engineering, financial, transportation, consulting, or other services. With respect to affiliate transactions, some official data are reported on sales of services by utilities and petroleum-related firms. However, as with cross-border transactions, the affiliate data do not capture energy-related sales of services by engineering, construction, or transportation companies, because such transactions cannot be distinguished from nonenergy sales. Due to these data limitations, the following data discussion addresses only affiliate transactions by firms engaged directly in petroleum-related and utility businesses.

¹ Electric power transmission involves the movement of large amounts of electricity across significant distances through high-voltage grids, whereas electric power distribution involves the delivery of lower voltage electricity to the ultimate consumer.

² Although electricity itself is traded across borders, it is classified as a commodity and therefore recorded in the merchandise trade account.

Recent Trends in Affiliate Transactions, 1992-96

International services transactions by affiliates are reported based upon the industry classification of the foreign affiliate rather than the type of service sold.³ With respect to energy services, data are reported under two industry categories: petroleum services and public utilities. Petroleum services comprise sales of services by affiliates associated with petroleum production, transportation, and distribution. Data on public utilities include sales of services by affiliates established as electric, gas, and sanitation service providers.⁴

In 1996, foreign affiliates of U.S. energy service firms recorded sales of \$20.1 billion to foreign customers, reflecting a 39-percent increase from sales of \$14.5 billion in 1995 (figure 10-1). Such sales were almost evenly proportioned between petroleum-related services and utility services, at 48 percent and 52 percent, respectively. Sales were nearly three times the corresponding purchases of energy services by U.S. customers through U.S. affiliates of foreign firms, which were \$7.7 billion in 1996. U.S. purchases of energy services also were fairly evenly divided between petroleum-related services and services provided by utilities, at 44 percent and 56 percent, respectively. The \$12.4-billion difference between U.S. sales and purchases of energy services through affiliates reflects U.S. firms' more pronounced presence abroad.⁵

As noted, sales of energy services by foreign affiliates of U.S. firms grew by 39 percent in 1996, considerably faster than the 9-percent average annual growth rate recorded during 1992-95. This growth was principally driven by an 84-percent increase in sales of services by utilities, which in turn reflected a number of major acquisitions in the United Kingdom and Australia by U.S. electric power companies.⁶ By contrast, purchases of energy services from U.S.-based affiliates of foreign firms in 1996 grew by 10 percent, slightly slower than the 14-percent average annual growth rate during 1992-95.

On a regional basis, European affiliates of U.S. firms accounted for 46 percent of U.S. sales of energy services through foreign affiliates in 1996 (figure 10-2). The United

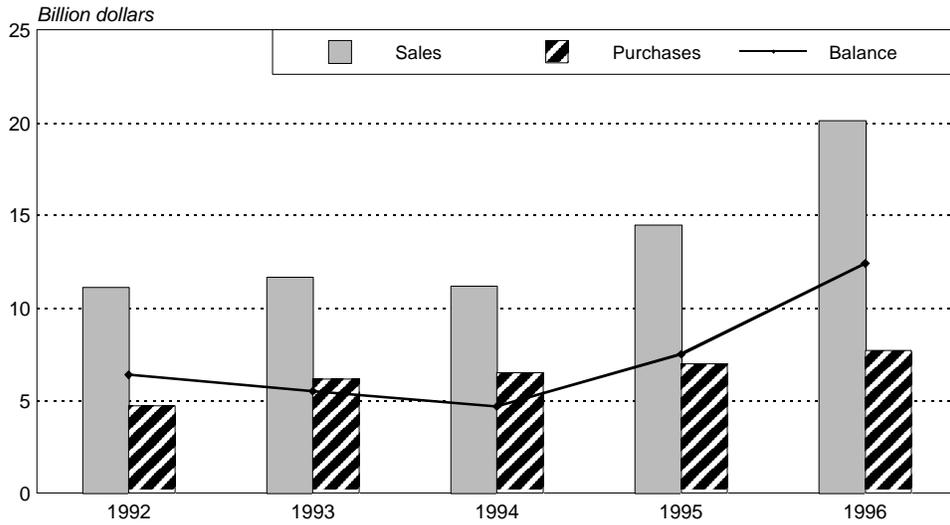
³ This means that sales of different kinds of services by a single affiliate can not be distinguished. For example, sales of telecommunication services by a subsidiary of a U.S. electric power company can not be distinguished from sales of electricity distribution services -- they both will be classified as services provided by electric power affiliates.

⁴ Sanitary services can not be separated from electric and gas services, which results in some overstatement of energy service transactions. However, as noted previously, energy services provided by construction, engineering, or consulting firms are not captured in the data, which results in some understatement of energy service transactions.

⁵ In 1995, foreign affiliates of U.S. energy service firms held assets measuring \$123 billion, which were nearly three times larger than the \$43 billion in assets held by U.S. affiliates of foreign energy firms. U.S. Department of Commerce (USDOC), Bureau of Economic Analysis (BEA), *Foreign Direct Investment in the United States, preliminary 1995 estimates*, June 1997, table A-1; and *U.S. Direct Investment Abroad, preliminary 1995 estimates*, Oct. 1997, Table II.A 1.

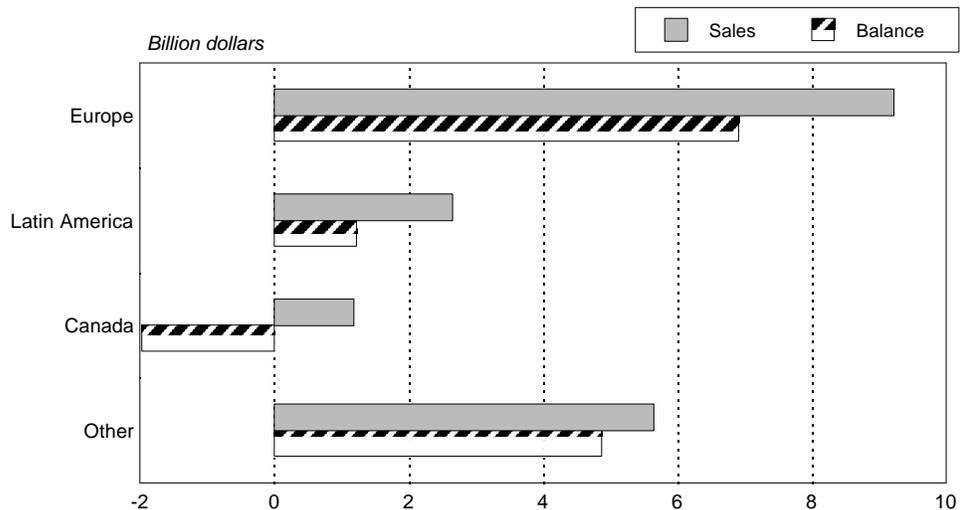
⁶ USITC, "Deregulation fosters globalization of the electric power industry," *Industry, Trade, and Technology Review*, USITC publication No. 3134, Sept. 1998, pp. 49-55.

Figure 10-1
Energy service transactions by majority-owned affiliates: U.S. sales, purchases, and balance, 1992-96



Source: U.S. Department of Commerce (USDOC), Bureau of Economic Analysis (BEA), *Survey of Current Business*, Sept. 1994, pp. 135-136; Sept. 1995, pp. 104-105; Nov. 1996, pp. 111-112; Oct. 1994, pp. 137-138; Oct. 1998, pp. 115-116; and USDOC, BEA, U.S. Direct Investment Abroad, 1994 Benchmark Survey, Final Results, table III.F 20.

Figure 10-2
Energy service transactions by majority-owned affiliates: U.S. sales and balance, by major trading partners, 1996



Source: U.S. Department of Commerce (USDOC), Bureau of Economic Analysis (BEA), *Survey of Current Business*, Sept. 1994, pp. 135-136; Sept. 1995, pp. 104-105; Nov. 1996, pp. 111-112; Oct. 1997, pp. 137-138; Oct. 1998, pp. 115-116; USDOC, BEA, U.S. Direct Investment Abroad, 1994 Benchmark Survey, Final Results, table III-F 20; and USITC staff estimates.

Kingdom alone accounted for 29 percent of such sales. The regional distribution of energy service sales varied somewhat by industry. Sales of services through petroleum-related affiliates were relatively widely distributed geographically. Europe accounted for 31 percent of such sales, almost half of which occurred in the United Kingdom, while Latin America accounted for 21 percent, and a collection of other countries in Asia and the Middle East accounted for 26 percent. By contrast, U.S. sales of services through foreign affiliates in the utility industry were much more concentrated in Europe. In 1996, Europe accounted for 60 percent of service sales through utilities, with the United Kingdom alone accounting for 41 percent of sales. Australian affiliates also recorded significant utility-related sales, accounting for 16 percent of U.S. sales. The predominance of affiliate transactions generated in the United Kingdom and Australia was a direct result of privatization and deregulation programs undertaken by these countries, which facilitated foreign investment in the electric power sector during the mid-1990s. In particular, new acquisitions by U.S. firms in the United Kingdom and Australia together were responsible for 93 percent of the growth in sales of services by utilities during 1996.⁷

With respect to U.S. purchases of energy-related services through affiliates of foreign firms in 1996, companies headquartered in Canada accounted for 41 percent, while European firms are believed to have accounted for about 30 percent.⁸ Canadian firms were particularly prominent in the utilities sector, accounting for 65 percent of U.S. purchases of services from U.S.-based utility affiliates of foreign firms. European firms held a more significant position in the petroleum-related sector, where they accounted for 35 percent of U.S. purchases of petroleum-related services through affiliates in 1996, followed by 11 percent purchased through affiliates of Canadian firms.

Summary and Outlook

Available data on affiliate transactions indicate that sales of energy services through foreign affiliates of U.S. firms increased significantly in 1996, principally due to several major acquisitions by U.S. firms. Meanwhile, U.S. purchases of energy services through affiliates of foreign firms increased marginally more slowly than in previous years, reflecting stable market conditions and the absence of major acquisitions by foreign firms. Regionally, Europe accounted for most U.S. sales of energy-related services through foreign affiliates, while Canada accounted for most U.S. purchases.

With several strong, well established firms, U.S. providers of energy services are well positioned to compete internationally in both the petroleum and utility businesses. In the oil field services industry, consolidation has resulted in the formation of three powerful

⁷ Sales of services by utilities that are foreign affiliates of U.S. firms operating in the United Kingdom increased by \$3.2 billion in 1996, which accounted for 67 percent of the increase in worldwide service sales by foreign affiliates of U.S. firms in the utility sector. Similarly, sales of services by utilities that are foreign affiliates of U.S. firms operating in Australia increased by \$1.2 billion in 1996, which accounted for 26 percent of the increase in worldwide service sales by foreign affiliates of U.S. firms in the utility sector.

⁸ USITC staff estimates, based on USDOC, BEA, "Direct Investment Positions for 1997: Country and Industry Detail," *Survey of Current Business*, July 1998, p. 44.

U.S. companies with broad international activities: Baker Hughes, Halliburton, and Schlumberger.⁹ Major U.S. oil companies, such as Chevron and Exxon-Mobil, are similarly well established global players that provide various services related to petroleum and natural gas extraction and distribution. Enron, a large U.S. energy concern with expertise in the natural gas sector, is also expanding in the electric utility sector, joining a number of private electric power companies that are major global competitors, including AES, CMS, Edison Mission Energy, Entergy, PP&L, Southern Energy, Texas Utilities, and Utilicorp.

U.S. firms such as these are well endowed in financial, managerial, and technological resources. Threats and opportunities facing these firms are driven principally by economic and political forces that may alter the operating environment. In 1998, these forces appeared to be sending petroleum-related businesses into decline while fostering international growth in the electric power industry. During 1997-98, increases in oil supplies from non-OPEC countries, combined with diminished demand in Asian markets, reduced oil prices from a high of \$27 to \$13 per barrel.¹⁰ With oil prices low, demand for services related to new exploration or relatively expensive extraction techniques is likely to decline as well. Such a decline was manifested by reductions in capital spending of 10 to 15 percent by the major oil companies in 1998, and by the November 1998 announcement of layoffs at Texaco, which plans to reduce "upstream" employment by 12 percent.¹¹

In contrast, government policy changes are fostering growth in international electric power services. To meet rapidly rising demand for electric energy, governments in developing countries are turning toward foreign investors, seeking their participation in build-operate-transfer programs, selling state-owned enterprises, and offering concessions to manage distribution services.¹² Meanwhile, to drive down electricity costs and improve service quality, governments in developed countries are breaking up monopolies and introducing competition into the generation and distribution sectors.¹³ The net effect of these policy changes is a boom in opportunities for foreign direct investment in electricity services, which has been manifested by 107-percent average annual growth in the U.S. direct investment position in foreign utilities during 1994-96.¹⁴ In dollar terms, the United Kingdom and Australia have been the largest recipients of U.S. direct investment,

⁹ CNN News Network, "Halliburton, Dresser merge," Feb. 26, 1998, found at Internet address <http://cnnfn.com/>, retrieved Mar. 17, 1998; Baker Hughes Company Profile, found at Internet address <http://www.bakerhughes.com/>, retrieved Nov. 10, 1998; and Standard & Poor's, "Oil & Gas: Equipment & Services," *Industry Surveys*, Sept. 11, 1997, p. 7.

¹⁰ Bhushan Bahree, "Oil prices likely to stay low through next year," *Wall Street Journal*, Nov. 10, 1998, p. A2.

¹¹ Upstream activities include exploration, development, and production functions. Anne Marie Morrego, "Unocal, Mobil to cut capital spending, joining moves of other oil companies," *Wall Street Journal*, Nov. 12, 1998, p. A20; and Texaco, "Texaco announces worldwide upstream reorganization," press release of Nov. 12, 1998, found at Internet address <http://www.texaco.com/>, retrieved Nov. 18, 1998.

¹² Standard & Poor's, "Oil & Gas: Equipment & Services," *Industry Surveys*, Sept. 11, 1997, p. 8.

¹³ USITC, "Deregulation fosters globalization of the electric power industry," *Industry, Trade, and Technology Review*, USITC publication 3134, Sept. 1998, p. 43.

¹⁴ USDOC, BEA, *Survey of Current Business*, Sept. 1997, p. 147.

reflecting U.S. acquisitions of eight electric power distribution companies in the United Kingdom and five in Australia.¹⁵

The opposing trends of declining demand for petroleum-related services and increasing opportunities in the electric power industry suggest that future prospects for energy services trade are mixed. Growth in world oil demand is projected to slow through 1999, and prices currently are not expected to recover soon, which suggests that sales of related services will likely suffer.¹⁶ Meanwhile, U.S. electric power providers appear to be continuing with their international expansion programs, despite some retrenchments. Although PacifiCorp and Entergy are exiting from foreign projects, other firms such as Utilicorp, Texas Utilities, CMS, and Enron are increasing their international activities.¹⁷ Due to the Asian economic slowdown, near-term growth in demand for electric power will likely slow and government-sponsored development projects may be curtailed across Asia. Despite such adverse market conditions, U.S. firms may actually find more opportunities to establish foreign affiliates in Asia as the weakened financial condition of Asian governments may accelerate the ongoing shift to private funding of electric power sector development. In addition, Latin American countries such as Mexico and Brazil continue to seek foreign investment in the electric power industry, and the European Union's movement toward the creation of a Common Energy Market is creating new business opportunities for affiliates of U.S. energy firms.¹⁸ These factors suggest that, despite an ailing petroleum industry, sales of energy services through U.S. affiliates will likely continue to grow strongly as utilities pursue international expansion, although, it is unlikely that the very high rate of growth experienced during 1995-96 will be sustained.

U.S. purchases of energy services through affiliates of foreign firms are likely to encounter similar forces, characterized by slowing growth in purchases of services from petroleum-related affiliates and accelerating growth in purchases from utilities owned by foreign firms. The U.S. electric power industry is undergoing significant change as several states restructure their regulatory frameworks to permit competition. Such changes provide increased incentives and opportunities for new competitors, both foreign and domestic, to enter U.S. regional markets through mergers and acquisitions. For

¹⁵ Ibid., pp. 42-3.

¹⁶ U.S. Department of Energy, Energy Information Administration, "Asian economic downturn slows growth in oil prices through 2007," press release of Nov. 17, 1998; and Bhushan Bahree, "Oil prices likely to stay low through next year," *Wall Street Journal*, Nov. 10, 1998, p. A2.

¹⁷ Kathryn Kranhold, "PacifiCorp says it is quitting foreign projects," *Wall Street Journal*, Oct. 26, 1998, p. A4; Business Wire, "Utilicorp announces Power New Zealand transaction creating largest New Zealand electric lines company," Nov. 13, 1998, found at Internet address <http://www.energycentral.com/>, retrieved Nov. 17, 1998; Reuters, "Texas Utilities in final Australia CitiPower bids," Nov. 16, 1998, found at Internet address <http://www.energy-central.com>, retrieved Nov. 17, 1998; Reuters, "CMS says plans to invest \$800 million in Brazil," Nov. 13, 1998, found at Internet address <http://www.energycentral.com>, retrieved Nov. 17, 1998; and Reuters, "Enron Mexico aims for top energy spot," Sept. 25, 1998, retrieved through Pointcast Sept. 28, 1998.

¹⁸ Reuters, "Spain opens electricity market to REN, Electrabel," Nov. 12, 1998, found at Internet address <http://www.energycentral.com>, retrieved Nov. 17, 1998; and USITC, "Deregulation fosters globalization of the electric power industry," *Industry, Trade, and Technology Review*, p. 37.

example, in November 1998, New Jersey-based GPU announced the sale of 23 power generation plants to Sithe Energies, a U.S. affiliate of the French company, Vivendi, for \$1.7 billion. The transaction allows GPU to concentrate on electricity distribution, while enabling Sithe to become the largest independent power producer in the United States. A number of other foreign companies are reportedly considering similar acquisitions in the United States, including Scottish Power and PowerGen of the United Kingdom, Statoil of Norway, and Tractebel of Belgium.¹⁹ Should these acquisitions take place, U.S. purchases of energy services would likely increase significantly in the near future.

¹⁹ Statoil and Tractebel, a majority-owned affiliate of Suez Lyonnaise des Eaux of France, already own some electric power plants in the United States. Kathryn Kranhold, "Planned purchase of GPU power plants highlights push by foreigners into U.S.," *Wall Street Journal*, Nov. 10, 1998, p. A4, and Business Wire, "Sithe Energies wins bid for GPU generating assets," Nov. 9, 1998, found at Internet address <http://www.energycentral.com/>, retrieved Nov. 10, 1998.

CHAPTER 11

ENVIRONMENTAL SERVICES

Introduction

The environmental services sector¹ as defined by the Organization for Economic Cooperation and Development (OECD), broadly comprises those activities incidental to the cleanup, mitigation, prevention, study, and measurement of environmental damage affecting air, land, water, noise levels, and ecosystems.² However, because of the relatively recent emergence of the environmental services industry, there is no consensus regarding the precise scope of this sector.³ For the purposes of this report, environmental services⁴ specifically include solid and hazardous waste management, environmental consulting and engineering, remediation,⁵ environmental analysis, and water treatment. Engineers, consultants, architects, and other professional service providers typically supply these services. National governments, local governments, and firms bound by environmental guidelines are the principal consumers of environmental services,⁶ with public sector spending accounting for the greatest share of environmental services demand in all OECD countries, except the United States and the Netherlands.⁷ Environmental goods and services are often provided as part of a single package, in which services

¹ The Bureau of Economic Analysis (BEA) does not classify and report data that indicate cross-border trade in environmental services or transactions by majority-owned affiliates in the environmental services industry in its annual report in the *Survey of Current Business* entitled "U.S. International Sales and Purchases of Private Services." Consequently, this chapter includes data compiled and reported by industry sources, primarily Environmental Business International, Inc. (EBI) and *Engineering News-Record*, published by the McGraw-Hill Companies.

² Organization for Economic Cooperation and Development (OECD), report prepared in conjunction with OECD/Eurostat Informal Working Group on the Environment Industry, "Interim Definition and Classification of the Environment Industry" (Paris: OECD, 1996), p. 7.

³ United Nations Conference on Trade and Development (UNCTAD), "Strengthening Capacities in Developing Countries to Develop their Environmental Services Sector," May 12, 1998, p. 5.

⁴ The scope of the environmental services sector, as discussed herein, is that used by EBI in the compilation of trade and market data.

⁵ Remediation services comprise the cleanup of polluted land and water sites, as well as the emergency cleanup of accidents that damage the environment, such as oil spills. UNCTAD, "Strengthening Capacities in Developing Countries to Develop their Environmental Services Sector," p. 5.

⁶ UNCTAD, "Strengthening Capacities in Developing Countries to Develop Their Environmental Services Sector," p. 5.

⁷ World Trade Organization (WTO), Committee on Trade and Environment, contribution by the United States, "Liberalization of Trade in Environmental Services and the Environment" (WT/CTE/W/70), Nov. 21, 1997.

frequently play the more important role.⁸ Although the data used in this chapter do not distinguish between cross-border trade and affiliate transactions, it is likely that trade in environmental services is conducted primarily through overseas affiliates, as cross-border trade is often infeasible in this sector.

Recent Trends

U.S. exports of environmental services reached \$3.5 billion in 1997, a 4-percent increase from the previous year (figure 11-1). This increase was lower than the average annual increase of 22 percent observed during 1994-96.⁹ U.S. imports rose by 43 percent to \$2 billion in 1997. This increase was in sharp contrast to the average annual decrease of 3 percent during 1994-96. As a result, although the U.S. environmental services trade surplus increased at an average annual rate of 58 percent during 1994-96, the surplus decreased by 24 percent to \$1.5 billion in 1997. These trends are likely a result of the recent consolidation of the U.S. environmental industry, which is discussed in further detail in the following section. Solid waste management services and consulting and engineering services accounted for the greatest share of U.S. exports, as well as a majority of the U.S. surplus in environmental services trade during 1994-97.¹⁰ In 1997, solid waste management services and consulting and engineering services respectively accounted for exports of \$1.3 billion and \$1.7 billion, and trade surpluses of \$1.1 billion and \$1.4 billion. In that same year, U.S. hazardous waste management services and remediation and industrial services accounted for trade surpluses of \$0.1 billion and \$0.3 billion, respectively.¹¹ Waste water treatment is the only environmental service sector in which the United States registered a trade deficit, amounting to \$1.5 billion in 1997.¹²

Available trade data do not indicate which countries or regions account for the greatest share of U.S. environmental services imports and exports. However, data do reveal the relative importance of certain foreign markets for the U.S. environmental industry. Europe is reportedly the largest market for U.S. environmental goods and services, accounting for 44 percent of the overseas revenue earned by the leading 200 U.S.-based environmental firms (figure 11-2). Asia/Australia, Latin America, and Canada are also important markets for U.S. environmental goods and services, accounting for 19 percent, 16 percent, and 13 percent of overseas revenues in 1997, respectively. By contrast, the Middle East and Africa accounted for only 7 percent and 1 percent of such

⁸ UNCTAD, "Strengthening Capacities in Developing Countries to Develop their Environmental Services Sector," p. 11.

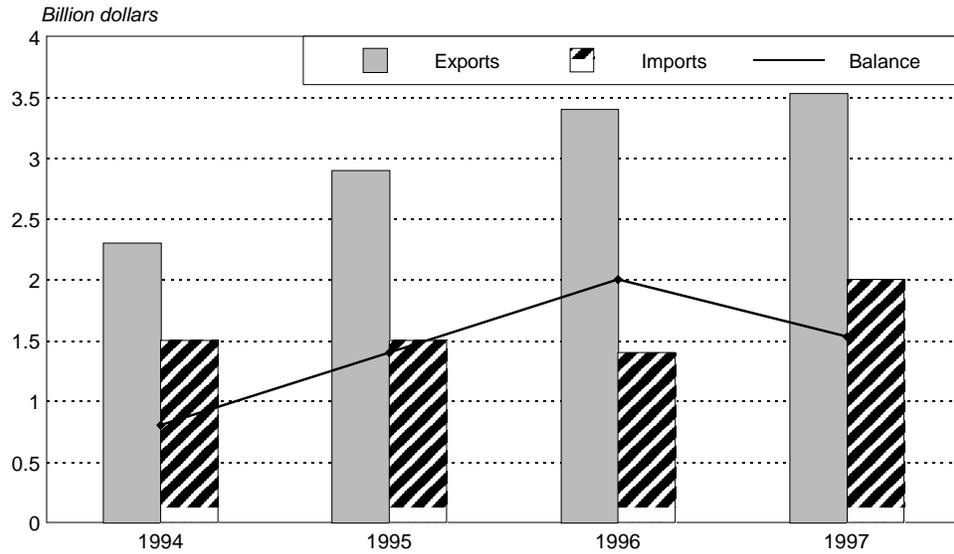
⁹ Environmental services trade data published by EBI are only available for the years 1994, 1995, 1996, and 1997.

¹⁰ The U.S. analytical services sector registered a small surplus of \$0.03 billion in 1997. During 1994-96, no imports or exports were registered in this sector.

¹¹ In 1997, no U.S. imports were registered in the hazardous waste management and remediation and industrial services sectors.

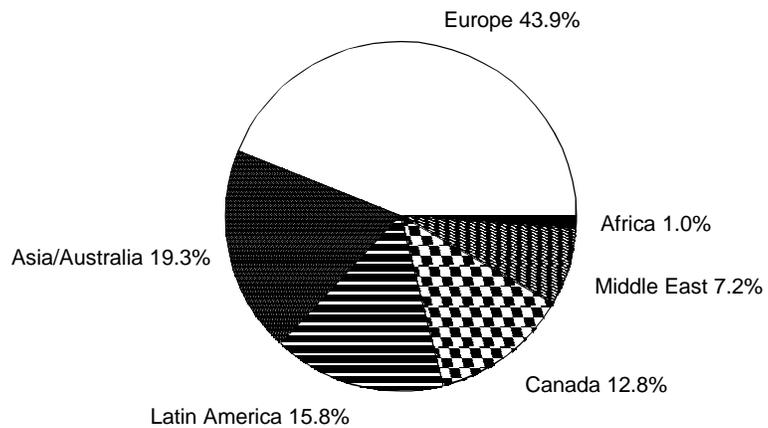
¹² EBI, *Environmental Business Journal*, Overview 1998, vol. 11, No. 7, p. 7; Annual Industry Overview, Aug. 1995, vol. 8, No. 8, p. 2; Apr. 1996, vol. 9, No. 4, p. 7; and Apr. 1997, vol. 10, No. 4, p. 11.

Figure 11-1
Environmental services: U.S. exports, imports, and balance, 1994-97



Source: EBI, *Environmental Business Journal*, Overview 1998, vol. 11, No. 7, p. 7; Annual Industry Overview, Aug. 1995, vol. 8, No. 8, p. 2; Apr. 1996, vol. 9, No. 4, p. 7; and Apr. 1997, vol. 10, No. 4, p. 11.

Figure 11-2
Environmental industry:¹ Foreign revenue of U.S.-based environmental goods/services firms, by region, 1997



¹ Data relating to the environmental industry, as presented in the *Engineering News-Record*, comprise both goods and services revenues earned by the leading 200 U.S.-based environmental firms in the following environmental sectors: hazardous waste management, nuclear waste management, water quality, wastewater treatment, environmental compliance, and other environmental markets.

Source: Compiled by USITC staff using data reported by Wright and Rubin, "Despite Some Rough Spots in Asia, International Markets Forge On," *Engineering News-Record*, July 6, 1998, p. 49.

revenues, respectively.¹³ Because environmental goods and services are often provided simultaneously, it is likely that these figures closely reflect the proportion of international revenues earned by the U.S. environmental service providers in each of these markets.

Summary and Outlook

Environmental firms in the United States have traditionally focused on meeting domestic demand, which is substantial. In 1997, less than 10 percent of U.S. environmental industry revenues were generated abroad.¹⁴ The domestic market has been particularly important to the small- and mid-size firms that generate more than half of U.S. environmental industry revenues, as such firms are frequently unable to market their goods and services abroad due to insufficient resources.¹⁵ In recent years, however, the U.S. environmental sector has experienced slower growth in domestic demand, because many firms have come into compliance with present environmental law, and little new legislation has been introduced. This slowdown in the U.S. market has led to greater competition and declining industry profits.¹⁶ Consequently, U.S. firms are pursuing mergers and acquisitions more aggressively, in an effort to broaden their companies' expertise and increase growth potential.¹⁷ Slowing growth in demand for environmental services also has precipitated market exit by many small environmental services firms.¹⁸

As a result of domestic trends, U.S. firms have shown increasing interest in the overseas environmental market, which is growing more rapidly than the domestic market for environmental services.¹⁹ Increasing international orientation is well illustrated by the fact that U.S. exports of environmental services grew at an average annual rate of 15

¹³ USITC staff estimates, based on data reported by Andrew G. Wright and Debra K. Rubin, et. al., "Despite Some Rough Spots in Asia, International Markets Forge On," *Engineering News-Record*, July 6, 1998, p. 49.

¹⁴ David R. Berg and Grant Ferrier, "The U.S. Environmental Industry Meeting the Challenge: U.S. Industry Faces the 21st Century," Sept. 1997, found at Internet address <http://www.gnet.org/>, retrieved July 8, 1998; and EBI, *Environmental Business Journal*, Overview 1998, vol. 11, No. 7, p. 15.

¹⁵ UNCTAD, "Strengthening Capacities in Developing Countries to Develop their Environmental Services Sector," May 12, 1998, p. 6; and Berg and Ferrier, "The U.S. Environmental Industry Meeting the Challenge: U.S. Industry Faces the 21st Century," Sept. 1997.

¹⁶ Berg and Ferrier, "The U.S. Environmental Industry Meeting the Challenge: U.S. Industry Faces the 21st Century," Sept. 1997.

¹⁷ Wright and Rubin, "Booming Economy Keeps Green Markets Afloat," p. 38.

¹⁸ Cary Perket, "Environmental Service Demands Shrink, Close Smaller Shops," *World Wastes*, May 1998, found at Internet address <http://www.umi.com/proquest/>, retrieved June 30, 1998.

¹⁹ Berg and Ferrier, "The U.S. Environmental Industry Meeting the Challenge: U.S. Industry Faces the 21st Century," Sept. 1997.

percent during 1994-97, while the domestic U.S. environmental services market registered average annual growth of 1 percent during that same period.²⁰

The relatively large number of small- and mid-size companies in the U.S. environmental sector, together with the traditional industry focus on domestic compliance, have had a negative effect on the overall competitiveness of the U.S. environmental industry.²¹ The U.S. environmental goods industry lags behind competitors from countries such as Germany and Japan in certain equipment sectors.²² However, with the exception of services incidental to water treatment works--in which France and the United Kingdom reportedly have a competitive advantage--U.S. firms are competitive in all areas of the environmental services industry.²³

The growing need for environmental goods and services in developing countries--caused by increasing population, urbanization, and industrialization--could precipitate the rapid growth of their environmental markets. However, potential market growth in the developing world is hampered by limited resources and a lack of environmental regulation, enforcement mechanisms, and knowledge.²⁴ Currently, industrialized countries reportedly remain the most important overseas markets for U.S. environmental goods and services firms. Europe had the fastest growing market for environmental services in 1997 (figure 11-3). Between 1996 and 1997, European revenues for the leading 200 U.S.-based environmental goods and services firms increased by 80 percent, from \$1.2 billion in 1996 to \$2.2 billion in 1997. This growth has been attributed to the low risk and relatively solid economic climate that have encouraged investment in the European market. The Latin American and Canadian revenues of leading U.S. environmental firms also grew significantly in 1997, registering increases of 66 percent and 53 percent, respectively. Though environmental business in Asia has slowed due to the recent currency crisis,²⁵ the Asia-Pacific revenues of leading U.S. environmental firms also rose by 18 percent in 1997.²⁶ By contrast, revenues generated by U.S. firms in Africa and the Middle East that year decreased by 34 percent and 12 percent, respectively.²⁷

²⁰ EBI, *Environmental Business Journal*, Apr. 1997, vol. 10, No. 4, p. 11; Apr. 1996, vol. 9, No. 4, p. 7; and Aug. 1995, vol. 8, No. 8, p. 2.

²¹ Berg and Ferrier, "The U.S. Environmental Industry Meeting the Challenge: U.S. Industry Faces the 21st Century," Sept. 1997.

²² Ibid.

²³ Ibid.

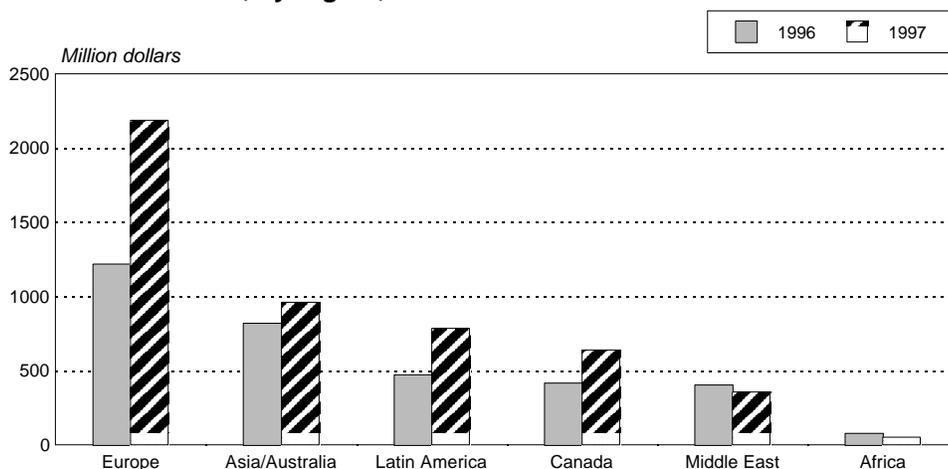
²⁴ UNCTAD, "Strengthening Capacities in Developing Countries to Develop their Environmental Services Sector," p. 7.

²⁵ Industry representatives indicate that business has decreased substantially in both Asia and Latin America as a result of the crisis, while another has suggested the possibility that the Asian crisis could have a delayed impact on the environmental industry. Moreover, the Asian crisis has reportedly resulted in an unwillingness to borrow funds for environmental projects from multilateral development banks, such as the Inter-American Development Bank. Wright and Rubin, "Despite Some Rough Spots in Asia, International Markets Forge On," *Engineering News-Record*, July 6, 1998, p.49; and industry representatives, facsimile responses to questions posed by USITC staff, received Oct. 15, 1998, Nov. 16, 1998, and Dec. 18, 1998.

²⁶ Wright and Rubin, "Despite Some Rough Spots in Asia, International Markets Forge On," *Engineering News-Record*, July 6, 1998, p. 49.

²⁷ Ibid.

Figure 11-3
Environmental industry:¹ Foreign revenue of U.S.-based environmental goods/services firms, by region, 1996 and 1997



¹ Data relating to the environmental industry, as presented in the *Engineering News-Record*, comprise both goods and services revenues earned by the leading 200 U.S.-based environmental firms in the following environmental sectors: hazardous waste management, nuclear waste management, water quality, wastewater treatment, environmental compliance, and other environmental markets.

Source: Wright and Rubin, "Despite Some Rough Spots in Asia, International Markets Forge On," *Engineering News-Record*, July 6, 1998, p. 49.

The ability of U.S. environmental firms to provide services abroad is dependent on various factors. For example, government procurement regulations, as well as the transparency of these rules, can have a considerable effect on environmental services providers, as federal and local governments are frequently the purchasers of environmental services. In some countries, government procurement restrictions place foreign firms at a competitive disadvantage, or prohibit their participation in the procurement process.²⁸ Because engineers, architects, consultants, and other professionals provide many environmental services, restrictions on the presence of foreign professionals, the failure to recognize professional degrees, and other barriers to professional services provision also have a chilling effect on the foreign provision of environmental services.²⁹ Barriers to commercial presence, a principal mode of environmental services supply, can also impede foreign provision of such services.³⁰ Moreover, access to financing is crucial. For example, firms that can secure project financing reportedly are more likely to win business in the water and wastewater treatment sector.³¹ Countries such as Canada, France, Germany, Japan, Korea, the Netherlands, and the United Kingdom reinforce the international competitiveness of

²⁸ UNCTAD, "Strengthening Capacities in Developing Countries to Develop their Environmental Services Sector," May 12, 1998, p. 21.

²⁹ *Ibid.*, p. 2. Additional information on recent trends in professional services provision can be found in chapters 5 and 21 of this report.

³⁰ *Ibid.*, p. 17.

³¹ "Frost & Sullivan—Regulations and Infrastructure Developments Drive Mexican Water and Wastewater Treatment Market," Frost & Sullivan, received by NewsEDGE/Lan, Oct. 19, 1998; and industry representative, facsimile response to questions posed by USITC staff, received Nov. 16, 1998.

their environmental industries by offering incentives such as “tied aid”³² and generous financing packages to potential customers.³³ In addition, European environmental firms occasionally provide analysis or management services inexpensively or at no charge in an effort to attract business.³⁴ U.S. services providers, on the other hand, can obtain financing from U.S. agencies such as the Export-Import Bank of the United States (Eximbank) and the Small Business Administration (SBA).³⁵ Creative financing techniques, such as build-operate-transfer (BOT),³⁶ have also been utilized in the environmental services sector.³⁷ However, because BOT projects are perceived as being risky, few U.S. environmental firms pursue such projects.³⁸ Client countries can also obtain project financing from various international agencies.

If current trends persist, growth will likely continue in the world environmental services market in spite of the recent economic downturn caused by the Asian currency crisis. Increasing environmental awareness, the return of economic growth, and new environmental legislation may cause demand for environmental services to rise in the developing world. For instance, China has recently demonstrated heightened environmental awareness and a greater willingness to enforce environmental regulations in response to poor environmental conditions caused by years of rapid industrialization. Government officials have adopted new laws and fines, closed a large number of small factories, and advocated media exposure of polluters.³⁹ Reportedly, business opportunities for U.S. environmental services firms in Eastern Europe are relatively abundant as a result of increasingly strict environmental regulations and a high regard for U.S. technologies in that region.⁴⁰ In Mexico, decreasing supplies of potable water, together with a growing population and expanding industrial sector, likely will lead to increased demand for water and wastewater treatment goods and services in the near future.⁴¹ The Kyoto Protocol and efforts to comply with ISO 14000 standards also could increase business opportunities for U.S. environmental services providers. Under the Kyoto Protocol, industrialized countries would be required to reduce greenhouse gas

³² Tied aid is project financing to which certain conditions are attached. Recipients of tied aid are often required to procure goods and services from firms based in the country that provides the aid.

³³ Berg and Ferrier, “The U.S. Environmental Industry Meeting the Challenge: U.S. Industry Faces the 21st Century,” Sept. 1997.

³⁴ Industry representative, facsimile response to questions posed by USITC staff, received Nov. 16, 1998.

³⁵ “Export Financing for Service Industries,” *Business America*, Apr. 1998.

³⁶ When operating under a BOT contract, a firm builds and operates a facility for a certain period of time, gradually transferring ownership to a public authority. UNCTAD, “Strengthening Capacities in Developing Countries to Develop their Environmental Services Sector,” p. 22.

³⁷ *Ibid.*, p. 22.

³⁸ Industry representative, facsimile response to questions posed by USITC staff, received Dec. 18, 1998.

³⁹ Jennifer Lin, “China awakes to the fact that its growth has created an environmental disaster,” Knight Ridder/Tribune Information Services, received by NewsEDGE/Lan, Nov. 7, 1998.

⁴⁰ Industry representative, facsimile response to questions posed by USITC staff, received Dec. 18, 1998.

⁴¹ “Frost & Sullivan—Regulations and Infrastructure Developments Drive Mexican Water and Wastewater Treatment Market,” Frost & Sullivan, received by NewsEDGE/Lan, Oct. 19, 1998.

emissions significantly.⁴² ISO 14000 is a set of standards according to which providers of environmental auditing services can certify the environmental management systems (EMS) of firms in various goods and services industries. Firms that obtain ISO 14000 certification may gain a competitive advantage among potential customers who prefer to do business with environmentally responsible companies. Though these standards are voluntary, approximately 1,500 firms around the world already have become ISO 14000 certified.⁴³

⁴² Obligations could also be satisfied through various other means, including emissions reducing projects in developing countries and the purchase of pollution permits. Though not in effect, this protocol has been agreed to by 160 countries. "Administration pushes Kyoto Protocol despite strong industry opposition," *Chemical Marketing Reporter*, Aug. 31, 1998, found at Internet address <http://www.umi.com/proquest/>, retrieved Nov. 5, 1998.

⁴³ Glenn Hasek, "ISO's green standards take root," *Industry Week*, Feb. 16, 1998, found at Internet address <http://www.umi.com/proquest/>, retrieved Mar. 10, 1998; and Charles W. Thurston, "Latin America finds profit in ISO 14000," *Chemical Marketing Reporter*, Feb. 16, 1998, found at Internet address <http://www.umi.com/proquest/>, retrieved Nov. 5, 1998.

CHAPTER 12

HEALTH CARE SERVICES

Introduction

Health care services encompass a broad range of services provided by medical professionals and health care institutions. For the purpose of this report, health care services include services provided to patients by hospitals and hospital chains; offices and clinics of medical doctors and other health care professionals; nursing homes and other long-term care providers; rehabilitation facilities; home health care providers; certain health maintenance organizations (HMOs);¹ medical and dental laboratories; kidney dialysis centers; and specialty outpatient facilities.

U.S. health professionals provide services to foreign patients and health care facilities both through cross-border transactions and through affiliates established in foreign markets. Cross-border trade consists of the treatment of citizens of one country by health care providers in another country.² Affiliate transactions reflect health care services provided to persons or facilities in their home countries by affiliates also based there, but whose parent firm is based in another country. Cross-border transactions account for the greatest proportion of U.S. receipts for providing health care services, while affiliate transactions account for most U.S. purchases. This indicates that most U.S. transactions in health care services involve the provision of treatment within the territory of the United States, as cross-border receipts are driven by patients traveling to the United States for treatment; and purchases through affiliates are driven by foreign firms acquiring or establishing health care facilities in the United States, which subsequently provide treatment to U.S. citizens.

Recent Trends

Cross-Border Trade, 1992-97

In 1997, U.S. cross-border exports of health care services amounted to \$888 million. Corresponding imports of health care services are not available because data on medical

¹ This discussion encompasses HMOs or similar organizations that provide medical or other health care services to members, but does not include organizations that provide only insurance for hospitalization or medical costs, as these services are captured under insurance services.

² Cross-border exports largely consist of the treatment of foreign persons in the United States by hospitals, clinics, medical doctors, and other health care service professionals. Cross-border imports comprise the treatment of U.S. citizens overseas by foreign health care service providers.

services are not reported by official data collection agencies.³ U.S. cross-border exports of health care services increased by 2 percent in 1997, slower than the 5-percent average annual rate of growth recorded during 1992-96. Slowing growth of health care services exports is likely a result of currency devaluations in Asia, Latin America, and Canada, which made traveling to the United States for elective procedures considerably more expensive in 1997. Although official data do not identify exports of health care services by country, Canada is believed to be the dominant export market for U.S. health care services.⁴ Other sizable markets for U.S. cross-border exports of health care services include the United Kingdom, Germany, Mexico, Australia, and Japan.

Affiliate Transactions, 1992-96

Sales of services by foreign-based affiliates of U.S. health care companies fell to \$360 million in 1996, while purchases of services through U.S.-based affiliates of foreign health care companies increased to \$3.5 billion (figure 12-1). The \$3.1-billion difference between U.S. sales and purchases of services through affiliates reflects the fact that the United States offers considerably greater opportunities for private-sector participation in the health care sector than most other countries. As a result, foreign firms have acquired or established health care facilities in the United States to a much larger extent than U.S. firms have abroad.

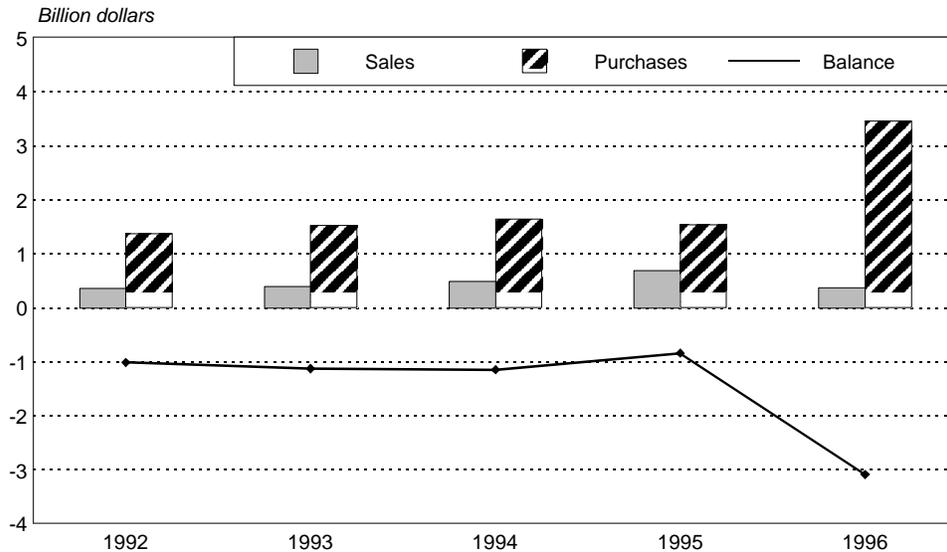
Sales of services by foreign affiliates of U.S. health care companies declined by 47 percent in 1996, which represents a significant reversal from the trend of 25-percent average annual growth recorded during 1992-95. This dramatic reduction in sales reflects a retrenchment by U.S. health care service providers, particularly Tenet Healthcare, Columbia/HCA, and Transitional Hospitals Corporation (formerly Community Psychiatric Centers).⁵ Each of these companies has undertaken substantial restructuring programs to better focus resources on core business activities in the

³ Reportedly, such data are very difficult to capture and presumed to be quite small. Bureau of Economic Analysis (BEA) representative, telephone interview by USITC staff, Nov. 24, 1998.

⁴ U.S. industry representatives, telephone interviews by USITC staff, Oct. 27-29, 1997.

⁵ In 1996, Tenet Healthcare sold two hospitals in Singapore, a 30-percent interest in a Malaysia hospital, a 52-percent interest in Australian Medical Enterprises, a 40-percent interest in a hospital in Thailand, and a 42-percent interest in Westminster Health Care Holdings of the United Kingdom. These sales represented a divestiture of \$464 million in assets. Columbia/HCA sold 50 percent of four hospitals it owned in the United Kingdom to PPP Healthcare Group (now a unit of Guardian Royal Exchange Group). Community Psychiatric Centers sold Priory Hospitals, an acute psychiatric company in the United Kingdom, to Foray 911 Ltd., for \$135 million. Foray 911 is a new British company formed by Mercury Development Capital, a division of Mercury Asset Management, Plc. Corporate annual report filings with the U.S. Securities and Exchange Commission, retrieved from <http://www.sec.gov>, Dec. 2-4, 1998.

Figure 12-1
Health care service transactions by majority-owned affiliates: U.S. sales, purchases, and balance, 1992-96



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Sept. 1995, pp. 104-105; Nov. 1996, pp. 111-112; Oct. 1997, pp. 137-136; and Oct. 1998, pp. 115-116.

home market.⁶ By contrast, foreign firms increased their level of participation in the U.S. market substantially in 1996. As a result, purchases of health care services through U.S.-based affiliates of foreign firms increased by 126 percent in 1996, reflecting a major jump from the 4-percent average annual rate of growth recorded during 1992-95.⁷ Much of this increase may be explained by two major acquisitions by the German firms Paracelsus Healthcare and Fresenius AG. In August 1996, Paracelsus Healthcare merged with Champion Healthcare, a U.S. firm, to form a for-profit hospital management company

⁶ In the case of Tenet, the restructuring was driven in part by major lawsuits brought by the U.S. Department of Justice concerning inappropriate business practices. In June 1994, Tenet, which at the time was named National Medical Enterprises, listed more than 50 percent of its hospitals in a guilty plea to criminal conduct (fraud). Under the settlement terms, Tenet was fined \$379 million and required to sell 75 percent of its U.S. hospitals. With respect to Community Psychiatric Centers, changes in the structure of the psychiatric care industry resulted in reduced profitability, prompting the company to exit the business and focus instead on the provision of long term acute care services under the new corporate identity of Transitional Hospitals Corp. In 1996, Columbia/HCA was focusing its resources on continuing its aggressive, acquisition-driven expansion in the United States. By 1997, however, Columbia/HCA had become the target of a U.S. Department of Justice investigation that prompted major management changes and the sale of several institutions. J.M. Wynne, "The Corporate Scene in Health," found at Internet address <http://www.uow.edu.au>, retrieved Dec. 4, 1998; corporate annual report filings with the U.S. Securities and Exchange Commission, retrieved from <http://www.sec.gov>, Dec. 2-4, 1998; and Columbia/HCA press releases, found at Internet address <http://www.columbia-hca.com/>, retrieved Dec. 4, 1998.

⁷ The slower growth trend reflects a decline of 6 percent recorded in 1995, which partially offset the modest growth recorded during 1992-94.

that owns and operates 31 acute care and psychiatric hospitals in eight states.⁸ Meanwhile, Fresenius became the world's largest fully integrated renal health care company in September 1996 when Fresenius AG acquired National Medical Care, Inc., formerly a subsidiary of W.R. Grace.⁹

As the foregoing discussion suggests, Germany appears to account for the majority of U.S. purchases of health care services through affiliates, followed by Canada.¹⁰ Australia and Japan are the only other countries from which purchases through U.S.-based affiliates were reported in 1996, but such purchases amounted to only \$14 million and \$5 million, respectively. U.S. sales of services through foreign-based health care affiliates were concentrated in the United Kingdom, which accounted for 51 percent of total sales through foreign affiliates in 1996. Switzerland also appears to account for significant U.S. sales of health care services through affiliates, although the actual value is not officially reported in order to avoid disclosing financial data concerning individual firms.

Summary and Outlook

U.S. international trade in health care services reflects the widely recognized capabilities of U.S. medical institutions. Significant numbers of foreign individuals travel to the United States each year to receive medical treatment at U.S. facilities. As a result, the United States is believed to consistently record a substantial surplus in cross-border trade of health care services. With respect to affiliate transactions, the strength and diversity of the U.S. health care industry has prompted foreign firms to enter the U.S. market by acquiring or establishing health care facilities. By contrast, U.S. firms typically have had relatively few investment opportunities abroad, where government agencies often control the entire health care system or where financing is unavailable for the provision of services by private institutions. The disparity between investment opportunities in the United States and abroad is manifested by the substantially greater volume of U.S. health care purchases through affiliates of foreign firms relative to U.S. sales by foreign affiliates.

Since cross-border trade in health care services is largely dependent upon the ability of foreign individuals to travel to the United States and typically to finance their treatment through personal resources, this trade is heavily influenced by changes in currency values. Consequently, the Asian financial crisis, which resulted in currency devaluations in Asia and Latin America, had a dampening effect on U.S. exports of health care services in 1997. Transactions through affiliates respond to different forces, as these are driven by new international investments and the microeconomic conditions of countries in which affiliates are located. In 1996, affiliate transactions reflected retrenchment by U.S. health care firms and further expansion by foreign firms into the

⁸ Weiss, Peck, & Greer Private Equity, "Paracelsus Healthcare Corporation," found at Internet address <http://www.wpgequity.com>, retrieved Dec. 1, 1998.

⁹ Fresenius Medical Care, *Annual Report 1996*, found at Internet address <http://www.fmc-ag.com>, retrieved Dec. 2, 1998.

¹⁰ USITC staff estimates.

U.S. market. In both cases, these actions appear to have been driven by individual corporate objectives rather than broader economic factors.

Strategically, the U.S. health care industry is well positioned with respect to international competitors. The industry enjoys the strengths of a large, wealthy domestic market with advanced capabilities in technology and expertise, while suffering from few, if any, functional weaknesses. The large volume of individuals who travel to the United States for medical treatment and the substantial level of foreign direct investment testify to the vitality of U.S. health care sectors. The principal challenges to the industry are financial and philosophical. Rising health care costs have become increasingly difficult to sustain in the United States and abroad, forcing governments, insurance companies, and health care institutions to adopt policies such as managed care programs.¹¹ Such policy shifts apply financial pressure to various segments of the market and force adaptation, as demonstrated by the rise of health maintenance organizations and the consolidation of hospitals into health care systems in the United States. The philosophical challenge confronting the industry lies in the common belief that health care is a fundamental right to which all members of society are entitled. In many countries, this provides the rationale for the government to serve as the principal provider of health care services. As a result, private health care companies are excluded from many of the world's markets, which limits international growth opportunities for U.S. firms.

Despite these challenges, international prospects for the U.S. health care industry are promising. The flow of patients into the United States for treatment is likely to continue growing, as medical centers are expanding their international marketing efforts. For example, a number of hospitals in the Boston area have begun working cooperatively to attract patients from around the world to their facilities.¹² The development of new health insurance products may further foster cross-border exports of health care services. In December 1998, International Health Alliance introduced a global medical plan that allows policy holders to travel anywhere in the world for treatment.¹³ This program is specifically marketed to non-U.S. citizens as well as to those who travel frequently for extended periods. A third factor that may influence cross-border trade in health care services is the increasing utilization of telemedicine, which involves providing health care services via telecommunication technology. For example, diagnostic images such as x-rays or magnetic resonance images may be transmitted via the Internet for examination by specialists in another country.¹⁴ As a leading provider of both health care technology and medical expertise, the United States could benefit significantly by the development of telemedicine applications. U.S. organizations such as Telequest, the

¹¹ "Health Care in America: Medicine for Export," *The Economist*, Mar. 7, 1998, and Standard & Poor's, *Industry Surveys, Healthcare: Facilities*, Nov. 19, 1998, p. 2.

¹² "Boston area hospitals seek global market," *Marketing News*, Mar. 3, 1997.

¹³ "International Health Alliance offers first online global plans," *PR Newswire*, Dec. 15, 1998.

¹⁴ Ernest D. Plock, "Telemedicine is emerging as a cost-effective health care alternative," *Business America*, Jan. 1998.

University of California San Francisco, and Telemedicine Applications Company, have already engaged in telemedicine ventures in India.¹⁵

International trade of health care services through foreign affiliates is likely to undergo continued growth as well. The United States remains an attractive market for foreign investors, particularly in discrete market segments such as dialysis treatment, while financing constraints are likely to create opportunities for additional merger and acquisition activity.¹⁶ Abroad, the investment climate seems to be showing signs of promise. Many countries are beginning to embrace participation by private institutions in at least some segments of their market. At the same time, some of the larger U.S. health care companies appear to have strengthened their domestic position to the extent that they are now exploring international opportunities more earnestly. As a result of these factors, U.S. firms appear to be gradually increasing their international activities. For example, in October 1997, HealthSouth acquired the Cedar Court Physical Rehabilitation Hospital in Melbourne, Australia; and in April 1998, Columbia/HCA acquired 54 percent of the Instituto Dexeus, a private, 110-bed tertiary-care hospital located in Barcelona, Spain.¹⁷

While there are some inherent impediments to trading health care services, and current global economic conditions appear to be having a deleterious effect, the overall outlook for health care trade is promising. The United States continues to hold a leadership role in technology and quality of care, which should translate into additional international opportunities. Financial limitations pose the principal constraint on the health care field, as even wealthy countries are increasingly having difficulty paying for high-quality treatment for all of their citizens. However, such financial constraints may also present opportunities for private firms that can develop management techniques or serve a market niche so as to offer cost savings without compromising the quality of care.

¹⁵ "BeeZee Launches Telemedicine Centre in Mumbai," *Economic Times*, Jan. 2, 1998; and K.S. Nayar, "U.S. Firm Offering Care via Telemedicine," *India Abroad*, Apr. 4, 1997.

¹⁶ Standard & Poor's, *Industry Surveys, Healthcare: Facilities*, Nov. 19, 1998, p. 2 and p. 6.

¹⁷ HealthSouth Corporation, "HealthSouth acquires Australian Rehabilitation Hospital," press release of Dec. 5, 1997, found at Internet address <http://www.healthsouth.com>, retrieved Dec. 1, 1998; and "Columbia completes acquisition of majority interest in Instituto Dexeus in Barcelona, Spain," *PR Newswire*, Apr. 25, 1998.

CHAPTER 13

INSURANCE SERVICES

Introduction

Insurance deals with the transfer of risk. The insurance business includes the underwriting of financial risk for life and non-life (property/casualty) products, as well as many specialty items. The latter include reinsurance (further transferring of risk between insurance companies), marine and transportation risks (hulls, cargoes, off-shore oil rigs), brokerage (specialists who package policies from several insurance underwriters to cover a given risk), and captive companies (a pool of insurance consumers with similar risks, such as airline companies, who self-insure part or all of their risks). In addition to risk transfer, insurance is also an important individual savings device in most countries.¹

Insurance companies are important to the functioning of national economies for two principal reasons. First, the transfer of risk encourages a significantly higher level of economic investment than would otherwise occur. Second, insurance companies provide a ready supply of long-term investment capital. A well functioning insurance industry is thus an essential tool for both developing and industrial countries. The business of insurance is increasingly being combined with other financial services such as banking, securities, mutual funds, and annuities, especially in the distribution of its products, but also as an integrated method of managing savings, investment, and risk.

International trade in insurance takes place on both a cross-border and an affiliate basis. Because insurance sales often demand knowledge of, and proximity to, consumers of insurance, international affiliate transactions are considerably more significant than cross-border trade.

¹ This is often due to favorable tax treatment. Japan is the largest insurance market in the world, largely because insurance companies are one of the few financial savings mechanisms widely understood and available in that country. See *Sigma*, Swiss Reinsurance Company, No. 4, 1997, table I, p. 19.

Recent Trends

Cross-Border Trade, 1992-97

In 1997, U.S. cross-border exports of insurance services² totaled \$2.4 billion and imports amounted to \$5.2 billion, resulting in a deficit of \$2.8 billion (figure 13-1). U.S. exports increased by 21 percent in 1997, slower than the average annual rate of 30 percent during 1992-96. Imports grew 38 percent in 1997, significantly faster than the 1992-96 average annual growth rate of 30 percent, although this average obscures a 30-percent drop in imports in 1996. Total imports for 1997 were slightly lower than the \$5.3 billion in imports in 1995. The trend for the cross-border trade deficit mirrors the trend in imports. The fluctuation in imports has led to a similar fluctuation in the trade deficit, which grew by an annual average of 29 percent during 1992-96, but declined by 56 percent in 1996 before increasing by 56 percent in 1997.

Measured in terms of net receipts (figure 13-2), in 1997 the largest export markets for U.S. insurance firms were the United Kingdom (18 percent), Canada (15 percent), Japan (13 percent), Bermuda (7 percent), and France (5 percent). Market shares shift somewhat when viewed solely in terms of premiums paid.³ The British share rises to 22 percent of U.S. exports, while Japan's share drops to 8 percent. Viewed by either the net or the premium figure, U.S. export market share among the major U.S. trading partners has remained stable over the period discussed here.

With respect to imports, in net terms the largest U.S. trading partners by far are Bermuda (45 percent) and the United Kingdom (27 percent). Other significant trading partners were Canada (10 percent) and France (4 percent). Japan and Germany each accounted for less than 2 percent of U.S. imports. Imports from Switzerland were actually negative on a net basis⁴ for every year from 1993 through 1997, with a positive net figure of only \$21 million in 1992.

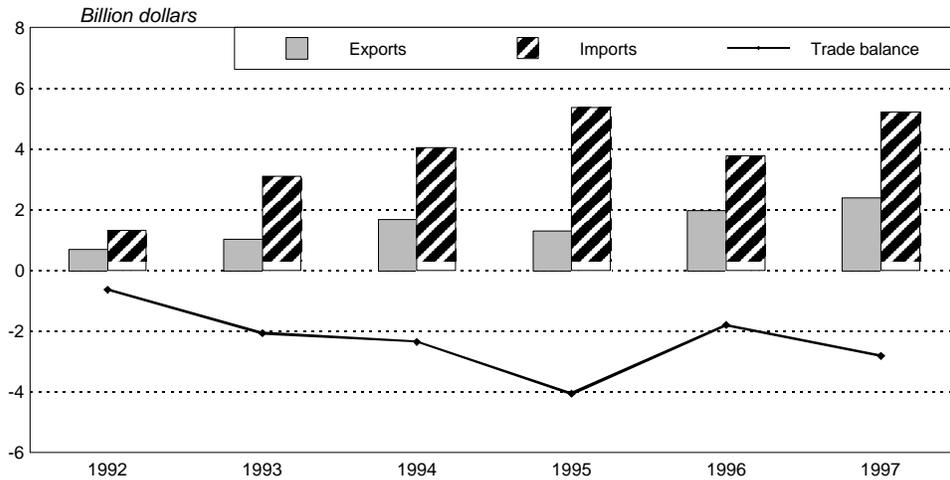
Again, the picture shifts when viewed in terms of premiums alone. Bermuda and the United Kingdom remained the dominant insurance suppliers in the U.S. market, but with greatly reduced shares (29 and 22 percent of imports, respectively). Canada and Germany (both 8 percent), and Switzerland (4 percent) were other prominent suppliers of insurance to the United States.

² Except where noted, all cross-border trade figures for insurance services are presented on a net basis, i.e., imports comprise premiums paid for insurance coverage from foreign providers, minus claims received from foreign insurers. Exports comprise premiums received from foreign policyholders, minus payments for claims.

³ The standard method of reporting only net insurance revenue obscures an understanding of which countries represent the largest, most active markets in insurance trade. The country comparisons are therefore reported in two ways.

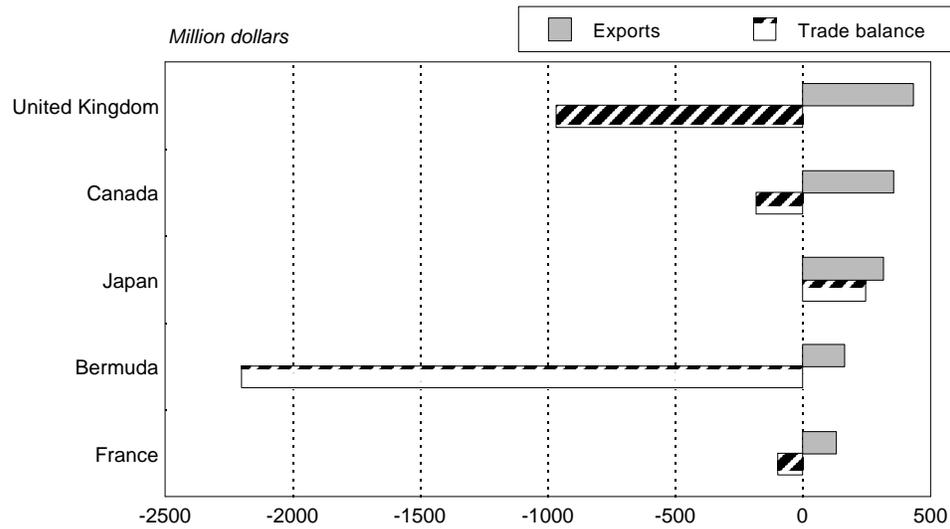
⁴ Negative net imports occur when claims paid to U.S. policyholders exceed premiums collected from these persons for a given year.

Figure 13-1
Insurance services: U.S. cross-border exports, imports, and trade balance, 1992-97



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1998, pp. 86-87.

Figure 13-2
Insurance services: U.S. cross-border exports and trade balance, by major trading partners, 1997



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1998, p. 109.

Affiliate Transactions,⁵ 1992-96

As noted previously, the vast majority of insurance trade, both within the United States and abroad, takes place through affiliates operating in foreign markets. In 1996, U.S.-owned foreign affiliates' sales reached \$41 billion, up 7 percent from 1995 (figure 13-3). The growth in such sales was significantly slower than the average annual growth rate of 15 percent during 1992-95, but continued an upward trend for the period. Meanwhile, foreign insurers in the United States generated \$56 billion through affiliates in the United States in 1996, up almost 9 percent from 1995, a considerably faster rise in U.S. imports than the 3-percent average annual growth rate during 1992-96. The resulting trade deficit totaled \$15 billion in 1996, a figure close to the average for the 1992-96 period.

Four countries accounted for over half of sales through foreign affiliates of U.S. insurance companies (figure 13-4). Japan and the United Kingdom accounted for the largest U.S. sales, with 22 and 21 percent of the market, respectively, followed by Germany (13 percent) and Canada (12 percent).⁶ Affiliates' sales in Germany were up over 40 percent in 1996, while sales in Japan dropped by 8 percent.⁷ Meanwhile, purchases of insurance in the United States from U.S. affiliates of foreign companies were very highly concentrated, with affiliates from only 6 countries accounting for 95 percent of such transactions. The countries were the United Kingdom and Canada, with 25 and 21 percent, respectively, followed by France, Germany, Switzerland, and the Netherlands, each accounting for 10 to 15 percent of sales.⁸ German firms' U.S. affiliates increased transactions in the United States by almost 50 percent over 1995 levels. On balance, sales by Japanese insurance affiliates of U.S. firms exceeded purchases from U.S. affiliates of Japanese firms by \$8 billion in 1996; however, with respect to other major trading partners, U.S. purchases from affiliates of foreign firms surpassed U.S. sales by affiliates in these foreign markets.

Summary and Outlook

U.S. trade in insurance continues to generate substantial deficits for both cross-border trade and affiliate transactions. This reflects the openness of the U.S. market and the

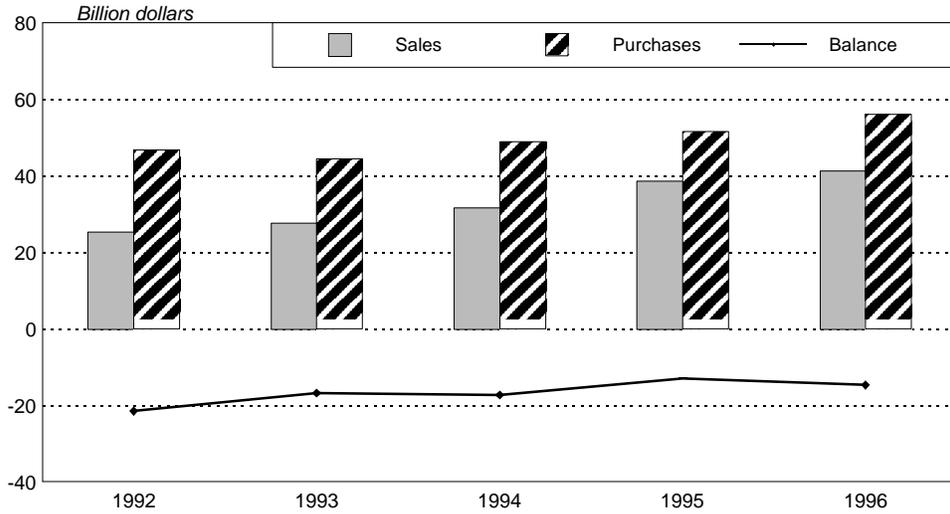
⁵ Data reflect premiums for primary insurance and reinsurance only. Affiliate trade data are not comparable with cross-border insurance trade data because cross-border data are net of claims paid.

⁶ Data for Switzerland and the Netherlands, usually important players in this market, were suppressed by the Bureau of Economic Analysis (BEA) to avoid disclosing data on individual companies.

⁷ This figure includes Bermuda, generally a strong export market for U.S. insurers. BEA does not report Bermuda separately in affiliate data; it is included within the Latin America category.

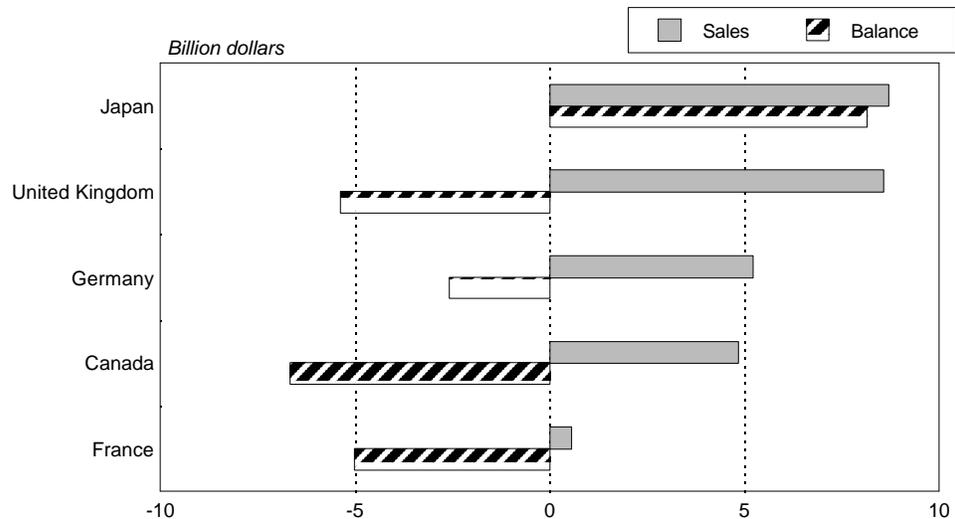
⁸ Latin American data, including Bermuda, a major source of U.S. insurance imports, were suppressed by BEA.

Figure 13-3
Insurance service transactions by majority-owned affiliates:¹ U.S. sales, purchases, and balance, 1992-96



¹ Data reflect premiums only for primary insurance and reinsurance. Affiliate trade data are not comparable with cross-border insurance trade data because cross-border are net of claims paid.
 Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Sept. 1995, pp. 104-105; Nov. 1996, pp. 111-112; Oct. 1997, pp. 137-136; and Oct. 1998, pp. 115-116.

Figure 13-4
Insurance service transactions by majority-owned affiliates:¹ U.S. sales and balance, by major trading partners, 1996



¹ Data reflect premiums only for primary insurance and reinsurance. Affiliate trade data are not comparable with cross-border insurance trade data because cross-border are net of claims paid.
 Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1998, pp. 115-116.

ability of foreign insurance companies to compete successfully in the United States. Over 10 percent of all U.S. premiums are collected by non-U.S.-owned insurance companies.⁹

The integration of traditional insurance, banking, and securities services continues, both in the United States and in Europe, where the trend is even more advanced. Called “bancassurance” in Europe, the trend has been accompanied by a record number of mergers of all types: across the banking and insurance industries, within the industries, and across national borders.¹⁰ Mergers hit record levels in 1998, with a total of 299 agreements announced by mid-December, valued at more than \$81 billion, compared to 1997 totals of 281 deals valued at \$31 billion. Industry analysts expect mergers to continue at these levels during 1999.¹¹ Industry consolidation has been spurred by the search for greater cost efficiency, the preparations for the advent of the new single European currency, and the greater capital requirements of competing in both the banking and insurance fields. The need for higher levels of capital has also spurred a trend toward demutualization, as more and more life insurers become publicly owned corporations.¹²

The year’s most prominent merger is the combination of Citibank and the Travelers Group into Citigroup, a firm with over \$750 billion in assets. Citigroup is expected to have a major impact on the banking, securities, and insurance markets. U.S. law still technically prohibits the combination of banking and insurance functions within a single company, so Citigroup is currently operating under a 2-year special exemption from the Federal Reserve Board (the Fed), with further 1-year extensions possible. The Fed approval of Citigroup is expected to serve as a model for future mergers between banking and insurance companies.¹³ Legislation to modernize the nation’s banking and insurance laws (H.R. 10) stalled in Congress in 1998, but upon reintroduction in the 106th Congress, the U.S. Senate passed legislation in this regard on May 6, 1999. Legislation is pending in the U.S. House of Representatives.

Insurers are also seeing moves toward liberalization in several important emerging markets. These countries represent important growth markets for U.S. companies, since insurance of all types has a very low penetration rate in emerging economies, compared to the mature markets of the industrial countries. Brazil has recently moved to privatize

⁹ See the U.S. National Association of Insurance Commissioners, annual reports on the foreign penetration of U.S. markets, beginning in 1992.

¹⁰ See “Europe’s Lovesick Bankers,” *The Economist*, Jan. 10, 1998, p. 61; Robert Stein and Beth Morrow, “The Changing Landscape,” *National Underwriter*, Jan. 12, 1998, p. 19; and Russ Banham, “Breaking Barriers,” *Reactions*, Mar. 1997, p. 63.

¹¹ “Megadeals Shook Industry Last Year,” *National Underwriter*, Dec. 28, 1998, p. 10.

¹² Mutual insurance companies are owned by their policy holders. When they demutualize, they buy out their policy holders and issue shares of stock, becoming shareholder-owned companies. This process generally allows higher levels of capitalization. Metropolitan Life, Prudential, and John Hancock in the United States, and Manulife, Mutual Life, Sun Life, and Canada Life in Canada have all announced demutualization plans this year. See “Met Life Will Go Public,” *National Underwriter*, Dec. 7, 1998, p. 1; and “1998 Top 10,” *National Underwriter*, Dec. 28, 1998, p. 3.

¹³ See “Citigroup: Historic Barriers Erode,” *Insurance Regulator*, vol. 9, No. 37, Sept. 28, 1998, p. 1.

its domestic insurance market.¹⁴ Market openings are also taking place in Asia. China has been slowly but steadily allowing private competition into its insurance market, granting approximately 3 licenses a year to foreign insurers, for an expected total of 30 new domestic and foreign market entrants by 2000.¹⁵ India is expected to open its insurance market to foreign investment in 1999, although legislation currently under consideration will only allow foreigners to hold a maximum stake of 26 percent in insurance companies.¹⁶

Insurers are also concerned about the impact of claims from Holocaust victims. Pressure on insurers and reinsurers operating in Europe during World War II to settle the claims has been mounting steadily, and it is estimated that the total settlement could reach \$1 billion.¹⁷ State insurance commissioners in the United States have threatened to suspend the operating certificates of European insurers' affiliates who do not honor Holocaust-era claims.¹⁸ Finally, the "Year 2000" (Y2K) problem is expected to impact the insurance industry both because companies are spending millions of dollars to ensure that their own computer systems are Y2K compliant, and because insurance companies are potentially responsible to pay claims on behalf of clients that inadequately address the Y2K problem. Many insurers have written "Y2K clauses" into their contracts, excluding all claims due to computer date change problems, but it is not clear whether these clauses will hold up in court.¹⁹ Legislation designed to limit Y2K liability claims is pending before Congress.

¹⁴ See "A Free Market - Of One," *Reactions*, 1997, Oct. 1998, pp. 49-52; "Brazil: The Latin Leader," *Latin America 1997*, a supplement to *Reactions*, 1997, p. 20; and "Insurance Boom," *Latin Insurance*, Spring 1998, p. 20.

¹⁵ For details on the opening of the Chinese insurance market, see "China's Life Insurance Market a Work in Progress," *National Underwriter*, Oct. 28, 1996, and "China: Emerging Giant or Sleepy Tiger?" *National Underwriter*, Oct. 26, 1998, both found at Internet address http://www.nuco.com/nu_online/, retrieved Dec. 29, 1998.

¹⁶ "India Moves to Open Insurance to Investors," *Wall Street Journal*, Dec. 16, 1998, p. A17; and "India - Insurance Scenario," presented by Venkatesh Mysore to the Roundtable on Insurance Conditions in Asia, sponsored by the International Insurance Council, Nov. 19, 1998.

¹⁷ See *World Insurance Report*, Aug. 21, 1998, p. 1; Oct. 7, 1998, p. 11; and Nov. 27, 1998, p. 14.

¹⁸ "Holocaust Insurance Issue Gains Momentum," *National Underwriter*, Dec. 28, 1998, p. 12.

¹⁹ See, e.g., "The Y2K Tally," *World Insurance Report*, May 29, 1998, p. 9; "Sinking feelings over Y2K," *World Insurance Report*, June 26, 1998, p. 8; and "Ship Shape?" *Reactions*, Aug. 1998, p. 38-40.

CHAPTER 14

INTANGIBLE INTELLECTUAL PROPERTY RIGHTS

Introduction

Trade in intangible intellectual property rights encompasses numerous service industries and is deemed especially important in advanced technology industries as an indicator of global competitiveness. In the U.S. balance of payments, cross-border trade in intangible property rights is reported as “royalties and license fees.” Such fees are collected by those who sell the rights to use industrial processes, techniques, formulas, and designs; copyrights and trademarks; business format franchising rights; and broadcast rights.¹ Additionally, royalties and license fees are collected for the rights to distribute, use, and reproduce computer software,² to sell products under a particular brand name or signature, and for management services.³

U.S. royalty and license fee receipts reflect U.S. exports of intangible intellectual property, whereas U.S. payments of royalties and license fees reflect U.S. imports of such property. Royalties and license fees predominately involve transactions between parent

¹ U.S. Department of Commerce (USDOC), Bureau of Economic Analysis (BEA), “U.S. International Sales and Purchases of Private Services,” *Survey of Current Business*, Oct. 1998, p. 79.

² In the 1998 *Survey of Current Business*, the USDOC, BEA began including general use computer software transactions in the royalties and license fees subcategory entitled “other.” General use computer software consists of two parts: (1) transactions involving the rights to distribute such software; and (2) transactions involving the rights to use or reproduce such computer software that was electronically transmitted or made from a master copy. General use computer software does not include fees for customs software and programming services. In 1997, transactions for general use computer software represented approximately 85 percent of the subcategory entitled “other.” The remaining 15 percent of the subcategory primarily reflects payments and receipts for the rights to performances and events pre-recorded on motion picture film and TV tape, and by communications carriers to secure capacity by indefeasible right of users. USDOC, BEA, *Form BE-93, Annual Survey of Royalties, License Fees, and Other Receipts and Payments for Intangible Rights Between U.S. and Unaffiliated Persons*, 1997, p. 3.

³ Management services essentially include administrative, professional, and managerial services. Management fees are payments exchanged for the receipt of such services. Management fees, like royalties and license fees, are payments for the rights to utilize intangible intellectual property. For example, a firm providing blueprints and technical advice to its affiliate may classify the associated charges as a licensing fee for know-how, whereas another firm may classify charges on an identical transaction as management fees. For more information on the USDOC survey of intangible intellectual property-related trade, see USDOC, BEA, “U.S. International Transactions in Royalties and Licensing Fees: Their Relationship to the Transfer of Technology,” *Survey of Current Business*, Dec. 1973, p. 15.

companies headquartered in one country and affiliates⁴ in another, termed “intracorporate trade,” although unaffiliated firms also trade intangible property.⁵ Intracorporate trade predominates because it allows large multinational firms to control the distribution of their intellectual property in foreign markets. Multinationals first sell property rights to their foreign affiliates, which subsequently sell the rights on behalf of the parent firm, as well as monitor protection of the intellectual property in the foreign markets.

Recent Trends in Cross-Border Trade, 1992-97

In 1997, the United States exported intangible intellectual property valued at \$33.7 billion and imported \$9.4 billion, resulting in a \$24.3-billion surplus (figure 14-1). This surplus is larger than that recorded for any other private service in 1997. Intangible intellectual property rights accounted for 14 percent and 6 percent, respectively, of U.S. exports and imports of all private services. Exports increased by 3 percent in 1997, considerably slower than the 12-percent average annual growth rate during 1992-96. In contrast, U.S. imports increased by 20 percent in 1997, substantially faster than the 11-percent average annual growth during 1992-96. The relatively faster growth in imports and slower growth in exports resulted in a 3-percent decline in the surplus in 1997, reversing the 12-percent average annual increase in the surplus recorded during 1992-96.

U.S. exports consisted of U.S. parents’ receipts from their foreign-based affiliates (\$23.5 billion), U.S.-based firms’ receipts from unaffiliated firms (\$8.2 billion), and U.S.-based affiliates’ receipts from their foreign parents (\$2.1 billion) (figure 14-2). In 1997, U.S. exports of intangible intellectual property grew more rapidly among affiliated firms than among unaffiliated firms.

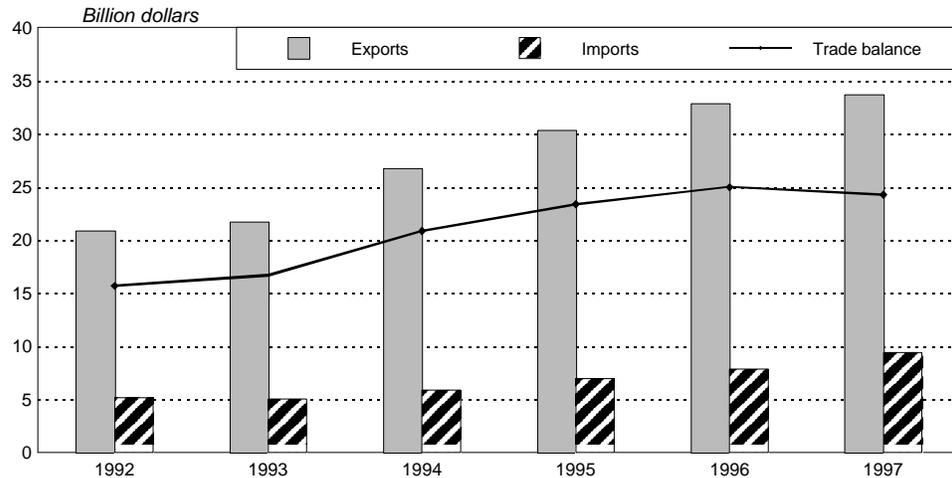
With regard to U.S. imports in 1997, the \$9.4 billion of intangible intellectual property imports consisted of U.S. affiliates’ payments to their foreign parents (\$6.1 billion), U.S.-based firms’ payments to unaffiliated firms (\$2.3 billion), and U.S. parents’ payments to their foreign affiliates (\$1 billion). For the year, U.S. imports increased among affiliated firms, especially U.S. affiliates’ imports from their foreign parents, but decreased among unaffiliated firms.

On balance in 1997, the United States recorded surpluses amounting to \$18.4 billion in trade among affiliated firms and \$5.8 billion in trade among unaffiliated firms. While the surplus in such trade among unaffiliated firms in 1997 was virtually unchanged from

⁴ Herein, foreign-based affiliates of U.S. firms are defined as those at least 10 percent owned directly or indirectly by U.S. parent firms. Similarly, U.S.-based affiliates of foreign-owned firms are defined as those at least 10 percent owned directly or indirectly by foreign parents.

⁵ In 1997, intracorporate trade accounted for approximately 75 percent of cross-border trade in intangible intellectual property rights.

Figure 14-1
Intangible intellectual property rights: U.S. cross-border exports, imports, and trade balance, 1992-97



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1998, pp. 86-87.

that in 1996, the surplus resulting from intracorporate trade declined by 4 percent, largely attributable to a 29-percent increase in payments to foreign parents by their U.S.-based affiliates.

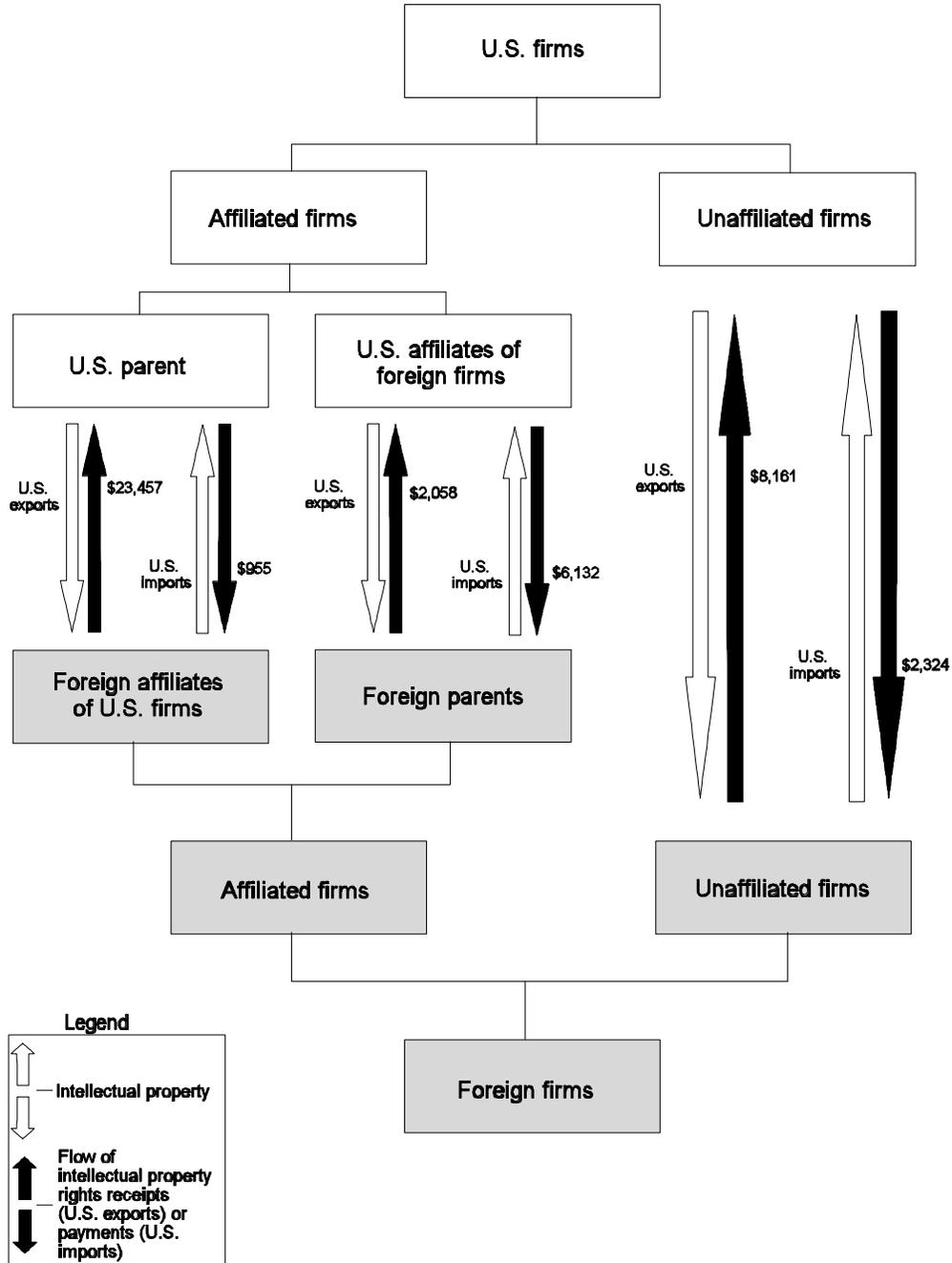
In 1997, the major U.S. export markets for intangible intellectual property were, in descending order, Japan, the United Kingdom, Germany, the Netherlands, and France (figure 14-3). Exports of \$6.6 billion to Japan more than doubled exports to the United Kingdom, measuring \$3.2 billion. Germany, the Netherlands, and France accounted for U.S. exports of \$2.8 billion, \$2.7 billion, and \$2.2 billion, respectively.

The major foreign suppliers of intangible intellectual property to the U.S. market in 1997 were the United Kingdom, Japan, Germany, Switzerland, and France. The United Kingdom and Japan were the largest single suppliers, each accounting for purchases of \$2.1 billion. Germany, Switzerland, and France accounted for imports of \$904 million, \$785 million, and \$723 million, respectively.

Summary and Outlook

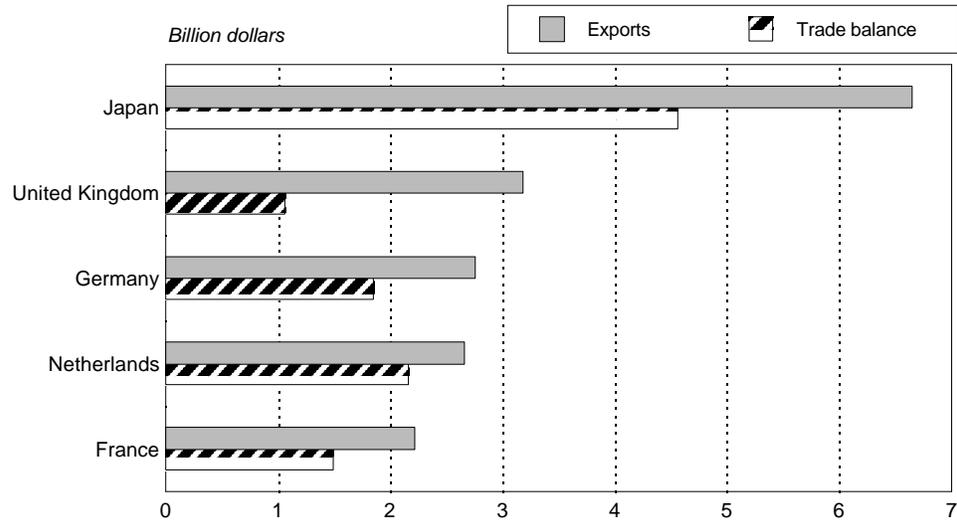
In 1997, the U.S. cross-border trade surplus in intangible intellectual property rights fell by 3 percent. The decline principally resulted from an increase in imports of intangible intellectual property rights, primarily caused by an increase in intracorporate trade between U.S. affiliates and their foreign parents. Future trade growth in intangible

Figure 14-2
U.S. cross-border trade in intangible intellectual property rights, 1997
(million dollars)



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1998, pp. 86-87.

Figure 14-3
Intangible intellectual property rights: U.S. cross-border exports and trade balance, by major trading partners, 1997



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1998, p. 97.

intellectual property partially depends upon scientific and technological innovations.⁶ The United States compares favorably with Germany, the United Kingdom, France, and the Netherlands with respect to most indicators of growth in scientific and technological innovation.⁷ The United States appears to be falling behind Sweden and Japan, however, with respect to certain indicators of innovation, such as total per capita research and development expenditures, and may face increased competition in intangible intellectual property trade from these nations. Indicators of growth in scientific and technological innovation suggest the United States may also face increasing competition in such trade from South Korea, Singapore, Taiwan, and Finland. The current economic and financial crisis in Asia, however, may cause financially strapped public and private institutions in the region to decrease expenditures

⁶ For example, this is likely the case in at least two of the most important components of intangible intellectual property rights--industrial processes and the rights to distribute, use, and reproduce computer software.

⁷ Indicators of growth in scientific and technological innovations primarily measure levels and growth rates in public and private research and development expenditures, expenditures on levels of education, and the number of science and technology professionals in the labor force. This chapter's observations regarding countries' future competitiveness in intangible intellectual property trade are derived from performance data found in *Second European Report on S&T Indicators, 1997*, by the European Commission Directorate-General XII, Science, Research and Development (European Commission: Brussels, 1997). The publication also provides an in-depth discussion of indicators of scientific and technological innovation.

on items associated with growth in scientific and technological innovation. Decreases in such expenditures could damage the future competitiveness of South Korea, Singapore, and Taiwan.

With respect to general use computer software-related rights, which represent a fast growing facet of trade in intangible intellectual property, the United States will likely remain strong. In certain market segments, however, the United States may face increased competition from software producers in China, Germany, India, Israel, and Japan.⁸ This could reduce the rate at which foreign consumers purchase general use computer software-related rights from U.S. firms, and increase the rate at which U.S. consumers purchase such rights from foreign firms. Although U.S. dominance in the software industry may be waning slightly, increasing world demand for new software products should lead to continued growth for U.S. software firms,⁹ as well as growth in foreign payments to U.S. firms for general use computer software-related rights.

⁸ Industry analysts, interviews with USITC staff, Nov. 23, 1998, and Feb. 1, 1999.

⁹ Ibid.

CHAPTER 15

LEGAL SERVICES

Introduction

Legal services include legal advisory and representation services in various fields of law (e.g., criminal or corporate law), advisory and representation services in statutory procedures of quasi-judicial bodies, and legal documentation and certification services. Legal services are traded both on an affiliate and a cross-border basis, although trade data are available only for the latter. Cross-border trade in this service industry occurs when legal professionals travel abroad to provide services to clients, when clients travel abroad to engage the services of foreign attorneys, or when legal documents or advice are transmitted via telecommunication devices, postal delivery, or other forms of correspondence. Trade through affiliates occurs when foreign affiliates of legal service providers engage in commercial activity.

In limited instances, legal service providers may become members of foreign bars and qualify to appear in foreign courts and prepare advice on foreign law. However, most U.S. lawyers practicing abroad are not locally accredited and, therefore, function more narrowly as foreign legal consultants.¹ Typically, U.S. foreign legal consultants may provide advice regarding U.S. law, international law, and third-country law, but are precluded from appearing in foreign courts or giving advice on foreign law, unless that advice is based on the counsel of a member of the foreign bar. This arrangement is common in most major legal markets throughout the world, although some jurisdictions, notably Japan and France, impose comparatively burdensome restrictions on all foreign providers of legal services.

¹ Although the term ‘foreign legal consultant’ (FLC) is widely used throughout the international legal community, the specific definition may differ among jurisdictions. In an effort to reduce ambiguity, the American Bar Association (ABA) and other national legal professional associations have developed a common approach to foreign legal consultancy. The Model Rule recognizes the ability of foreign lawyers to enter a country so as to qualify as a FLC, to hire local lawyers as partners, and, although restrictions would apply, to participate fully with local lawyers in providing a wide variety of legal services.

Recent Trends in Cross-Border Trade, 1992-97

In 1997, U.S. cross-border exports of legal services totaled \$2.1 billion (figure 15-1), up nearly 6 percent over the previous year. This increase trailed the 10-percent average annual increase achieved during 1992-96. U.S. cross-border imports of legal services decreased by 2 percent to \$568 million in 1997. This reversed course from the 17-percent average annual growth rate achieved during 1992-96. Consequently, the U.S. cross-border trade surplus in this sector widened to approximately \$1.5 billion.

Regarding trade with individual countries in 1997, Japan and the United Kingdom remained the largest foreign markets for U.S. legal services exports, each accounting for 18 percent of the total (figure 15-2). Other significant cross-border export markets included France (10 percent), and Germany and Canada (8 percent each). Exports to Canada rose particularly rapidly, growing by 34 percent. Concerning imports, the leading trading partners were similar to those for exports, with U.S. residents purchasing approximately 23 percent of foreign-provided legal services from the United Kingdom and 12 percent from Japan. The United States recorded a surplus on legal services trade with each of these trading partners.

Summary and Outlook

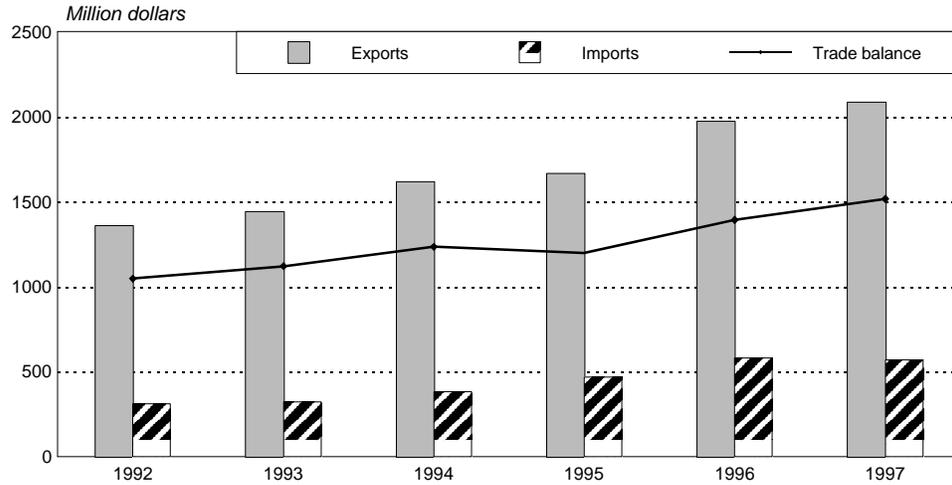
The U.S. legal profession continues to lead the world in the provision of legal services.² In 1997, activity concerning mergers and acquisitions (M&A), project finance, and corporate debt was at or near record levels for many U.S. law firms. International business and foreign clients contributed significantly to the U.S. industry's global success. Although U.S. exports of legal services to some major international legal markets, such as Japan and the United Kingdom, fell or stalled in 1997, exports to other markets, including Canada and Germany, experienced strong growth. In the troubled Asia-Pacific region, to which U.S. exports of legal services rose only 3 percent, U.S. providers were often able to compensate for lost business by moving from activities such as project finance into corporate restructuring and other services more pertinent to the region's current needs.³ For example, the U.S. law firm Baker & McKenzie, the largest law firm in the world, increased its presence in Malaysia and formed a debt restructuring and insolvency team to help address the region's economic problems.⁴

² Results from a recent survey indicate that U.S. firms have lost ground in the worldwide legal marketplace, while British firms have made significant advancements. After years of mergers and overseas expansion, 6 of the 10 largest international firms are now British, measured by number of attorneys. "Americans Lead on Billings and Profits but Trail in Size in Global Race," *The American Lawyer*, Nov. 3, 1998, found at Internet address <http://www.newsedge/>, retrieved Nov. 3, 1998.

³ John McGuigan, "Opportunities amidst the pain of Asia's economic crisis?" *Asia Pacific Legal Developments Bulletin*, Baker and McKenzie, Mar. 1998.

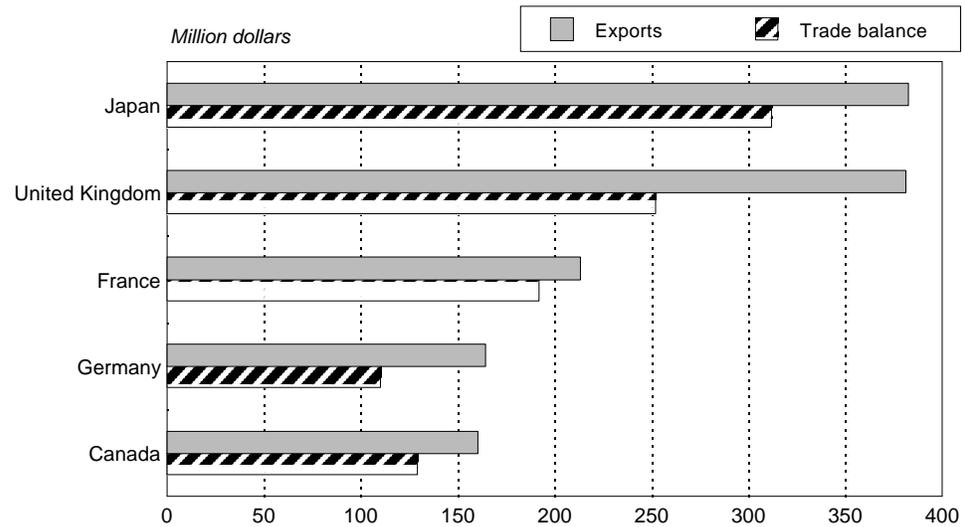
⁴ Ian Jarrett, "An eagle-eye for opportunity," *Asian Business*, Apr. 1998, pp. 58-59.

Figure 15-1
Legal services: U.S. cross-border exports, imports, and trade balance, 1992-97



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1998, pp. 86-87.

Figure 15-2
Legal services: U.S. cross-border exports and trade balance, by major trading partners, 1997



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1998, p. 113.

International clients are increasingly important to many U.S. law firms, which continue to compete in foreign markets by establishing or expanding foreign relationships. In 1997, Baker and McKenzie opened offices in Baku, Azerbaijan, and Hsin Chu, Taiwan, its 58th and 59th locations worldwide.⁵ Another large U.S. firm, Skadden, Arps, Slate, Meagher and Flom, reported that its record-setting revenues in 1997 were due, in part, to the firm's global activities. The firm represented clients from around the world including the participants in privatizations of national telephone companies in Denmark, Hungary, Portugal, Romania, Spain, and Venezuela. Skadden, Arps also represented underwriters in the initial public offering of Vimpel-Communications, the first Russian company listed on the New York Stock Exchange since the Russian Revolution of 1917.⁶ Squire, Sanders and Dempsey opened its first Spanish office in September 1997, reportedly in anticipation of the strong potential for U.S. investment work. Before Spain's entry into the EU, the Spanish legal market was virtually closed to foreigners. However, since entry, Spain has become an attractive market for international firms.⁷

U.S. firms operating in London report strong demand for advice and assistance to U.S. and multinational companies acquiring businesses, investing, or forming joint ventures in the United Kingdom, other European locations, and the United States. Other activities focus on tax and corporate matters, often in complex multijurisdictional settings. Across Europe, U.S. firms foresee significant growth in areas including M&A, corporate tax planning, and financing as the European Community Single Market evolves, and plan to expand to meet additional demands for legal services.⁸ Outside Western Europe, U.S. firms continue to build a presence in the emerging markets of Eastern Europe and Asia. Several U.S. firms are planning to open offices in Moscow. The market for legal services in Russia has been increasing since 1994 and amounted to Ruble 15 billion (USD 3 million) in 1996.⁹ Davis, Polk and Wardwell advised principals in connection with a Securities and Exchange Commission (SEC)-registered \$500 million offering of bonds by the Republic of the Philippines, which was the first sovereign offering consummated in the region since the Asian economic crisis began.¹⁰

Increased political stability, and social and economic reforms have led to a resurgence of interest in Latin America by U.S. law firms. As regional economies mature, large multinational companies invest in new markets using funding from the global debt and capital markets. This economic activity often requires legal assistance. Baker and McKenzie opened centers in London and Spain specifically for clients interested in doing business in Latin America and for Latin American companies interested in investing in

⁵ The Law Society of England and Wales, *Gazette*, May 12 and May 22, 1998, found at Internet address <http://www.lawgazette.co.uk/>, retrieved on Nov. 4, 1998.

⁶ Skadden, Arps, Slate, Meagher & Flom, LLP, "1997 Year in Review," found at Internet address <http://www.skadden.com/>, retrieved Nov. 3, 1998.

⁷ Nick Ferguson, "Spanish firms regroup to prepare for a turbulent future," *International Financial Law Review*, Oct. 1997, p. 38.

⁸ Jones, Day, Reavis & Pogue, found at Internet address <http://www.jonesday.com/>, retrieved Nov. 3, 1998.

⁹ U.S. Department of Commerce (USDOC), International Trade Administration (ITA), "Russia - Survey of Service Industries - IMI980130," Jan. 30, 1998, found at Internet address <http://domino.stat-usa.gov/>, retrieved Oct. 23, 1998.

¹⁰ Davis Polk & Wardwell, "In the News," found at Internet address <http://www.dpw.com/news.htm>, retrieved Oct. 23, 1998.

Europe.¹¹ Within the region, Argentina and Brazil have the most established domestic legal services, but the opening of the Argentine economy to international trade and investment is likely to create additional opportunities for foreign legal service providers. Although foreign attorneys presently are not allowed to practice Argentinean law, there is substantial and growing demand for legal consulting services in areas such as privatizations, corporate mergers, capital markets, tax law, and environmental regulations.¹²

Although the largest foreign market for U.S. exports of legal services, the Japanese market continues to pose difficulties. The Ministry of Justice (MOJ) released a report on October 30, 1997, that proposes measures on three issues of interest to foreign lawyers operating in Japan: 1) prior practice experience requirements; 2) restrictions on the handling of third-country law; and 3) restrictions on business links between foreign and domestic lawyers in Japan. The U.S. Government has repeatedly sought elimination or substantial liberalization of these restrictions and requirements. However, the report recommended only minor changes in two of the restrictions and called for no substantive change in business ties between foreign and Japanese lawyers in Japan, the most important restriction.¹³ The situation was slightly improved by a 1998 revision of the Foreign Lawyers' Law¹⁴ that allows foreign legal consultants to practice third-country law in Japan and reduces the prior experience requirement from 5 years to 3 years. However, the revision does not relax the ban on foreign lawyers hiring or forming partnerships with Japanese lawyers.¹⁵

U.S. lawyers report China has been less affected by the Asian financial crisis than other regional economies, and project finance and securities issues are still doing well. Furthermore, interest in investing in China continues to increase and, consequently, some firms that offer investor services have seen a slight upturn in business, with more expected. Also, the Chinese Government announced that the pace of privatization needs to quicken. This mandate, if enacted, is expected to create significant opportunities for legal consulting services. Consequently, hundreds of foreign law firms reportedly have applied for a licence to practice in China.¹⁶

Various professional and government organizations from the United States and China are working together to develop China's international legal capabilities. On October 8, 1997, officials from the USDOC and the Chinese Ministry of Justice (MOJ) evaluated ways the United States could help China develop its legal system and a rule of law. The USDOC noted that U.S. assistance would be maximized if additional foreign law firms were

¹¹ Baker & McKenzie, "Baker & McKenzie Launch Latin American Centres," news release, Jan. 28, 1998, found at Internet address <http://www.bakerinfo.com/>, retrieved Oct. 23, 1998.

¹² USDOC, ITA, "Services Markets of Opportunity," *Business America*, Apr. 1998.

¹³ U.S. Department of State telegram, "Legal Services: Study Group on Foreign Lawyers Offers Easing on Two out of Three Restrictions Reviewed," message reference No. 009486, prepared by U.S. Embassy, Tokyo, Oct. 30, 1997.

¹⁴ The measure still requires final Diet action.

¹⁵ U.S. Department of State, "Japan's Services Trade Regime," message reference No. 007858, prepared by U.S. Embassy, Tokyo, Sept. 28, 1998.

¹⁶ Barbara Galli, "One country, two legal markets," *International Financial Law Review*, June 1998, pp. 30-43.

permitted in China and if foreign firms already on site were allowed to open additional branches.¹⁷ The MOJ explained that the expansion of foreign legal services is a lengthy “process” with many complex steps that must be completed before additional reforms could be enacted.¹⁸ More recently, the American Bar Association (ABA) and the All China Lawyers’ Association (ACLA) agreed on a program to explore areas of mutual interest. The agreement includes programs to encourage development of an independent bar, which would include training ACLA members in bar management and developing procedures for selecting Chinese lawyers to train at U.S. law firms.¹⁹

The ABA is also working to improve the delivery of legal services among signatories to the NAFTA. A joint recommendation promoting the cross-border delivery of legal services was signed by Mexican, Canadian, and U.S. representatives to the NAFTA Committee on June 19, 1998. Members of the Federation of Law Societies of Canada, the Mexican Committee on the International Practice of Law, and the ABA agreed to encourage the association or partnership between Mexican, Canadian, and U.S. lawyers and foreign legal consultants and promote the Model Rule regarding foreign legal consultants, along with other procompetitive initiatives. The Model Rule provides a framework through which regulatory bodies of each signatory are encouraged to adopt regulatory schemes which are substantively the same or less restrictive.²⁰

Another factor likely to influence the provision of legal services is the emergence of full-service professional firms. In this context, the global consolidation of professional service providers is expected to lead to a restructuring of the legal industry.²¹ The U.S. “Big 5” accounting houses have expanded their legal capabilities in recent years, and plan future growth by offering clients a single source for tax preparation and legal advice. Still, in the United States, state bar association professional ethics codes effectively prevent attorneys at accounting firms from practicing law. By contrast, in the early 1990s, a number of European countries relaxed rules that had kept the accounting and legal professions separate, spurring accounting firms to hire lawyers and affiliate with or buy entire law firms. With the apparently successful European

¹⁷ Foreign firms are currently allowed a single office in China.

¹⁸ U.S. Department of State telegram, “DOC General Counsel Pincus’ October 8 Meeting at Ministry of Justice: Cooperation in Legal Services,” message reference No. 036775, prepared by U.S. Embassy, Beijing, Oct. 14, 1997.

¹⁹ ABA, “U.S. and Chinese Lawyers to Work Together To Promote Rule of Law,” Aug. 2, 1998, found at Internet address <http://www.abanet.org/>, retrieved Oct. 23, 1998.

²⁰ Federation of Law Societies of Canada, Mexican Committee on the International Practice of Law, American Bar Association, “Foreign Legal Consultants and related Aspects of the Cross-Border Delivery of Legal Services: Joint Recommendation of the relevant Canadian, Mexican, and American Professional Bodies,” June 19, 1998.

²¹ A managing partner at Clifford Chance, Europe’s largest law firm, predicts that the international legal profession will undergo more change in the next 2 or 3 years than it has in the last 50 because international businesses are likely to increasingly expect a full-service professional services firm to provide a seamless, global response to all their legal and accounting needs. Carla Vitzthum, “Mergers Transform Europe’s Law firms,” *Wall Street Journal*, July 22, 1998.

experience setting a precedent and international clients expecting the unified service they now get overseas, the ABA is examining how law and accounting operations might be combined.²²

Already, the “Big 5” are informally considered the world’s largest law firms. Ernst & Young reportedly employs 3,300 lawyers worldwide and 850 lawyers in the United States, nearly double the number of a few years ago.²³ PricewaterhouseCoopers employs 3,000 lawyers around the world, at least 30 percent more than three years ago.²⁴ KPMG reported that about 60 percent of its offices in Europe have a legal services capability that goes beyond tax work. Areas of expertise include corporate law, financial law, labor law, and estate organization.²⁵ In January 1997, Andersen ALT, a Spanish affiliate of Andersen Worldwide, merged with Garrigues, one of the largest Spanish law firms with offices in New York and Brussels. The new firm has more than twice the partners and revenue of Cuatrecasas, the next largest Spanish firm.²⁶

²² The president of the American Bar Association appointed a Commission on Multi-disciplinary Practice to examine how professional service firms that are operated by accountants and other non-lawyers are providing legal services. ABA, “ABA President Philip S. Anderson Appoints Commission On Multi-disciplinary Practice,” news release, Aug. 4, 1998, found at Internet address <http://www.abanet.org/>, retrieved Nov. 4, 1998.

²³ Ernst & Young was the first of the “Big 5” firms to enter the Canadian legal market through its link with Toronto’s Donahue & Associates. Paul Lee, “Canadian firms prepare for foreign invasion,” *International Financial Law Review*, Jan. 1998, p. 33.

²⁴ David Segal, “Tax Advisers Target Law Firms’ Clients,” *Washington Post*, Nov. 11, 1998, p. F1.

²⁵ Jacquelyn Lynn, “A trend to watch: Accounting firms expanding through law practices,” *Commercial Law Bulletin*, May/June 1998, pp. 9-11.

²⁶ Nick Ferguson, “Spanish firms regroup to prepare for a turbulent future,” *International Financial Law Review*, Oct. 1997, p. 38.

CHAPTER 16

RETAIL SERVICES

Introduction

Retailers serve as intermediaries between wholesalers or manufacturers, and ultimate consumers, who may be individuals, households, or businesses. Retailers may take title to merchandise or they may hold merchandise through a contractual arrangement. Although international trade in retail services is increasingly taking place across borders through catalogue shopping and the Internet, the majority of transactions currently take place through foreign-based affiliates. For this reason, data collection agencies have focused solely on affiliate transactions. Such trade data capture sales of all services whether incidental or nonincidental to retailing. Nonincidental services provided by retailers could include installation or repair services, credit services, or warranty services, as well as promotion and advertising services. In the case of computer systems, retailers also may provide systems integration and support services.

Recent Trends in Affiliate Transactions, 1992-96

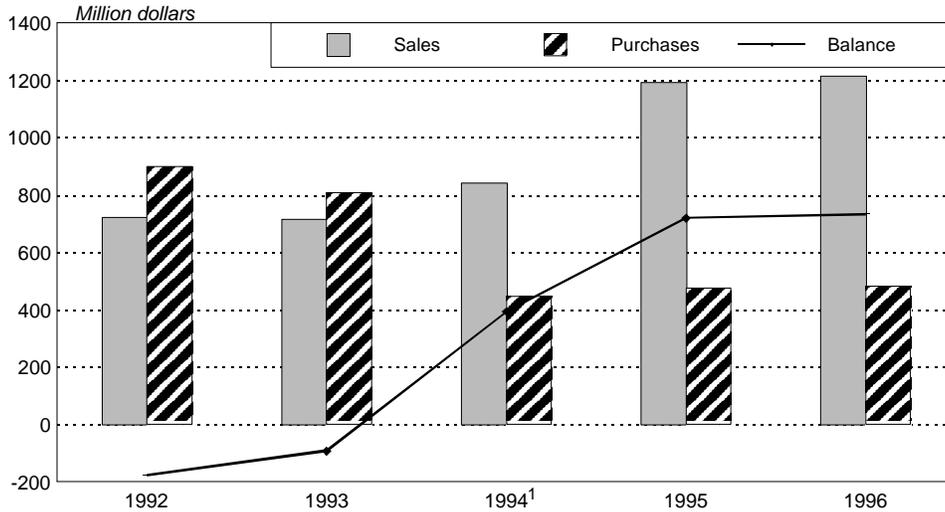
In 1996, U.S. sales of services through foreign-based retail affiliates measured \$1.2 billion, while U.S. purchases from U.S.-based retail affiliates of foreign firms amounted to \$481 million (figure 16-1). In 1996, sales of services through retailing affiliates of U.S. parents increased by 2 percent, far slower than the average annual growth of 18 percent during 1992-95. Slower sales growth abroad may have resulted from the appreciation of the dollar,¹ which raised the cost to foreign consumers of U.S.-denominated goods sold in foreign markets, and slower economic growth in key markets such as the United Kingdom, Canada, France, Germany, and Italy.² U.S. purchases of retail services increased by 2 percent in 1996, in sharp contrast with the 19-percent average annual decline experienced during 1992-95. This decline was most pronounced in 1994, when U.S. purchases dropped by 55 percent. The reversal of transaction patterns that brought the United States into surplus in 1994 was principally caused by the exclusion of two U.S. affiliates of foreign firms that are no longer counted as retailing affiliates.³ This accounting change significantly reduced the recorded number of purchases of retail services by U.S. consumers.

¹ The U.S. dollar appreciated by 4 percent on a trade-weighted average basis from the end of December 1995 to the end of December 1996. U.S. Department of Commerce (USDOC), Bureau of Economic Analysis (BEA), *Survey of Current Business*, Apr. 1997, pp. 19 and 24.

² United Nations, *World Economic and Social Survey, 1998* (New York: UN, 1998), p. 126.

³ BEA representative, telephone interview by USITC staff, Dec. 13, 1996.

Figure 16-1
Retail service transactions by majority-owned affiliates: U.S. sales, purchases, and balance, 1992-96



¹ Data for 1994 understate U.S. sales because selected data were suppressed in order to avoid disclosing information about the operations of individual firms.
 Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Sept. 1995, pp. 104-105; Nov. 1996, pp. 111-112; Oct. 1997, pp. 137-136; and Oct. 1998, pp. 115-116.

On a bilateral basis, only data for the United Kingdom, Switzerland, and the Netherlands were reported. British retailing affiliates of U.S. firms accounted for sales of \$120 million, or 10 percent of the total, followed by affiliates in Switzerland with \$36 million, or 3 percent, and the Netherlands with \$3 million, or less than 1 percent. Data on sales through Canadian, French, German, Australian, and Japanese affiliates of U.S. retailers were not reported, as BEA suppressed the data in order to avoid disclosing proprietary information about the operation of individual firms. Reflecting a high level of investment in the United States, Japanese firms accounted for 22 percent of total U.S. purchases of services from retailing affiliates of foreign firms, amounting to \$105 million. U.S. consumers also frequented retailing affiliates of British firms, purchasing services valued at \$65 million, or 14 percent of total U.S. purchases.⁴

Summary and Outlook

In 1994, the accounting classification of large U.S. affiliates of foreign firms was changed, causing U.S. surpluses on retailing affiliates' transactions after a long period of deficits. In addition, BEA suppressed data on bilateral sales to major trading partners to prevent disclosure of activities by certain large affiliate firms. These changes impede both trend analysis of purchases from U.S. affiliates of foreign firms and bilateral trade

⁴ USDOC, BEA, *Survey of Current Business*, Oct. 1998, pp. 115-116.

analysis. Nonetheless, sales of services through foreign affiliates of U.S. firms have demonstrated consistently strong growth that seems to be indicative of a broader trend toward increased internationalization of U.S.-owned retailing affiliates.

The United States has one of the most competitive retail industries in the world. U.S. consumers have access to a wide variety of products and services through distribution channels that range from the Internet to factory outlets and department stores. Furthermore, to keep prices low, U.S. retailers have become highly efficient at the fundamental elements of retailing, which include sourcing, logistics, and merchandising. They also provide services such as credit card financing, installation and repair, or computer systems integration services, further boosting sales.

The U.S. market comprises 260 million consumers and has one of the highest per capita incomes in the world.⁵ Consequently, despite intense competition, the U.S. market remains attractive to major foreign retailers. Some foreign retailers take advantage of the relatively open U.S. policy toward direct investment by acquiring U.S. retailers. Ahold NV, a large Dutch food retailer, purchased grocery chains Stop & Shop in 1997 and Giant Food Inc. in 1998, making it the largest food retailer on the East Coast.⁶ Other foreign firms such as The Body Shop entered the market by setting up U.S. affiliates.

A mature home market has motivated U.S. retailers to seek new geographic markets, particularly in the developing regions of Asia, Latin America, and Eastern Europe. Before the economic crisis in Asia, the region was expected to provide growth opportunities for foreign retailers. However, retailers were adversely affected by the crisis and Asian retail sales are expected to decline significantly. For example, Korean retail sales in 1998 were expected to drop by 14.8 percent from 1997 levels.⁷ Yet, U.S. discount stores in Korea such as Price Costco and Wal-Mart may fare relatively well despite the region's setback, as consumers are seeking bargain-priced goods. Foreign-owned discount stores in Korea were expected to increase total sales by 35 percent in 1998. Price Costco entered into a joint venture in May 1998 with Shinsegae, a Korean department store, and Wal-Mart acquired five Makro discount stores in Korea in July 1998.⁸

As with wholesaling, restrictions on foreign direct investment impede trade in retailing services. Foreign retailers are prohibited from investing in certain markets, such as the Philippines.⁹ China only allows retailing joint ventures and limits foreign retailers to minority ownership.¹⁰ Despite these restrictions, Wal-Mart has established three

⁵ "Global Powers of Retailing," *Stores*, Jan. 1998, Section 3, p. S30.

⁶ Martin Du Bois, "Retailer Ahold Says Size Isn't All That Matters," *Wall Street Journal*, Dec. 3, 1998, pp. A15, A18.

⁷ USDOC, International Trade Administration (ITA), "Korea - Retail Development Growth - ISA980901," STAT-USA database, found at Internet address <http://www.domino.stat-usa.gov/>, retrieved Dec. 8, 1998.

⁸ USDOC, ITA, "Korea - Retail Development Growth - ISA980901," STAT-USA database, found at Internet address <http://www.domino.stat-usa.gov/>, retrieved Dec. 8, 1998.

⁹ USDOC, ITA, "Philippines - Retailing - ISA971001," STAT-USA database, found at Internet address <http://www.domino.stat-usa.gov/>, retrieved Dec. 8, 1998.

¹⁰ "Global Powers of Retailing," *Stores*, Jan. 1998, Section 3, p. S30.

minority-owned joint ventures in China.¹¹ Other countries, such as Indonesia, also limit the ownership position of foreign firms, typically requiring them to operate through a joint venture as a minority partner.¹² Indonesia also preserves small- and medium-sized indigenous retail establishments by requiring large retailers to partner with smaller establishments in towns outside provincial capital cities, and by limiting the market area of big retailers such as supermarkets and department stores.¹³ However, Indonesia plans to fully liberalize the retailing sector by 2003.¹⁴

Other emerging markets have been more receptive to foreign investment and, consequently, are attracting the attention of U.S. retailers. Although slower growth is expected for Latin American countries as a result of the aftershocks of the Asian currency crisis, the region is viewed with cautious optimism due to lower inflation, stronger economic growth, and a growing middle class. As a result, Wal-Mart has established discount stores in Argentina and Brazil,¹⁵ and JCPenney has acquired a majority stake in Lojas Renner S.A., a department store chain in Brazil.¹⁶ U.S. retailers have also become interested in Eastern Europe. Although European firms have a leading position in these countries, U.S. firms such as Office Depot have established a presence in Hungary and Poland.

The industrial economies of Canada and Western Europe also offer considerable potential. Wal-Mart and Costco capitalized on a shift in Canadian consumer patterns toward discounting and both companies now have a strong presence in the Canadian market. U.S. firms have steadily been developing a presence in major European markets, such as the United Kingdom and Germany. Wal-Mart followed up its 1997 purchase of Germany's Wertkauf hypermarket¹⁷ chain with the purchase of Spar Handels AG, another German firm that owns retail and wholesale operations throughout the country.¹⁸

¹¹ "Wal-Mart China Expansion to Accelerate," Wal-Mart Homepage, June 5, 1998, found at Internet address <http://www.wal-mart.com/>, retrieved Mar. 1, 1999.

¹² Industry representative, telephone interview by USITC staff, Apr. 15, 1997.

¹³ USDOC, ITA, "Indonesia - Restrictions on Retail Chains - IMI970611," Stat-USA Database, found at Internet address <http://www.stat-usa.gov/>, posted June 11, 1997, retrieved Oct. 14, 1997; and "Global Powers of Retailing," *Stores*, Jan. 1998, Section 3, p. S30.

¹⁴ "Global Powers of Retailing," *Stores*, Jan. 1998, Section 3, p. S30.

¹⁵ James Mammarella and Pete Hisey, "Wal-Mart International reshapes the world retailing order," *Discount Store News*, Jan. 20, 1997, pp. 21 and 28.

¹⁶ "JCPenney Acquires Majority Interest in Brazilian Lojas Renner Department Stores," Newswire, found on The PointCast Network, retrieved Dec. 9, 1998.

¹⁷ Hypermarkets combine food and non-food offerings under one roof. Susan Reda, "Target: Global Opportunities," *Stores*, Sept. 1998, p. 24.

¹⁸ "Wal-Mart Acquires Interspar Hypermarkets," Newswire, found on The PointCast Network, retrieved Dec. 9, 1998; and Robert O'Connor, "Target Europe: Wal-Mart Sets Up a Beachhead in Germany," *Chain Store Age*, Mar. 1998, found at Internet address <http://proquest.umi.com/>, retrieved Dec. 9, 1998.

CHAPTER 17

TELECOMMUNICATION SERVICES

Introduction

Telecommunication services trade encompasses both basic¹ and value-added² services, which can be provided across national borders and through foreign-based affiliates. Cross-border trade, which involves the placement of a call in the home market and the termination of the call in a foreign market, is the dominant mode of trade. However, affiliate transactions are increasing in importance as U.S. trading partners continue to privatize state-owned monopolies and liberalize foreign ownership restrictions, thereby creating more opportunities for overseas participation by U.S. carriers. Both cross-border and affiliate trade, with the aid of ever advancing technologies, have adapted to keep pace with the globally connected and mobile customer. Thus, in recent years, telecommunication services providers have introduced new services such as call-back³ and country direct services, which increase incentives to trade but also introduce anomalies in trade data.⁴ In addition, trade has been facilitated by the distribution of pre-paid calling cards⁵ and international toll-free phone numbers,⁶ and by the completion of roaming agreements for cellular and mobile satellite telecommunication services.⁷ Related services, such as telecommunications training and consultancy, constitute a relatively minor portion of telecommunication services trade.

¹ Basic services entail the transmission of voice and data without change in form or content.

² Value-added services include services such as computer processing, electronic mail, electronic data interchange, electronic funds transfer, enhanced facsimile, and on-line database access.

³ Call-back services enable a customer outside the United States to call an assigned U.S. telephone number, let it ring once or twice, and then hang up; the caller will then receive a computer-driven, return call with a U.S. dial tone. These calls appear as outbound U.S. calls for accounting purposes.

⁴ Country direct services allow U.S. travelers abroad to place calls from foreign locations and have the calls billed by U.S. carriers at relatively lower rates. These calls appear as outbound U.S. calls for accounting purposes.

⁵ With pre-paid calling cards, a customer purchases in advance a set amount of calling time, for example 30 minutes of long distance, or value, typically \$1, \$5, \$10, \$20, or \$50 worth of long distance. Each time the card is used, the value of the card decreases. The card may be embedded with technology that tracks the value of the card, or the accounting is performed through a remote switch that the user dials to make his or her calls.

⁶ Toll-free numbers are those in which the receiver of the connection pays for the call. They are the equivalent of 800 and 888 numbers in the United States.

⁷ Cellular and mobile satellite service providers must secure the proper licensing requirements or “roaming agreements” from foreign carriers and governments so that their customers may utilize their services when in foreign countries.

Recent Trends

Cross-Border Trade, 1992-97

U.S. carriers periodically make settlement payments to foreign carriers that carry incoming international calls from the United States. Such settlement payments to foreign carriers are recorded as U.S. imports in the U.S. balance of payments. Conversely, foreign carriers make settlement payments to U.S. carriers that carry incoming international calls from foreign countries. These settlement payments to U.S. carriers are recorded as U.S. exports in the U.S. balance of payments. The settlement payments to U.S. and foreign carriers are based on bilaterally negotiated accounting rates and accounting rate shares. Accounting rate shares, usually equal to one-half the accounting rates and referred to as settlement rates, are used to determine settlement payments between U.S. and foreign carriers.⁸ The United States consistently recorded a trade deficit in cross-border telecommunication services during 1992-97 (figure 17-1), primarily because most calls between the United States and foreign countries originate in the United States, and U.S. carriers terminate more collect calls, which obligate U.S. carriers to remit to the originating foreign carrier. Other factors that affect the U.S. cross-border trade balance include the relative wealth of the United States and relatively low U.S. international calling prices, both of which encourage increased usage; the average length of calls, which tends to be longer for calls originating in the United States; the exchange rate of the dollar, which may increase or decrease the size of settlement payments; and the magnitude of foreign direct investment abroad, which results in outbound calls from U.S.-based parent companies to foreign affiliates.

In 1997, U.S. exports of telecommunication services totaled \$3.8 billion, while U.S. imports measured \$8.1 billion, resulting in a \$4.3-billion deficit in telecommunication services trade.⁹ Exports increased by 15 percent in 1997, significantly faster than the 3-percent average annual increase during 1992-96 (slowed temporarily by a 3-percent decline in 1993). Meanwhile, U.S. imports declined by 2 percent, in contrast to the 8-percent average annual increase during 1992-96. The \$4.3-billion deficit represents an approximately \$690-million drop in the perennial trade deficit in telecommunication services, a 14-percent decline from the year before.¹⁰

⁸ The Federal Communications Commission (FCC) through its International Settlements Policy regulates accounting rate agreements between U.S. and foreign carriers.

Although telegraph and telex services figure into settlement payments, today, telephone service accounts for almost all payments and receipts. For a detailed discussion of the accounting rate system and settlement payments, see FCC, *Trends in the U.S. International Telecommunications Industry* (Washington, DC: FCC, Aug. 1998), pp. 62-80.

⁹ U.S. Department of Commerce (USDOC), Bureau of Economic Analysis (BEA), *Survey of Current Business*, Oct. 1998, pp. 86-87, 102-105.

¹⁰ It should be noted that because of differences in reporting requirements, in recent years, FCC data have shown greater U.S. carrier payments (imports) to foreign carriers than do the BEA data, and BEA data show greater U.S. carrier receipts (exports). For a detailed discussion of the reporting differences and their effects on the balance of payments, see FCC, *Trends in the U.S. International Telecommunications Industry*, pp. 86-87.

Increased competition in foreign telecommunication services markets, especially from call-back service providers and new facilities-based¹¹ and resale¹² service providers, has put downward pressure on foreign calling fees. Lower fees have translated into increased calling and increased traffic incoming to the United States and, therefore, a significant rise in U.S. exports. Steadily declining accounting rates account for the significant decline in U.S. imports despite a continued increase in outgoing traffic.¹³

Mexico, the United Kingdom, Canada, Japan, and China continued to be the top five export markets for U.S. telecommunication services (figure 17-2). The United Kingdom and Canada exchanged places on the top-five list, as exports to the United Kingdom grew by 18 percent to \$325 million in 1997, whereas exports to Canada fell by 8 percent to \$272 million. Exports of telecommunication services to the other three countries continued to climb. Most significantly, exports to Mexico rose from \$350 million in 1996 to \$432 million in 1997, representing a 23-percent increase. However, because the accounting rate with Mexico is much higher than those with the other major trading partners, and because the volume of U.S. outgoing traffic to Mexico is second only to that which is directed to Canada, Mexico continues to be the top recipient of U.S. settlement payments at \$1.1 billion. In 1997, the \$698-million trade deficit with Mexico represented 16 percent of the U.S. cross-border trade deficit in telecommunication services.¹⁴

Affiliate Transactions, 1992-96

As privatization and liberalization of the world's telecommunication services markets continue, trade in telecommunication services through foreign-based affiliates is increasingly important. Further, because accounting rates continue to remain well above the marginal cost of placing an international call, firms have further incentive to locate operations abroad.¹⁵ This is demonstrated by the significant increases in the levels of affiliate transactions in recent years. In 1996, sales of telecommunication services by foreign affiliates of U.S. firms generated revenues of \$6.2 billion. This represents a 94 percent increase over 1995 sales of \$3.2 billion, reversing a 6-percent average annual

¹¹ Facilities-based services are those provided using transmission facilities owned in whole or in part by the carrier providing the service.

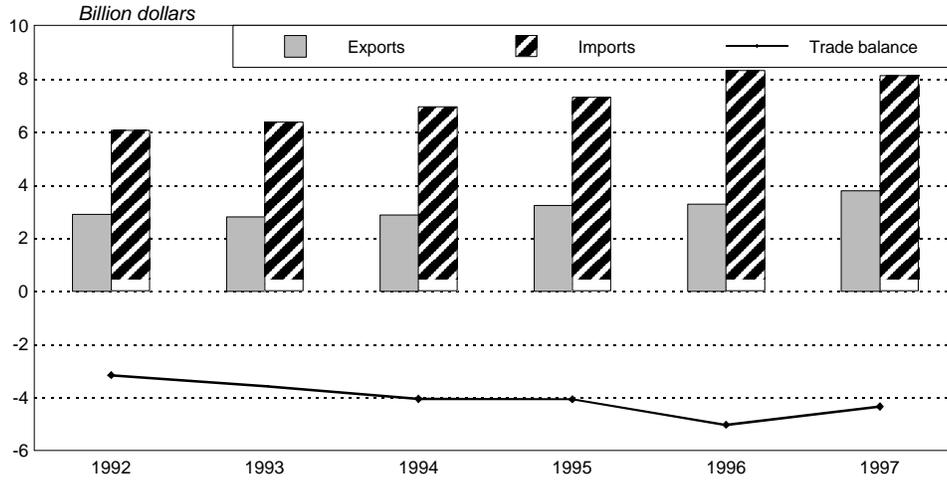
¹² There are two types of resale services. A carrier provides pure resale services by switching traffic to another carrier which in turn carries the traffic over its network to the international point. A carrier provides facilities-resale services by carrying traffic over international circuits it leases from other international carriers.

¹³ FCC officials, telephone interviews by USITC staff, Jan. 12, 1999. See also table 4.1-International Message Telephone Service of the Domestic United States for the Year Ending December 31, 1997, in FCC, *1997 Statistics of Common Carrier*, found at Internet address <http://www.fcc.gov/ccb/>; and discussion on price trends in FCC, *Trends in the U.S. International Telecommunications Industry*, pp. 28-40.

¹⁴ The accounting rate for Mexico dropped in 1995 from \$0.91 per minute to \$0.67 per minute. The rate has increased since then, reaching \$0.68 in 1996, and \$0.70 in 1997 and 1998. For a complete listing of accounting rates between U.S. and foreign carriers, see FCC, "IMTS Accounting Rates of the United States, 1985-1998," Oct. 1, 1998, found at Internet address <http://www.fcc.gov/ib/td/pf/account.html/>.

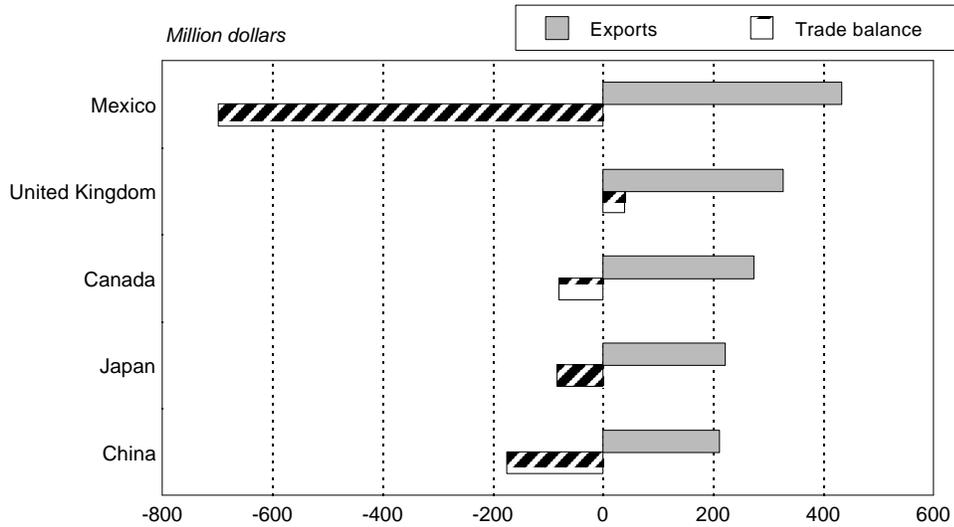
¹⁵ FCC official, telephone interview by USITC staff, Nov. 19, 1998.

Figure 17-1
Telecommunication services: U.S. cross-border exports, imports, and trade balance, 1992-97



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1998, pp. 86-87.

Figure 17-2
Telecommunication services: U.S. cross-border exports and trade balance, by major trading partners, 1997



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1998, pp. 104-105.

decline during 1992-95. Even more dramatic is the increase in sales of services by U.S.

affiliates of foreign firms. Such sales rose from \$876 million in 1995 to \$5.5 billion in 1996, representing a 530- percent increase, compared to a 4-percent decline during 1992-95.¹⁶ Notably, sales to the United Kingdom in 1996 stood at \$1.7 billion, accounting for 28 percent of all telecommunication sales by foreign affiliates of U.S. firms. Sales in 1996 were up 67 percent from 1995 sales of just over \$1 billion. The large overall increases in affiliate transactions do not represent increased sales by existing affiliates; rather, they reflect increased foreign direct investment and the creation of new affiliates, both foreign affiliates of U.S. firms and U.S. affiliates of foreign firms.¹⁷

Summary and Outlook

In 1997, U.S. exports of telecommunication services rose significantly, while imports fell for the first time since 1992. Overall international calling volume continued to rise, lifted by increased competition globally, lower accounting rates, lower calling fees, and greater access. Affiliate transactions, both sales and payments, demonstrated unprecedented growth, as the privatization and liberalization of international telecommunication services markets continued apace. The world's telecommunication services markets will likely see a continuation of the above trends in 1998 as countries push ahead with privatization, liberalization, and deregulation, in efforts to modernize and expand their telecommunication infrastructures.

The most notable recent event related to the liberalization of the world's telecommunication services markets was the completion of the WTO Agreement on Basic Telecommunications, which entered into force in February 1998. At the time the agreement entered into force, signatories to the agreement included the United States and 71 of its trading partners. Together, those participating in the agreement represent 91 percent of global telecommunication service revenues. Although commitments vary from country to country, the agreement aims to provide foreign telecommunication carriers with access to local, long-distance, and international service markets via all means of network technology (e.g., wireline, cellular, microwave, and satellite), either on a facilities basis or through resale. The agreement also aims to ensure that foreign

¹⁶ Source of affiliate data: USDOC, BEA, *Survey of Current Business*, Oct. 1998, pp.115-116. Data on affiliate transactions by telecommunication firms are bundled with sales by firms in other communications industries, such as broadcasting services, and presented as "communication" sales. Telephone and telegraph services sales constitute an estimated 80 percent of communication sales. The data on affiliate transactions by firms in the communication industry are not available in certain years and in sufficient detail to identify all major trading partners. Additionally, the data for sales by foreign affiliates of U.S. firms in 1994 have been suppressed and are not available. BEA official, telephone interview by USITC staff, Oct. 20, 1998.

¹⁷ USDOC, BEA, *Survey of Current Business*, Oct. 1998, pp. 84-85; and BEA official, telephone interview by USITC staff, Jan. 12, 1999.

investors can acquire, establish, or hold a significant stake in many foreign telecommunication companies, and it obligates most U.S. trading partners to maintain or implement largely new procompetitive telecommunication regulations.

The European Union (EU) commitments under the WTO agreement mirror what its member states have accomplished through intra-EU negotiations and the implementation of the European Union Telecommunications Policy. With few exceptions, the EU's telecommunication services market is fully liberalized. As such, activity in its market has reached a frenetic pace.¹⁸ New entrants to the market, merger and acquisitions, and network expansions have been ubiquitous throughout the Community. In Europe, of the approximately \$11.2 billion raised in high-yield debt¹⁹ across all industries during the first 6 months of 1998, the telecommunications and cable industry's share was \$5.7 billion, or 51 percent.²⁰ Most recently, Cable and Wireless (C&W) (U.K.) announced plans for a billion-dollar investment in a voice, data, and Internet network that will link 40 European cities in 13 countries. C&W will link this high-speed, broadband network to its Internet backbone in the United States and networks in the United Kingdom and Asia. C&W will target corporate voice and data clients in the estimated \$170-billion European market. This mammoth undertaking is facilitated by C&W's purchase of MCI's (U.S.) Internet backbone in the United States, which will accommodate increased demand for interconnection between the United States and Europe. A company official said C&W hopes to double its European revenue each year for the next 3 to 5 years.²¹ Interestingly, C&W's announcement comes on the heels of AT&T's announcement that it will team up with British Telecommunications (BT) (U.K.), with whom it plans to ultimately form a third company that will combine their respective international assets, to offer new global voice and data services to corporate clients through BT's Concert Communications venture. Depending upon the service, Concert services offered through AT&T reportedly will be available in 15 to 40 countries.²²

Active telecommunication markets are not limited to Europe. In 1997, telecommunication firms accounted for approximately one-third of global merger and acquisition volume. In recent years, telecommunication and media deals accounted for almost 40 percent of all high-yield debt financing.²³ In July 1998, the privatization and break-up of Brazil's Telecomunicações Brasileiras SA (Telebrás) was expected to bring in a minimum of \$11.6 billion. In the end, individual buyers and consortiums representing 26 firms and 7 countries, including the United States, paid \$19 billion for 12 "Baby Brás," including

¹⁸ Industry representative, telephone interview by USITC staff, Nov. 10, 1998.

¹⁹ High-yield debt primarily consists of high-yield corporate bonds with a rating of BB or lower that pay a higher yield to compensate for greater risk. Financial industry representative, telephone interview by USITC staff, Feb. 25, 1999.

²⁰ Gautam Naik, "The Telecom Consolidation Wave Should Wash Over Europe Soon," *Wall Street Journal*, June 29, 1998.

²¹ Vanessa Clark, "C&W Launch Billion-Dollar European Network," *Total Telecom*, Nov. 17, 1998, found at Internet address <http://www.totaltele.com/>, retrieved Nov. 18, 1998.

²² Tom Leithauser, "AT&T Takes First Step Toward BT Alliance," *Communications Today*, Nov. 12, 1998, pp. 5-6.

²³ Beth McGoldrick, "Will Telecom Weather the Storm?" *Global Finance*, Nov. 1998, p. 56.

3 fixed-line,²⁴ 8 cellular, and 1 long-distance service providers. In January 1999, the Brazilian Government held a second auction for four telephone operating licenses for so-called “mirror” companies covering three fixed-line concessions and national long-distance. Each new mirror company will compete in the circumscribed operating area of a Baby Brás. Controlled duopolies will exist in these areas through the year 2000.²⁵ In December 1998, the Brazilian Government received only three bids for three of the four licenses, but in January 1999, the Government disqualified a Brazilian group from the bidding because minority shareholders in the group already held stakes in other fixed-line operators above the 5- percent limit prescribed by the bidding rules. Thus, two groups were left in the running for two licenses, including a group led by the U.S. service provider Sprint Corp. that includes France Telecom S.A. and National Grid Plc (U.K.). On January 15, 1999, the Sprint-led group was awarded a license to provide long-distance services in Brazil in competition with Embratel Participações S.A. A group led by Canada’s BCE Inc. and Qualcomm Inc. (U.S.) was awarded a license to operate Brazil’s largest fixed-line concession in competition with Brazil’s largest phone company, Tele Norte Leste Participações S.A., which provides services in 16 Atlantic-coast states and the Amazon. No bids were submitted for two fixed-line licenses covering Sao Paulo and southern Brazil.²⁶

Not all the news has been positive for the telecommunications industry. Although 1997 and early 1998 saw tremendous growth and market activity accompanying countries’ efforts to liberalize their service markets, the Asian financial crisis and worsening economic conditions in Latin America and Russia have tightened capital markets and raised the cost of financing growth.²⁷ On the other hand, faltering economic conditions, in Asia at least, have had unexpected side effects. Economic turmoil has accelerated liberalization and deregulation. In order to attract capital, foreign investment caps have

²⁴ Fixed-line, or landline, telecommunication services are those provided over terrestrial circuits, be they wire, fiber, or microwave. Traditional residential telephone service is the best example of fixed-line telecommunication service.

²⁵ See “Cellular Bids Mark \$19 Billion Telebras Privatization,” *Communications Today*, July 30, 1998; Peter Fritsch, Gautam Naik, and Carltta Vitzthum, “Telebras Sale Far Exceeds Forecasts: Telefonica, MCI Emerge as Winners,” *Wall Street Journal*, July 30, 1998; “Competition for Telebrás,” *Latin America Monitor: Brazil*, Sept. 1998, p. 6; and “Expansion Continues in Telecom Sector,” *Latin America Monitor: Brazil*, Nov. 1998, pp. 6-7.

²⁶ See Christian Plumb, “Sprint, Bell Canada Among Bidders for Brazil Phone Licenses,” *Total Telecom*, Dec. 11, 1998, found at Internet address <http://www.totaltele.com/>, retrieved Jan. 13, 1999; Alexandre Spatuzza, “Brazil Reduces Fixed-line Bids to One,” *Total Telecom*, Jan. 6, 1999, found at Internet address <http://www.totaltele.com/>, retrieved Jan. 13, 1998; “Few Bidders for Telebrás ‘Mirrors,’” *Latin America Monitor: Brazil*, Jan. 1999, p. 1; and Christian Plumb and Jeb Blount, “Sprint, Bell Canada Win Brazil Phone Licenses,” *Total Telecom*, Jan. 15, 1999, found at <http://www.totaltele.com/>, retrieved Jan. 19, 1999.

²⁷ McGoldrick, “Will Telecom Weather the Storm?” Nov. 1998, p. 56.

been eased in places like South Korea, Indonesia, Thailand,²⁸ and Malaysia. The more advanced economies of Hong Kong and Singapore, in attempts to lower costs and enhance competitiveness, are planning to open their markets earlier than expected. Additionally, newly relaxed investment barriers combined with cheap asset valuations have prompted several international carriers with solid credit ratings, including U.S. carriers, to go on a spending spree in Asia. SBC Communications, Inc. (U.S.), the United Kingdom's BT and Cable & Wireless, Japan's NTT, Germany's DT, and Spain's Telefonica, have all invested, or are looking to invest, billions of dollars throughout the Asia-Pacific region, especially in mobile services.²⁹ Thus, technological advances, continued liberalization and deregulation, and pent-up demand in developing countries will continue to push telecommunications development and growth forward.³⁰

²⁸ Thailand has up to now limited foreign participation in its telecommunication services market to build-transfer-operate (BTO) arrangements. Such arrangements invite foreign and domestic firms to invest in network infrastructure with the promise of an exclusive license to operate the network and collect revenue for some years into the future, typically 10 to 25 years, thereby recouping their investment and making a profit. Thailand now plans to eliminate BTO arrangements, allowing private investors, including foreign investors, to own infrastructure.

²⁹ "Testing Times for the Tigers' Telecoms," *The Economist*, Oct. 31, 1998, pp. 65-66.

³⁰ McGoldrick, "Will Telecom Weather the Storm?" Nov. 1998, p. 56.

CHAPTER 18

TRANSPORTATION SERVICES

Introduction

For the purpose of this discussion, transportation services include passenger transportation, freight transportation, and port services.¹ Exports of passenger transportation services arise when U.S. air and ocean carriers transport foreign residents to and from the United States or between two foreign points of travel. Conversely, imports occur when foreign air and ocean carriers transport U.S. residents between the United States and foreign countries.² Trade in freight transportation and port services stems from merchandise trade. For instance, exports of freight transportation services take place when U.S. airline and ocean vessels³ transport U.S. goods exports to foreign destinations, or when such carriers convey cargo between two foreign ports.⁴ Imports of freight transportation services, on the other hand, occur when foreign air and ocean carriers transport imports to the United States.⁵ Finally, exports of port services encompass the value of both the goods and services procured by foreign air and ocean carriers at U.S. air and sea ports, whereas port services imports comprise the value of goods and services procured by U.S. carriers in air and sea ports of foreign countries.

Cross-border delivery is the prevailing mode of trade in transportation services. For example, in 1996, the most recent year for which transaction data are available for affiliates in the transportation industry, sales by majority-owned foreign affiliates of U.S.

¹ The discussion does not include reference to land transportation services (i.e., the transport of passengers and freight by road and rail).

² Although payments by U.S. residents to foreign carriers for travel between two foreign points is not incorporated within data pertaining to passenger fare imports, such payments are recorded in the travel and tourism data prepared by the Bureau of Economic Analysis (BEA). BEA official, interview by USITC staff, Nov. 16, 1998.

³ A U.S. ocean carrier is one which carries a U.S. flag and is operated by crew members whose country of residence is the United States.

⁴ According to balance-of-payments accounting convention, the importer is said to assume ownership of the goods when they cross the border of the exporting country and, as a consequence, to bear all subsequent transportation costs. Therefore, receipts of U.S. carriers for the transport of U.S. imports are excluded from U.S. transportation receipts because, by this convention, they represent transactions between U.S. importers and U.S. carriers. By the same token, payments to foreign carriers for transporting U.S. exports are not included in U.S. payments because they represent transactions between foreign importers and foreign airline, vessel, and truck operators. Michael A. Mann and Laura L. Brokenbaugh, "U.S. International Sales and Purchases of Private Services: U.S. Cross-Border Transactions in 1997," U.S. Department of Commerce (USDOC), BEA, *Survey of Current Business*, Oct. 1998, p. 78.

⁵ Transactions involving a U.S. resident contracting with a foreign carrier to transport goods between two foreign points are not included in calculations of U.S. payments for freight imports. BEA official, interview by USITC staff, Nov. 16, 1998.

firms amounted to approximately one-fifth of cross-border exports. However, the relative importance of cross-border delivery and affiliate transactions varies substantially depending upon both the type of transportation service provided and the geographic location of the countries involved. For instance, trade in airline transportation services is inherently a cross-border transaction, while sales by affiliates play a large role in freight transportation in countries where regulatory barriers prohibit cross-border delivery.

Recent Trends in Cross-Border Trade, 1992-97

In 1997, the U.S. cross-border trade surplus in transportation services decreased by 81 percent, principally due to an increase in imports of air passenger transport services. In aggregate terms, U.S. cross-border exports of transportation services equaled \$47.8 billion, representing an increase of 3 percent above the previous year's level (figure 18-1). This growth rate was slower than the 5-percent average annual increase recorded during 1992-96. U.S. cross-border imports of transportation services, which totaled \$47.2 billion in 1997, increased by 9 percent. The percentage increase was higher than the average annual growth rate of nearly 6 percent recorded during 1992-96.

Numerically, the decrease in the U.S. cross-border trade surplus stemmed from the \$4.0-billion increase in imports, which exceeded the \$1.3-billion gain in exports in 1997. As mentioned, the increase in U.S. imports of transportation services is largely attributed to an increase in airline passenger fare payments as more U.S. citizens traveled overseas on foreign airlines. Such payments rose by 15 percent in 1997, whereas U.S. passenger fare receipts increased by only 2 percent. The slower growth of U.S. passenger fare exports indicates a smaller increase in the number of foreigners traveling to the United States on U.S. airlines.⁶ In particular, the lag also reflects a significant decrease in the number of travelers to the United States from Asia. For example, U.S. passenger fare receipts from Japanese travelers, which comprised 26 percent of all such receipts in 1997, decreased by 6 percent.

Separately, U.S. receipts for "other" transportation services⁷ increased by 3 percent in 1997. The increase resulted chiefly from a 9-percent rise in the merchandise export volume of U.S. air carriers.⁸ The gain most likely derived from the growing importance of just-in-time manufacturing, and the desire of exporters to avoid intermediate warehousing and distribution costs.⁹

Leading U.S. trading partners in transportation services in 1997 included Canada, Germany, the United Kingdom, Japan, Korea, and Taiwan (figure 18-2). Of these six trading partners, the United States posted a trade surplus with Canada and Japan only, although, in both cases, the size of the surplus diminished compared to the previous

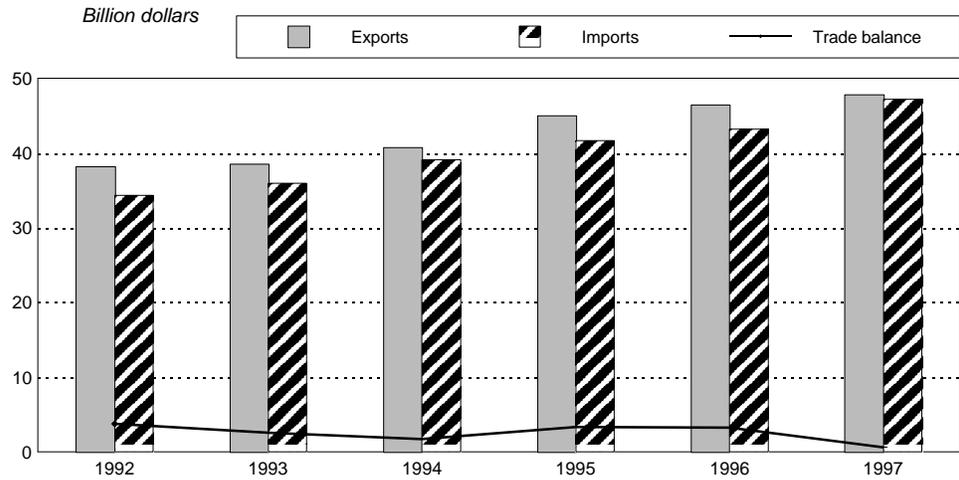
⁶ Ibid.

⁷ "Other" transportation includes both freight and port services.

⁸ USDOC, BEA, *Survey of Current Business*, Oct. 1998, p. 78.

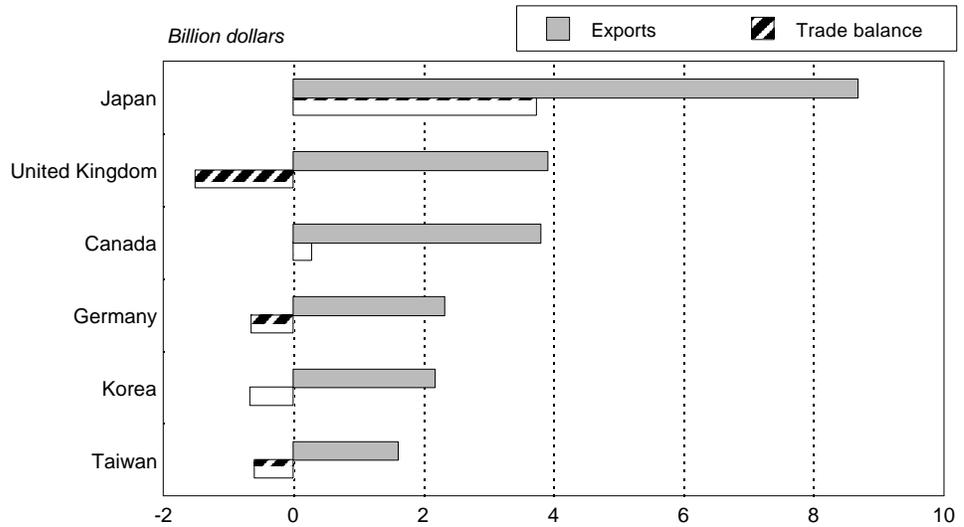
⁹ "More Shippers Moving Bulk Cargoes by Air," *Journal of Commerce*, May 26, 1998.

Figure 18-1
Transportation services: U.S. cross-border exports, imports, and trade balance, 1992-97



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1998, pp. 86-87.

Figure 18-2
Transportation services: U.S. cross-border exports and trade balance, by major trading partners, 1997



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1998, p. 93.

year's level. The decrease in the U.S. trade surplus with Canada was due to a fall in the procurement of services by Canadian airlines¹⁰ at U.S. airports, while that with Japan was attributable to a decrease in U.S. airline passenger exports. Elsewhere, U.S. exports of passenger transportation services to Germany declined by 20 percent from 1996, causing the U.S. trade balance in transportation services with Germany to shift from surplus to deficit. Similarly, the United States posted a deficit in its transportation services account with the United Kingdom. The trade balance was most impacted by a larger increase in U.S. freight transportation imports relative to exports. In East Asia, U.S. exports of passenger transportation services to Taiwan increased by 36 percent in 1997. However, U.S. imports of both passenger and freight transportation services from Taiwan continued to surpass exports, leading the United States to record a trade deficit with that country. Finally, U.S. freight services receipts from Japan and Korea also decreased, due to adverse economic conditions in both countries and a consequent decline in the volume of U.S. goods exports.

Summary and Outlook

A relatively high rate of growth in imports and a concurrent lag in the rise of exports, compared to previous years under review, resulted in a declining surplus in cross-border trade in transportation services in 1997. Data from industry sources suggest that, despite adverse economic conditions in Asia, trade in both the U.S. airline and maritime service industries will experience continued growth, albeit at slower rates than were previously forecasted.¹¹ Globally, air passenger traffic is anticipated to expand at an average annual rate of 5 percent during 1998-2007. Growth in air cargo traffic, on the other hand, is estimated at 6 percent per year.¹² Further, for container shipping, U.S. worldwide exports are forecasted to grow 6 percent by volume¹³ in 1999.¹⁴

¹⁰ Port services include aircraft handling and terminal services, such as aircraft repair, maintenance, storage, and cleaning, as well as expenses covering fuel, wages and salaries paid to employees in the United States, agents' and brokers' fees and commissions, and aircraft leasing. USDOC, BEA, "U.S. International Transactions in Private Services: A Guide to the Surveys Conducted by the Bureau of Economic Analysis," Mar. 1998, p. 117.

¹¹ In March 1998, the International Air Transport Association (IATA) revised its forecasts on growth in air passenger and cargo traffic in the Asia-Pacific region. For the period 1997-2001, passenger traffic growth, which was originally projected at 7.7 percent, was revised downward to 4.4 percent per year, while cargo traffic forecasts were lowered from 9 percent to 6.5 percent per annum. IATA, *Annual Report 1998*, found at Internet address <http://www.iata.org/>, retrieved Aug. 5, 1998.

¹² Forecasts are predicated on annual worldwide economic growth of 2.9 percent during 1998-2007. Boeing, *Current Market Outlook—State of the Industry*, found at Internet address <http://www.boeing.com/>, retrieved Aug. 4, 1998.

¹³ Export volumes are assessed in 20-foot equivalent units (TEUs), a standard unit of measurement used to indicate container vessel capacity.

¹⁴ By comparison, U.S. worldwide containerized exports in 1998 are estimated to decline by 0.5 percent, principally due to a 30-percent fall in exports to Southeast Asia. "U.S. Containerized Exports to the World in TEUs," Trade Horizons, *PIERS/Journal of Commerce*, Summer 1998.

The future course of trade in the U.S. airline and maritime service industries presently appears likely to be influenced by three principal factors. Broadly, these factors include the repercussions of the Asian financial crisis; advances towards industry deregulation at home and liberalization abroad; and worldwide industry consolidation.

The Effects of the Asia Crisis

The Asia crisis has produced significant changes in both the U.S. airline and maritime industries. For shipping firms, the reasons for such changes are twofold. On the one hand, currency devaluations, along with substantially weakened economies, have reduced demand for U.S. merchandise exports to Asia. On the other, a decline in the price of Asian manufactures has augmented U.S. demand for such goods. Consequently, U.S. shipping lines have had to contend with excess capacity on westbound trades¹⁵ and lack of capacity on ships returning eastbound from Asia. The cost of repositioning empty containers, together with depressed freight rates on westbound trades, have adversely affected the financial performance of U.S. container shipping lines.¹⁶ For example, one U.S. shipping firm reported a 12-percent drop in transpacific revenue in the first three quarters of 1998.¹⁷ A persistent lag in the demand for U.S. goods exports to Asia is likely to further decrease U.S. freight receipts from the region.¹⁸ Moreover, recent endeavors by U.S. shipping lines to raise rates on capacity-filled eastbound trade may be unsuccessful in the long term. One industry expert notes that, historically, it has been difficult to sustain such rate increases given the competitive environment of international shipping.¹⁹ Finally, falling capacity utilization on Asia-bound ships may cause some carriers to redeploy vessels to alternative trade lanes.²⁰

The air transport industry has been similarly affected by economic conditions in Asia. For instance, passenger traffic on both transpacific and intra-Asian routes has declined, leading some U.S. airlines to eliminate flights to the region. The impact of the crisis on air cargo operations has been mixed. Lower demand for U.S. goods exports has caused both passenger and all-cargo airlines to depress rates for cargo on westbound flights.²¹ Concurrently, air carriers have benefitted from capacity shortages on eastbound ocean vessels, causing some importers to divert merchandise shipments to air carriage.²² In the near term, as the effects of the Asia crisis continue to reverberate throughout the Asia-Pacific region, it is likely that westbound shipping traffic will continue to experience pronounced overcapacity, and that air passenger and cargo operations will

¹⁵ For the purposes of this discussion, “westbound” trade refers to the transpacific movement of U.S. goods exports to Asia, whereas “eastbound” trade denotes the transport of U.S. goods imports from Asia.

¹⁶ “Ship Lines Try to Make Sense of the Pacific,” *Journal of Commerce*, Sept. 23, 1998.

¹⁷ CSX Corporation and Subsidiaries, *Quarterly Flash*, Jan.- Sept. 1998, found at Internet address <http://www.sealand.com/>, retrieved Oct. 27, 1998.

¹⁸ “Ocean Carriers Want Big Payback,” *Purchasing*, July 16, 1998, p. 98.

¹⁹ Industry representative, telephone interview by USITC staff, Oct. 22, 1998.

²⁰ “Carriers from Asia Consider at Least \$500-a-Box Increase,” *Journal of Commerce*, Oct. 22, 1998.

²¹ “Shippers Pay Top Dollar to Send Goods East by Air,” *Journal of Commerce*, Sept. 15, 1998.

²² “Airborne Exports Rebound--Sort of,” *Journal of Commerce*, Sept. 15, 1998.

continue to experience depressed revenues. Longer term, industry experts indicate that the rejuvenation of transpacific air passenger travel and shipping volume will likely depend on the recovery of key Asian economies such as Japan's.²³

Deregulation at Home and Liberalization Abroad

Deregulation of the U.S. shipping industry could advance the global competitiveness of U.S. ocean carriers. In particular, one deregulatory measure, the Ocean Shipping Reform Act of 1998, brings the U.S. industry into closer alignment with the practices of shipping companies in other parts of the world.²⁴ Illustratively, the 1998 law grants individual conference carriers²⁵ the right to enter into confidential service contracts with shippers. Further, such carriers are no longer required to file their shipping rates with the government, but must publish price lists in automated tariff systems that are accessible to the public. The law will enable carriers to tailor their terms of contracts, including shipping rates, to suit different customers. Previously, most independent carriers used uniform contracts developed by large shipping conferences.²⁶ In the short term, the law will likely lead to more vigorous price competition among ocean carriers, particularly in major east-west and north-south trades.²⁷ More permanently, however, the legislation will likely result in the proliferation of long-term contracts between carriers and shippers, and improve the ability of U.S. shipping lines to acquire greater market share.²⁸

Although the U.S. domestic airline industry underwent deregulation 20 years ago, efforts by the U.S. Government to encourage the liberalization of the international aviation market have been most notable in the past few years. For example, in 1997, the United States negotiated 15 "open skies" agreements²⁹ with foreign countries, allowing U.S. carriers to transport passengers and cargo between second- and third-country markets. In the first half of 1998, the United States signed an additional six bilateral air service agreements, including those with Japan and Korea, the United States' top two air transport markets in Asia.³⁰ In Europe, domestic deregulation of the

²³ "Riding the Roller Coaster," *Journal of Commerce*, Sept. 8, 1998.

²⁴ Industry representative, telephone interview by USITC staff, Oct. 16, 1998.

²⁵ Shipping conferences are groups of ship lines which collectively set rates and vessel capacity for geographically based trades.

²⁶ "Shippers Eager for May 1 and Tailor-Made Contracts," *Journal of Commerce*, Feb. 26, 1999.

²⁷ Industry representative, telephone interview by USITC staff, Oct. 16, 1998; and "Clinton Signs Ship-Reform Bill," *Journal of Commerce*, Oct. 16, 1998.

²⁸ Industry representative, telephone interview by USITC staff, Oct. 16, 1998.

²⁹ Open skies agreements remove fare and route restrictions on service between signatory countries, and allow airlines to fly beyond each other's territory to third-country markets.

³⁰ Although the U.S.-Japan bilateral agreement does not eliminate all restrictions on airline service, it does allow U.S. passenger and cargo carriers to add flights to Japan, as well as to expand service from Japan to third-country destinations. The U.S. open skies agreement with Korea, on the other hand, permits the full liberalization of air transport between the two countries.

European Union's³¹ aviation market has led to full cabotage rights for all EU-member airlines. From April 1, 1997, such rights have allowed EU-licensed carriers to fly unrestricted on any route inside the European Union. Plans for the development of a multilateral aviation agreement, representing all EU members, could hamper future U.S. efforts to negotiate separate open skies agreements with European countries.³² However, the United States currently has open skies agreements with eight EU members³³ and, in April 1998, negotiated major liberalization in a new bilateral air service agreement with France.³⁴

Globalization and Industry Consolidation

Industry consolidation, through mergers and cross-border alliances, has occurred in both the shipping and airline industries. Mergers among shipping lines have been prompted by the capital and labor intensive nature of the shipping industry, and an increasing tendency towards cost competition among ocean carriers.³⁵ Overcapacity on certain trade lanes, due to the Asian economic crisis, has further encouraged consolidation. More recently, the industry has seen the emergence of strategic alliances³⁶ among groups of large container carriers that enable shipping lines to extend service networks worldwide.³⁷ Such alliances have also invested in megaships, or large containerships, which allow cargo carriers to achieve economies of scale.³⁸ Industry consolidation will

³¹ The European Union comprises 15 member-countries including Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, and the United Kingdom.

³² Lois Jones, "When the Going Gets Tough...," *Airline Business*, May 1998, p. 27.

³³ As of June 1998, the United States had concluded open skies agreements with Austria, Belgium, Denmark, Germany, Finland, Luxembourg, the Netherlands, and Sweden. The three largest EU markets in terms of U.S. passenger fare receipts are, in descending order, the United Kingdom, Germany, and France. In 1997, these three countries collectively accounted for 66 percent of U.S. passenger fare receipts from Europe and 21 percent of U.S. receipts worldwide.

³⁴ U.S. Department of Transportation, Office of the Assistant Secretary for Aviation and International Affairs, "Bilateral Aviation Agreements," found at Internet address <http://ostpxweb.dot.gov/>, retrieved Sept. 3, 1998.

³⁵ In November 1997, Singapore-based Neptune Orient Lines Ltd. merged with U.S. firm APL Ltd. to form one of the world's five largest container shipping lines. The merger has left only one remaining major container carrier that is U.S.-owned. Tim Minahan, "Carriers United to Lower Costs, Improve Service," *Purchasing*, May 22, 1997, p. 67.

³⁶ Whereas a strategic alliance among global carriers operates in multiple trade lanes, a shipping conference typically operates in only one trade lane. Further, unlike in shipping conferences, carriers in global alliances share vessel ownership and cargo terminals, and they may also combine feeder networks and intermodal operations. Richard L. Clarke, "An Analysis of the International Ocean Shipping Conference System," *Transportation Journal*, Summer 1997, pp. 17-29.

³⁷ Jim Dow, "Expect More Vessel Sharing, More Mergers, More Acquisitions," *Journal of Commerce*, Sept. 23, 1998.

³⁸ Susan Dienshouse, "Raising the Stakes on the Waterfront," *New York Times*, Nov. 22, 1998, p. 4.

likely result in improved efficiency among shipping firms. In the long term, shipping conferences may be replaced by global carrier alliances.³⁹

Deregulation and a subsequent intensification of price competition have driven alliance formation among air carriers. Through code-sharing alliances,⁴⁰ airlines can expand their route service without incurring additional expenditures for aircraft and crew. When such alliances take place among carriers of separate nationalities, airlines may also circumvent market access restrictions in foreign countries. In the U.S. market, strategic alliances⁴¹ have been proposed by pairs of six major U.S. carriers.⁴² Should the alliances receive antitrust approval, the airlines would collectively control 85 percent of domestic routes.⁴³ Global partnerships could dominate the worldwide market in much the same way. For example, four international alliances, each consisting of four or more carriers, could account for over 80 percent of the global aviation market.⁴⁴ Although these alliances may result in cost efficiencies and enhanced service, they may also protect the industry from new entrants and, consequently, engender higher fares for air travelers.⁴⁵

³⁹ “Bargains Across the Atlantic,” *Purchasing*, Mar. 20, 1997, p. 36; and “Clinton Signs Ship-Reform Bill,” *Journal of Commerce*.

⁴⁰ Code sharing permits the integration of two or more airlines’ flights under a single code, and affords their connecting flights favored treatment in computer reservation systems.

⁴¹ A strategic alliance is distinct from an arms-length contract, or marketing alliance, between two or more carriers. In strategic alliances, airlines not only coordinate schedules, fares, and frequent flier programs to provide customers with “seamless” service, but also share assets such as aircraft, routes, and personnel as part of a mutual alignment of business objectives. “Airline Strategic Alliances: Definition and a Case for Caution,” *Transportation Advisor*, vol. 3, No. 1, GRA, Inc., Jan. 1993, found at Internet address <http://gra-inc.com/>, retrieved Sept. 21, 1998.

⁴² Scott McCartney, “Airline Agreements Encounter Some Turbulence,” *Wall Street Journal*, Aug. 24, 1998.

⁴³ “Come Fly with Me,” *The Economist*, June 20, 1998, p. 69.

⁴⁴ As of this writing, the two largest global alliances are oneworld, which includes, among others, American Airlines, US Airways, Canadian Airlines, British Airways, and Japan Airlines, and the Star Alliance, which includes United Airlines, Lufthansa, Air Canada, All Nippon Airways, and others. “Alliances in the Skies,” *The Economist*, Sept. 26, 1998, p. 68.

⁴⁵ “One World, Few Airlines,” *The Economist*, Sept. 26, 1998, p. 19.

CHAPTER 19

TRAVEL AND TOURISM SERVICES

Introduction

Trade in travel and tourism services encompasses expenditures made by travelers while in another country, such as for lodging and meals. Expenditures in the United States by foreign visitors are counted in the current account of the U.S. balance of payments as U.S. cross-border exports, while expenditures abroad by travelers from the United States are U.S. cross-border imports. Although passenger fares may be considered a component of travel and tourism revenues, such fares fall outside the scope of this discussion. Passenger fares are addressed in the previous discussion of transportation services. Travel and tourism services are traded mainly through cross-border channels, although transactions also transpire through affiliates.

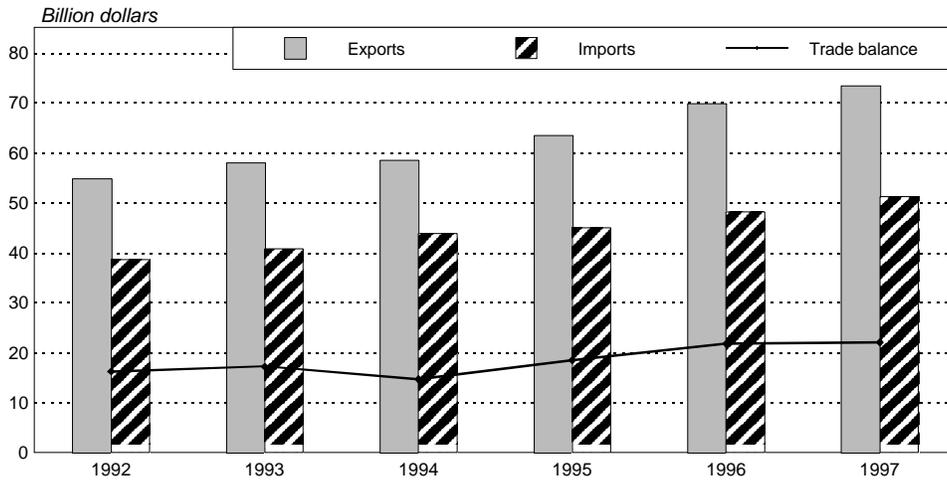
Recent Trends

Cross-Border Trade, 1992-97

In 1997, the United States earned \$73.3 billion from cross-border travel and tourism exports (figure 19-1), representing 31 percent of total U.S. service exports. Cross-border exports increased by 5 percent in 1997, slightly slower than the 6-percent average annual growth rate during 1992-96. Cross-border imports grew by 7 percent to \$51.2 billion in 1997, slightly faster than the 6-percent average annual growth rate during 1992-96. The resulting U.S. surplus of \$22 billion in 1997 grew by 2 percent, slower than the 8 percent average annual growth rate during 1992-96 (despite a 15-percent decline in the surplus in 1994).

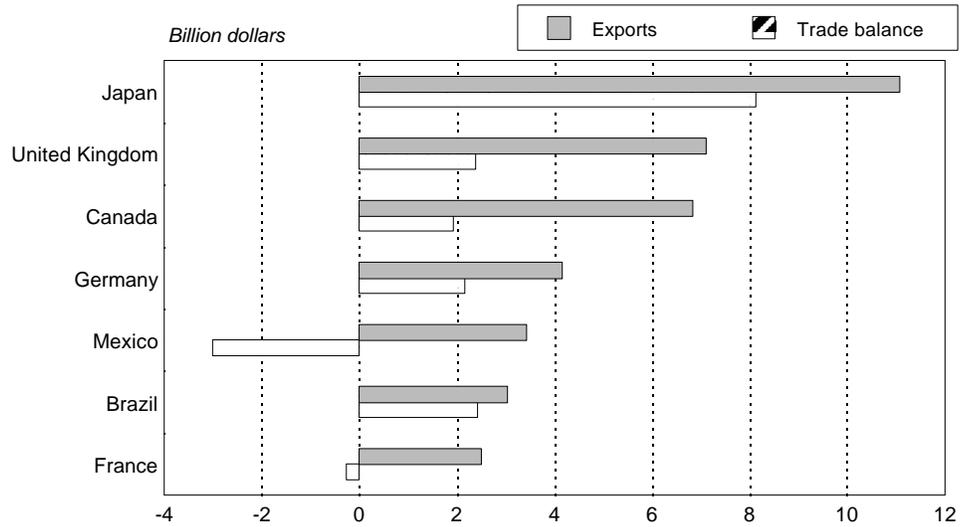
Visitors from Japan, the United Kingdom, Canada, Germany, Mexico, Brazil, and France, ranked in descending order by expenditures in the United States, accounted for slightly above one-half of U.S. cross-border travel and tourism exports in 1997 (figure 19-2). The United States recorded a travel and tourism trade surplus with all these countries except Mexico and France. Japan accounted for by far the largest U.S. surplus in such services, at \$8.1 billion. However, the surplus with Japan fell by 9 percent in 1997. Japanese travelers' expenditures in the United States fell by 6 percent in 1997, reversing the 6-percent average annual growth rate during 1992-96, and indicating that Japan's recession and the U.S. dollar's strength against the yen significantly affected U.S. travel and tourism receipts from Japan. Arrival data indicate that although the 5.4 million Japanese-resident arrivals in the United States in 1997 rose

Figure 19-1
Travel and tourism services: U.S. cross-border exports, imports, and trade balance, 1992-97



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1998, pp. 86-87.

Figure 19-2
Travel and tourism services: U.S. cross-border exports and trade balance, by major trading partners, 1997



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1998, p. 93.

by 3 percent, this rate trailed the 13-percent increase in the previous year and the 9 percent average annual growth rate in arrivals during 1992-96.¹

U.S. travel and tourism trade with the United Kingdom expanded in both directions in 1997, although the U.S. surplus with that country fell by 10 percent, to \$2.4 billion. The 3.6-million arrivals by U.S. residents in the United Kingdom in 1997 represented a 24-percent increase from the 1996 level, while 3.7 million arrivals by British residents in the United States in 1997 represented an increase of 15 percent.²

As for Canada, U.S. imports in 1997 increased by 5 percent, while exports held virtually steady, reducing the U.S. surplus by 11 percent, to \$1.9-billion. Nevertheless, the erosion of the travel surplus with Canada in 1997 was not as steep as the 17-percent average annual rate by which the surplus fell in 1992-96, during Canada's economic lull.³

In 1997, the United States recorded a \$3-billion deficit for the second consecutive year in such trade with Mexico. The last U.S. travel and tourism surplus with Mexico was recorded in 1992. Nonetheless, U.S. travel exports to Mexico have partially recovered since the peso devaluation in late 1994. Such exports rose by 14 percent in 1997, to \$3.4 billion. Meanwhile, U.S. travel imports from Mexico in 1997 rose by 8 percent above 1996, to \$6.4 billion, at twice the average annual rate of increase during 1992-96. Ranking behind Mexico as the leading foreign destinations for U.S. travelers during 1997 were Canada (\$4.9 billion), the United Kingdom (\$4.7 billion), and Japan (\$2.9 billion).

Affiliate Transactions, 1992-96

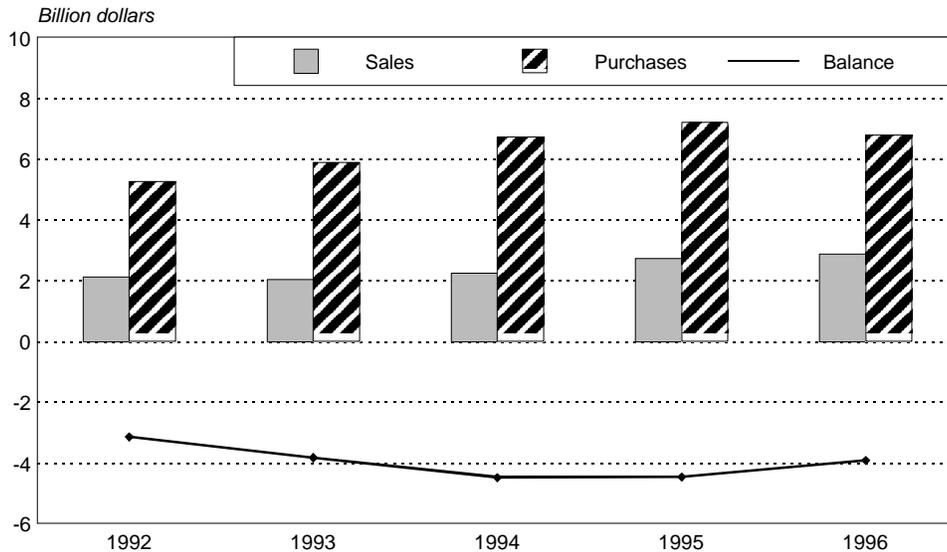
As noted, travel and tourism services are also sold through majority-owned affiliates. However, data on affiliate transactions in such services are available only for the lodging industry, comprising hotels, motels, resorts, and similar establishments. Foreign-based lodging affiliates of U.S. firms generated sales estimated at \$2.9 billion in 1996, up by 5 percent from 1995 (figure 19-3). Such growth was only about one-half as fast as the 9-percent average annual growth rate recorded during 1992-95. U.S. purchases from foreign-owned lodging affiliates in the United States in 1996 fell by 6 percent, to \$6.8 billion. This decline, due in part to divestments of lodging properties by foreign parents, reversed the course of U.S. purchases during 1992-95, which grew by 11 percent annually, on average. Thus, U.S. purchases exceeded sales in 1996 by \$3.9 billion, down 12 percent from net purchases of \$4.5 billion in 1995. The narrowing of the gap between U.S. purchases and sales in 1996 sharply contrasted with the 12-percent average annual rate of increase in net U.S. purchases recorded during 1992-95.

¹ U.S. Department of Commerce (USDOC), International Trade Administration (ITA), Tourism Industries, "Non-Resident Arrivals to the U.S. by World Region/Country of Residence, 1997," retrieved Jan. 28, 1999, and "International Arrivals to U.S. by Country of Residency, Historical Visitation, 1986-1996r," retrieved Feb. 27, 1998, found at Internet address <http://www.tinet.ita.doc.gov/>.

² Ibid.

³ Ibid.

Figure 19-3
Travel and tourism service transactions by majority-owned affiliates: U.S.
sales, purchases, and balance, 1992-96



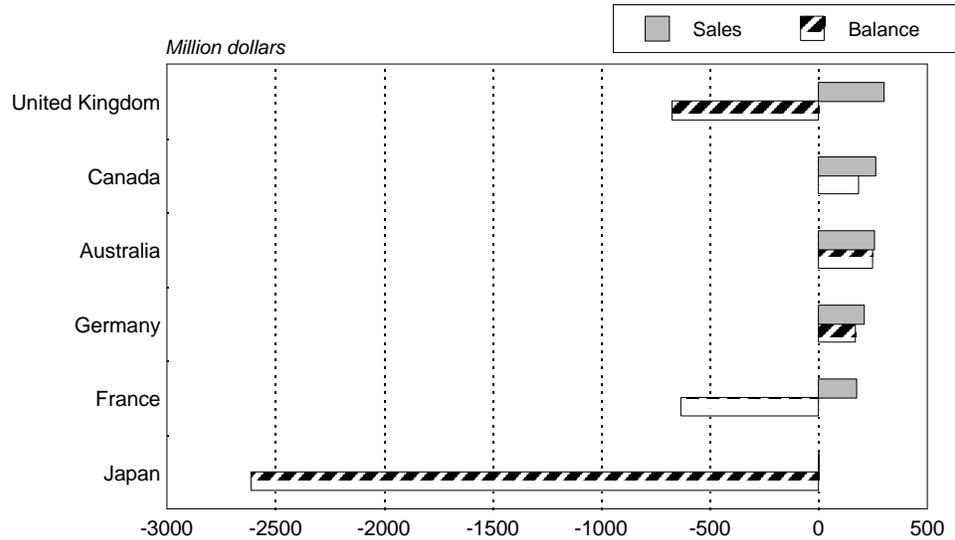
Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Sept. 1995, pp. 104-105; Nov. 1996, pp. 111-112; Oct. 1997, pp. 137-138; and Oct. 1998, pp. 115-116.

Available data indicate that U.S. sales in 1996 were highest in the United Kingdom (\$298 million), Canada (\$259 million), and Australia (\$253 million). Sales to Japan were negligible (figure 19-4). Conversely, purchases from U.S. affiliates of Japanese-owned firms amounted to \$2.6 billion, yielding by far the largest single share, 39 percent, of U.S. purchases of lodging services. British- and French-owned affiliates in the U.S. market ranked second and third in U.S. purchases, with \$972 million and \$805 million, respectively. On balance in 1996, U.S. purchases from affiliates of Japanese firms exceeded sales by Japanese affiliates of U.S. firms by \$2.6 billion, a margin virtually unchanged since 1992. U.S. purchases also surpassed sales by more than \$600 million each with respect to the United Kingdom and France. In contrast, U.S. sales exceeded purchases by margins of \$249 million with Australia and \$183 million with Canada.

Summary and Outlook

Proportional gains in U.S. cross-border trade in travel and tourism services were slightly slower for U.S. exports and faster for imports in 1997, slowing the growth rate in the sector's surplus compared to that recorded during 1992-96. Excluding visitors from Canada and Mexico, Japanese were by far the most numerous visitors to the United States and the largest contributors to the U.S. surplus in such services in 1997. Although Japanese visitors increased numerically by 4 percent, their expenditures in the U.S. market in 1997 fell by 6 percent, owing in part to the yen's weakness against the

Figure 19-4
Travel and tourism service transactions by majority-owned affiliates: U.S. sales and balance, by major trading partners, 1996



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1998, pp. 115-116.

U.S. dollar and price reductions by package tour operators seeking to sustain demand.⁴ Meanwhile, the largest U.S. deficit in travel and tourism trade, with Mexico, remained unchanged in 1997, as the rise in U.S. imports offset increased expenditures by Mexican travelers in the U.S. market.

It is likely that official statistics for the full year 1998 will report a decrease in the U.S. travel and tourism surplus, as U.S. exports fell by 4 percent while imports rose by 3 percent during January through September 1998, compared to the same period in 1997.⁵ In particular, expenditures in the United States by travelers from Asia-Pacific countries, as well as from Canada, fell, as the relatively strong U.S. dollar relative to other currencies eroded U.S. receipts and slowed travel to the United States from numerous countries. U.S. exports to Japan decreased by 15 percent during January through September 1998. The rate of expenditures in the United States by travelers from other Asian countries fell commensurately. As with data on travel receipts and payments, data on arrivals in the United States during the first nine months of 1998 indicate downturns from Asia.⁶ Overall, such arrivals from Asia fell by 14 percent below the comparable 1997 period. Available data show arrivals from Korea down by 56 percent, Taiwan, 14 percent, and Japan, 8 percent. In countries experiencing rapid or widely fluctuating currency outflows, stock market declines, and currency devaluations, measures were taken to stem the flight of local currency. Such measures included those intended to curtail

⁴ "Tourism and Leisure: More Work, Less Income Make for Dull Market," *Japan Economic Almanac 1998* (Tokyo: Nihon Keizai Shimbun, Inc., 1998), p. 126.

⁵ USDOC, Bureau of Economic Analysis (BEA), "U.S. International Transactions," *Survey of Current Business*, July 1998 and Jan. 1999.

⁶ USDOC, ITA, Tourism Industries, "Non-Resident Arrivals to the U.S. by World Region/Country of Residence, 1998," found at Internet address <http://www.tinet.ita.doc.gov/>, retrieved Jan. 22, 1999.

outbound travel, such as Indonesia's 300-percent increase in its air departure tax.⁷

Canadian travelers decreased spending in the U.S. market by almost 10 percent through September 1998, as 12-percent fewer travelers arrived from Canada.⁸ Although the weak Canadian dollar was thought to be the major factor in the decline, travel from Canada to countries other than the United States increased during the same period. Meanwhile, U.S. imports from Canada increased by more than 20 percent through September 1998, as strong economic conditions in the U.S. market, the low Canadian dollar, a new open skies agreement between the two countries, and Canadian tourism promotion likely combined to attract substantially more visitors from the United States.⁹

Indicators of travel and tourism trade with Latin American countries in partial-year 1998 are mixed. U.S. exports to Latin America and other countries in the hemisphere rose by 3 percent in the first 9 months of 1998, compared to the same period in 1997.¹⁰ U.S. arrivals from Mexico during January through September 1998 rose by 19 percent, and Venezuela, by 12 percent. However, arrivals from Brazil fell by 6 percent, reversing the pattern of arrivals from that country in recent years.¹¹

With regard to affiliate transactions, U.S. hotel firms have stepped up construction and acquisition activity in foreign markets, just as in the domestic market, in recent years. Total assets by U.S. hotel firms increased by 29 percent in 1996, to \$3.3 billion, and capital expenditures almost doubled, to \$2.1 billion.¹² Foreign activity by U.S. hotel firms has proliferated in developed as well as developing countries. Parent firms, well capitalized by several years of rising profits and revenues per available room,¹³ spurred expansion. In Europe, where approximately 75 percent of the hotels reportedly are independently owned,¹⁴ large U.S. hotel firms expanded operations.

Meanwhile, foreign direct investment in the U.S. lodging market decreased during 1994-97, declining by 8 percent in 1996 and 1997.¹⁵ The dominant foreign presence in the U.S.

⁷ "Executive Travel in Asia This Week," *Asia Pulse*, Feb. 4, 1998, found on NewsEdge/Web, retrieved Feb. 5, 1998.

⁸ USDOC, ITA, Tourism Industries, "Canadian Arrivals Continue Double Digit Decline; Is It Exchange Rate or Does Marketing Strategy Need an Upgrade?" news announcement, Dec. 3, 1998.

⁹ Ibid.

¹⁰ USDOC, BEA, "U.S. International Transactions, First Quarter 1998," and "U.S. International Transactions, Third Quarter 1998," *Survey of Current Business*, July 1998 and January 1999, respectively.

¹¹ USDOC, ITA, Tourism Industries, "Canadian Arrivals Continue Double Digit Decline; Is It Exchange Rate or Does Marketing Strategy Need an Upgrade?" news announcement, Dec. 3, 1998.

¹² USDOC, BEA, "U.S. Multinational Companies, Operations in 1996," *Survey of Current Business*, Sept. 1998, pp. 66-67.

¹³ Standard & Poor's, "Industry Surveys: Lodging & Gaming," Aug. 27, 1998.

¹⁴ "In European Hotel Business, Everybody is Going Global," *New York Times*, Oct. 3, 1997.

¹⁵ USDOC, BEA, "Foreign Direct Investment in the United States," *Survey of Current Business*, June 1998 and June 1997.

market, Japanese firms, experienced a 2-percent decline in gross product¹⁶ at U.S. lodging affiliates in 1996, and reportedly sold numerous hotels they had purchased or developed to U.S. investors.¹⁷ More recently, as the divestment of U.S. hotels by Japanese firms continued in 1997 and 1998, U.S. firms stepped up lodging acquisitions in Asian markets. For example, in 1997, Marriott acquired Renaissance Hotels, a company with sizable holdings in Asia. U.S. positions have increased in Asian hotel firms unable to raise sufficient capital on their own during the 1997-98 financial market crisis.¹⁸ For U.S. firms willing to ride out the financial distress in Asia and elsewhere, the opportunity to acquire new properties is likely to be significant. Investors from other nations are also looking to acquire Asian properties, as well. For example, in 1998, Bass PLC, the British firm that owns Holiday Inns, won the competitive bidding against Marriott and other firms to acquire the Inter-Continental Hotel and Resorts chain of 117 upscale hotels, formerly owned by Saisa Group of Japan.

¹⁶ With respect to U.S. lodging affiliates, gross product reflects the contribution by such affiliates to U.S. gross domestic product. The latter measures goods and services produced by labor and property in the United States. USDOC, BEA, *Survey of Current Business*, Sept. 1998, p. 48.

¹⁷ "U.S. investors buying Hawaiian hotels," *Hotel and Motel Management*, July 20, 1998.

¹⁸ "Reversal of Fortunes: Study Finds U.S. Investors Spent \$10 Billion in Asian Property-Buying Spree," *Wall Street Journal*, Nov. 18, 1998.

CHAPTER 20

WHOLESALE SERVICES

Introduction

Wholesalers serve as intermediaries, purchasing merchandise from manufacturers that they subsequently resell to retailers. Frequently established by parent manufacturing concerns, wholesaling firms also act as representatives of the parent in foreign markets. Often, wholesaling affiliates license patents and trademarks to foreign retailers in exchange for royalties and license fees (see discussion of intangible intellectual property). The majority of wholesaling transactions take place through foreign-based affiliates. For this reason, data collection agencies focus solely on affiliate transactions. These data capture sales of all services, whether incidental or nonincidental to wholesaling. Nonincidental services provided by wholesalers could include the provision of credit management services; extension of credit; assembly, installation, and delivery of products; maintenance and repair services; and, with respect to computer wholesalers, systems integration services. Transactions data do not reflect the sales of goods.

Recent Trends in Affiliate Transactions, 1992-96

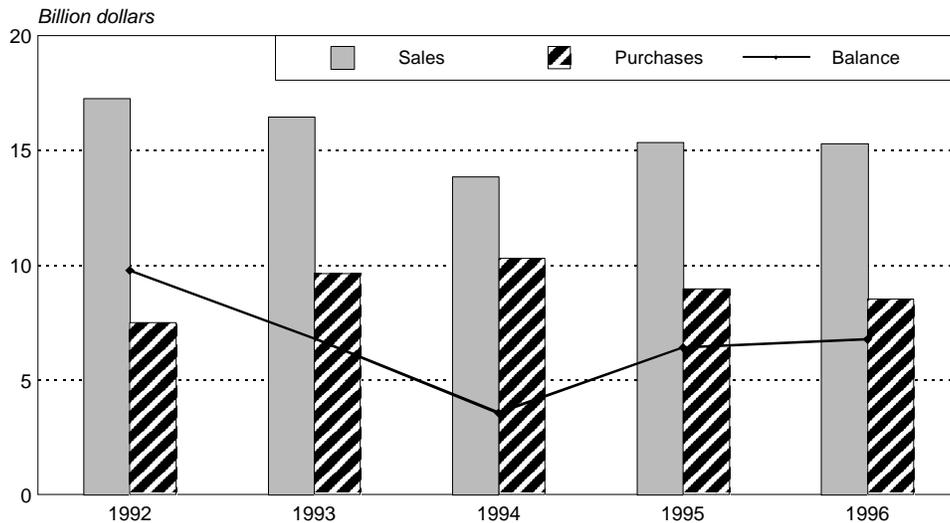
In 1996, sales of services by wholesaling affiliates of U.S. firms totaled \$15.3 billion, while U.S. purchases from U.S.-based affiliates of foreign firms amounted to \$8.5 billion (figure 20-1). These values represent 7 percent and 5 percent of total sales and purchases through affiliates, respectively.

Sales of services by wholesaling affiliates of U.S. firms declined slightly, by 0.4 percent, in 1996, reflecting weaker economic growth abroad. This was markedly slower than the overall downward trend recorded during 1992-95, when sales declined at an average annual rate of 4 percent (except for an increase in 1995).¹ Purchases from U.S.-based affiliates of foreign firms declined by 5 percent in 1996, as a result of an apparent change in reporting by foreign-owned affiliates. This reversed 6-percent average annual growth experienced during 1992-95 (despite the decrease registered in 1995). As a consequence, the surplus was \$6.8 billion, a 6-percent increase from the year before.

General economic conditions and direct investment through affiliates most significantly influence the volume of wholesaling transactions. Slower economic growth abroad appears to explain the slight decrease in sales recorded during 1996, despite the

¹ The Commission calculates the average annual rate of change by using the standard statistical method employed in calculating compound interest.

Figure 20-1
Wholesale service transactions by majority-owned affiliates: U.S. sales, purchases, and balance, 1992-96



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Sept. 1995, pp. 104-105; Nov. 1996, pp. 111-112; Oct. 1997, pp. 137-136; and Oct. 1998, pp. 115-116.

establishment overseas of 51 new U.S.-owned wholesaling affiliates that year.² Evidently, slower economic growth in key markets, particularly in the European Union, where growth slowed from 2.4 percent in 1995 to 1.8 percent in 1996,³ exerted a somewhat stronger influence over affiliate sales than did the acquisition and establishment of additional wholesaling affiliates.

The 5-percent decline in purchases of services from foreign-owned wholesaling affiliates appears to stem from a change in the product mix of foreign-owned wholesaling affiliates. These affiliates evidently identified a larger proportion of their total sales as sales of goods rather than sales of services in 1996. The decrease in purchases is attributed to an apparent change in product mix because a faster growing U.S. economy in 1996,⁴ combined with the foreign acquisition and establishment of over 5,000 wholesaling affiliates in the United States in 1996,⁵ would have tended to result in an increase of U.S. purchases of services, all else being equal.

The United States recorded a surplus on wholesaling transactions with most countries. However, deficits of \$3.6 billion and \$1.8 billion were recorded with Japan and Germany, respectively (figure 20-2). Wholesaling affiliates with parents in these two countries accounted for most purchases by U.S. residents, with Japan responsible for 57

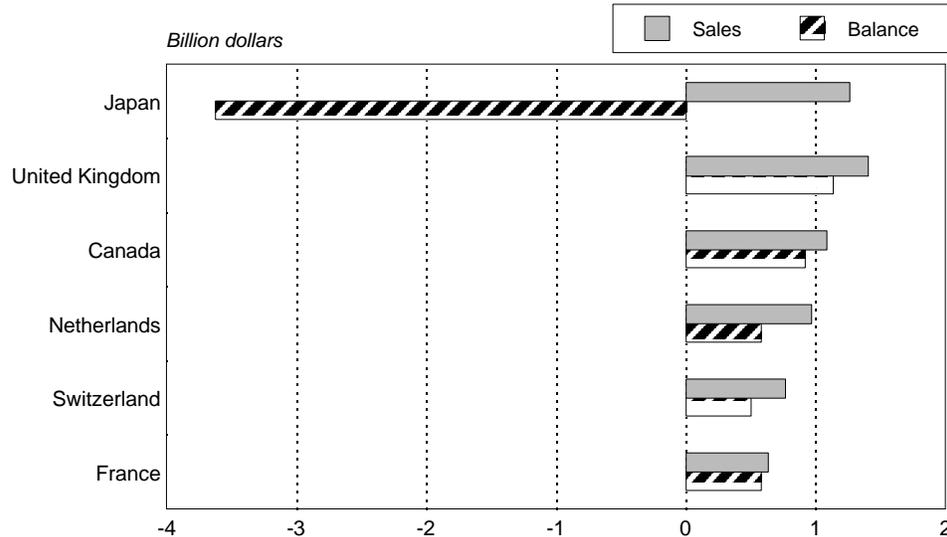
² U.S. Department of Commerce (USDOC), Bureau of Economic of Analysis (BEA), *Survey of Current Business*, Sept. 1998, p. 59.

³ United Nations, *World Economic and Social Survey, 1998* (New York: United Nations, 1998), p. 126.

⁴ Ibid.

⁵ USDOC, BEA, *Survey of Current Business*, June 1997, p. 59.

Figure 20-2
Wholesale service transactions by majority-owned affiliates: U.S. sales and balance, by major trading partners, 1996



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1998, pp. 115-116.

percent and Germany for 27 percent. In 1996, the United Kingdom displaced Japan as the largest market for U.S.-owned wholesaling affiliates. These affiliates registered sales of \$1.4 billion in the United Kingdom, accounting for 9 percent of total U.S. sales by wholesaling affiliates. U.S.-owned wholesaling affiliates in Japan and Canada recorded sales of \$1.3 billion and \$1.1 billion, respectively, accounting for 8 percent and 7 percent of total sales by all such affiliates.⁶

Summary and Outlook

In 1996, sales of wholesaling services by affiliates of U.S. firms declined slightly, while purchases of services from wholesaling affiliates of foreign firms declined by 5 percent. Declining sales can be most attributed to slow growth in key markets, especially the European Union, while declining purchases of services by U.S. residents appears to be rooted in a change in the mix of goods and services offered by foreign-owned wholesaling affiliates.

Wholesaling affiliates established by U.S. manufacturers of commercial equipment, including computers, computer peripherals, and medical equipment, are most active in foreign services markets. According to Ingram Micro, a large U.S. microcomputer products distributor, certain foreign markets for computer products are less mature and are growing more rapidly than the U.S. market, offering growth opportunities for U.S.

⁶ USDOC, BEA, *Survey of Current Business*, Oct. 1998, pp. 14-15.

computer wholesalers who move abroad.⁷ Ingram Micro recently expanded its presence in Latin America, Asia, and Europe.⁸ Since U.S. manufacturers of professional and commercial equipment enjoy a relatively strong competitive position internationally, foreign-based wholesale affiliates of these firms will likely continue to increase sales of incidental services abroad.

However, sales of equipment, and hence services, are heavily influenced by economic factors such as currency fluctuations, disposable income levels, domestic demand, and overall economic growth. Weak economic conditions due to the lingering currency crisis in the Asia-Pacific region have clouded the outlook for sales of services by affiliates of U.S. wholesalers. The currency devaluations that occurred in Thailand, Malaysia, and Indonesia during 1997-98 caused the relative prices of U.S. products exported to these countries to increase, which in turn reduced sales of goods and services through wholesaling affiliates of U.S. firms.

Another major factor affecting affiliate transactions is the relative ability of foreign firms to acquire or establish a commercial presence. Many countries continue to restrict foreign investment. For example, China generally does not permit foreign firms to engage in wholesaling or distribution, although it is experimenting with foreign-owned distribution facilities in Shanghai.⁹ On the other hand, there are some countries where the market for distribution services has improved. For example, in November 1997, Indonesia changed its distribution regulations, such that foreign manufacturers may now decide how their products are distributed, either by themselves, through an Indonesian distributor, or through another foreign firm granted a license to distribute products.¹⁰

The trend toward consolidation among wholesalers will also continue to affect international performance.¹¹ Retailers are pressing wholesalers to reduce costs and offer a larger product assortment. In addition, manufacturers are using fewer wholesale distributors and retailers are under pressure to reduce their supplier base.¹² In response, wholesalers have undertaken mergers and acquisitions to ensure their survival. In particular, the computer products wholesaling industry has recently experienced rapid

⁷ Ingram Micro, Form 10-K, found at Internet address <http://www.sec.gov/>, retrieved Dec. 7, 1998.

⁸ Ibid.

⁹ Justin Zubrod, Robert Tasiaux, and Alan Beebe, "The Challenges of Logistics Within Asia," *T&D*, Feb. 1996, p. 86; and USDOC, "IMI -- China 1998 Investment Climate Statement," Zyfind Database, retrieved Nov. 5, 1998.

¹⁰ "New Wholesale/Distribution Regs," *East Asian Executive Reports*, Oct. 15, 1997, found at Internet address <http://proquest.umi.com/>, retrieved Nov. 5, 1998; and USDOC, "Indonesia - New Wholesale/Distribution Regs - IMI971125," STAT-USA database, found at Internet address <http://www.domino.stat-usa.gov/>, retrieved Dec. 9, 1998.

¹¹ The wholesaling industry is second only to banking in merger and acquisition activity. Adam J. Fein, "Wholesale Distribution's Bright Future," IBM Wholesale Distribution Consultants' Corner, found at Internet address <http://wholesaledistribution.services.ibm.com/>, retrieved Dec. 7, 1998.

¹² "Can Consolidation Continue?" *Purchasing*, Oct. 23, 1997, found at Internet address <http://proquest.umi.com/>, retrieved Dec. 4, 1998.

consolidation, strongly influencing market share leadership and cost efficiency.¹³ Ingram Micro, for instance, has pursued a “growth-through-acquisition” global strategy.¹⁴ In 1997, Ingram Micro acquired Computacio Tecnica SA and its affiliate companies in Brazil, Miami, Florida, and Peru.¹⁵ Tech Data Corporation acquired Computer 2000 AG, a German firm, in 1998, significantly increasing its global presence and making it one of the top distributors in Europe. Tech Data sold its previous German subsidiary, Macrotron AG, to Ingram Micro.¹⁶

Internet use will also exert a strong influence over wholesalers in the coming years, although the ultimate consequences of this are as yet unclear. Through the Internet, wholesalers can provide consumers with round-the-clock access to product and service information, and in some cases allow them to purchase products online 24 hours per day.¹⁷ However, these capabilities also are available to manufacturers, who may be encouraged to sell directly to retailers and other consumers, bypassing wholesalers altogether.

¹³ Tech Data Corp., Form 10-K, found at Internet address <http://www.sec.gov/>, retrieved Dec. 7, 1998; and Ingram Micro, Form 10-K, found at Internet address <http://www.sec.gov/>, retrieved Dec. 7, 1998.

¹⁴ Alice LaPlante, “Case Study: Ingram Buying Spree,” *Computerworld*, Sept. 28, 1998, found at Internet address <http://proquest.umi.com/>, retrieved Dec. 8, 1998.

¹⁵ Pedro Pereira, “As Latin Markets Grow, Playing Field Shrinks,” *Computer Reseller News*, Nov. 3, 1997, found at Internet address <http://proquest.umi.com/>, retrieved Dec. 4, 1998.

¹⁶ “Tech Data Reports Record Second Quarter Results,” *PR Newswire*, Sept. 2, 1998, found at Internet address <http://today.newscast.com/>, retrieved Mar. 1, 1999; and “Tech Data Earnings Beat Expectations,” *St. Petersburg Times*, Sept. 3, 1998, found at Internet address <http://today.newscast.com/>, retrieved Mar. 1, 1999.

¹⁷ Alan Zachary, “IBM Survey - Wholesale Distribution Executives Embracing Technology to Help With Business,” found at Internet address <http://wholesaledistribution.services.ibm.com/>, retrieved Dec. 7, 1998.

CHAPTER 21

SPECIAL TOPIC: PROFESSIONAL SERVICES

The professional services sector is a diverse group of industries that includes areas such as accounting and related services; advertising services; architectural, engineering, and construction services; computer systems design and related services; health services; scientific research and development services; specialized design services; management, scientific, and technical consultancy services; and legal services. Firms in these industries provide professional and technical expertise, information, and counsel to individuals, private-sector businesses, and government institutions. This chapter briefly examines employment and pay in the professional services sector and discusses recent efforts to liberalize professional services trade.

Employment and Salaries

The professional services sector provides relatively high-salaried jobs to millions of workers. In 1997, the U.S. professional services sector employed a full-time workforce of 13.1 million, while the U.S. durable goods and non-durable goods manufacturing sectors employed 10.9 million and 7.5 million full-time workers, respectively (table 21-1). Moreover, employment in the U.S. professional services sector grew at an average annual rate of 3.1 percent during 1990-97. In comparison, employment in the U.S. durable goods and nondurable goods sectors declined, on average, by 0.1 percent and 0.4 percent, respectively, during 1990-97. Employment in the service sector, defined broadly, increased by 2.4 percent per annum, on average, during 1990-97.¹

In 1997, full-time employees in the U.S. durable goods, nondurable goods, and service sectors² earned average annual salaries of \$41,170, \$36,554, and \$32,412,³ respectively (table 21-2). The average annual salary of full-time employees in the professional

¹ U.S. Department of Commerce (USDOC), Bureau of Economic Analysis (BEA), *Survey of Current Business*, Aug. 1998, p. 80.

² Wage and employment data for the entire service sector reflect activity in construction, transportation and public utilities, wholesale trade, retail trade, finance, insurance, real estate, hotels and lodging places, personal services, business services, auto repair and services, parking, miscellaneous repair services, motion pictures, amusement and recreation services, health services, legal services, educational services, and other services.

³ Annual wages in the retail sector, which averaged \$19,562 in 1997, are considerably lower than average annual wages in other service sectors. This disproportionately low value significantly decreases the overall value of average annual wages in the service sector as a whole. When wages earned in the retail sector were excluded from this calculation, the value of annual wages in the services sector averaged \$36,917 in 1997. This value is comparable to wages earned in the nondurable goods sector.

Table 21-1
Full-time equivalent employees,¹ by sector, 1990-97

(Thousands of full-time equivalent employees)

	1990	1991	1992	1993	1994	1995	1996	1997
Durable manufacturing	10,924	10,413	10,126	10,076	10,337	10,560	10,661	10,874
Nondurable manufacturing . . .	7,691	7,591	7,545	7,586	7,676	7,628	7,503	7,465
Services	61,127	60,614	61,143	62,879	65,277	67,845	69,983	72,360
Professional services	10,511	10,800	11,235	11,574	11,870	12,241	12,685	13,056

¹ The number of full-time equivalent employees in each sector is the product of the total number of employees and the ratio of average weekly hours per employee for all employees to average weekly hours per employee on full-time schedules.

Source: Compiled by USITC staff from data found in U.S. Department of Commerce (USDOC), Bureau of Economic Analysis (BEA), *Survey of Current Business*, Aug. 1998, p. 80; and USDOC, BEA, *National Income and Product Accounts, 1929-94, 1996*, p. 30.

Table 21-2
Annual wages and salaries per full-time equivalent employee, by sector, 1990-97

(Dollars)

	1990	1991	1992	1993	1994	1995	1996	1997
Durable manufacturing	31,739	32,890	34,506	35,521	36,724	37,684	39,118	41,170
Nondurable manufacturing . . .	27,890	28,980	30,542	31,271	32,032	33,200	34,610	36,554
Services	25,568	26,438	27,785	28,698	28,930	29,809	30,992	32,412
Professional services	32,849	33,936	35,671	36,130	36,756	38,214	39,027	40,381

Source: Compiled by USITC staff from data found in U.S. Department of Commerce (USDOC), Bureau of Economic Analysis (BEA), *Survey of Current Business*, Aug. 1998, p. 81; and USDOC, BEA, *National Income and Product Accounts, 1929-94, 1996*, p. 36.

services sector,⁴ which stood at \$40,381 in 1997, is significantly higher than the average salary in the nondurable goods sector, and is comparable to wages earned in the durable goods manufacturing sector. However, between 1990 and 1997, average yearly salaries per full-time employee in the professional services sector grew by only 3.0 percent, more slowly than the average annual increases of 3.8 percent and 3.9 percent recorded in the durable and nondurable goods manufacturing sectors, respectively.

High wages and rapidly increasing employment help to explain the considerable importance that the United States has attached to liberalizing international trade in professional services. Foreign markets present U.S. professional service providers with considerable growth opportunities, and U.S. professionals have rapidly moved into

⁴ Wage and employment data for professional services include health services; legal services; and other services, including engineering, architectural, accounting, research and development, management consulting, and other professional services.

foreign markets in order to capitalize on these opportunities.⁵ During 1990-97, U.S. exports of professional services rose by an average annual rate of more than 17 percent, to \$21.3 billion (table 21-3). Imports of professional services, on the other hand, grew by 19.5 percent, to \$6.6 billion. Between 1990 and 1997, U.S. trade in professional services produced a yearly surplus that increased at an average annual rate of 16.5 percent. Overall, trade in professional services accounted for more than 18 percent of the total U.S. services trade surplus in 1997.⁶

Recent Efforts to Liberalize Professional Services Trade

Multilateral trade bodies and other fora have begun to promote development of new regulations and procedures that recognize the qualifications and facilitate the mobility of foreign professional service providers. Such activity is ongoing at the World Trade Organization (WTO), the Organization for Economic Cooperation and Development (OECD), the Asia-Pacific Economic Cooperation (APEC) forum, and under the North American Free Trade Agreement (NAFTA). Various regional economic or trade blocs, and professional organizations, both international and national, are also at work in this area, and may ultimately improve opportunities for trade in professional services. These international and professional organizations have focused primarily on improving market access and obtaining national treatment for those services which are provided by licensed professionals, such as accounting, legal, architectural, and engineering services.

WTO Working Party on Professional Services

Since 1995, the WTO's Working Party on Professional Services (WPPS)⁷ has chiefly focused on issues relating to accountancy, the priority professional service sector addressed in the Ministerial Decision on Professional Services.⁸ The Ministerial Decision called for the development of multilateral disciplines on the regulation of accounting services. These disciplines are to ensure that domestic regulatory

⁵ Everette James, "Services—U.S. Firms are Leaders in the Global Economy," *Business America*, found at Internet address <http://www.stat-usa.gov/>, retrieved Oct. 22, 1998.

⁶ USDOC, BEA, *Survey of Current Business*, July 1998, p. 59.

⁷ The WPPS is a subsidiary body of the WTO's Council for Trade in Services. As recommended in the Uruguay Round Ministerial Decision on Professional Services, the Council for Trade in Services established the WPPS, subsequently overseeing its progress and considering adoption of its work. In so doing, the Council for Trade in Services partially fulfills responsibilities to facilitate liberalization in services trade as set forth in the General Agreement on Trade in Services (GATS). The GATS and various other agreements negotiated during the Uruguay Round are annexed to the Agreement Establishing the World Trade Organization. The WTO entered into force on January 1, 1995, as the institutional foundation of the multilateral trading system.

⁸ World Trade Organization (WTO), *The Results of the Uruguay Round of Multilateral Trade Negotiations* (Geneva: WTO, 1995).

Table 21-3
Professional services: U.S. exports, imports, balance, and average annual rate of growth, 1990-97

	1990	1991	1992	1993	1994	1995 ¹	1996 ¹	1997	1990-97 ²
	<i>Million dollars</i>								<i>Percentage</i>
Exports	6,951	11,249	11,994	13,446	15,893	16,064	17,599	21,304	17.4
Imports	1,891	2,785	2,835	3,350	3,628	4,822	5,550	6,571	19.5
Balance	5,060	8,464	9,159	10,096	12,265	11,242	12,049	14,733	16.5

¹ Revised.

² Average annual rate of growth.

Source: U.S. Department of Commerce (USDOC), Bureau of Economic Analysis (BEA), International Accounts Data, found at Internet address <http://www.bea.doc.gov/bea/di1.htm>, and USDOC, BEA, *Survey of Current Business*, July 1998.

requirements are based on objective and transparent criteria;⁹ are not more burdensome than necessary to ensure quality service; and, in the case of licensing procedures, do not in themselves restrict supply of the service.¹⁰ Further, in accordance with the Ministerial Decision, the WPPS has endeavored to establish guidelines for recognizing service providers' foreign-acquired qualifications in accountancy and to monitor development of international accounting standards in cooperation with relevant international organizations.

The WPPS ultimately agreed on a set of nonbinding guidelines for mutual recognition agreements (MRAs)¹¹ in accountancy, which was then adopted by the Council for Trade in Services in May 1997. The guidelines are intended to simplify the negotiation of agreements on mutual recognition of professional qualifications, and to help third parties negotiate accession to MRAs and comparable agreements.¹² Further, the WTO indicated that the guidelines would curtail the emergence of new disparities between national recognition regimes.¹³

The WPPS has also developed disciplines for the regulation of accountancy, adopted by the Council on Trade in Services in December 1998. The WPPS developed provisions regarding the administration of licensing, qualification requirements and procedures, and technical standards for the accountancy profession. With respect to regulations in these areas, WTO members have agreed that measures should not be more trade restrictive than is necessary to fulfill legitimate objectives such as ensuring consumer protection, service

⁹ Ibid. Such criteria include competence and the ability to supply the service, as indicated in the GATS, part II (General Obligations and Disciplines), article VI (Domestic Regulation), par. 4.

¹⁰ WTO, *The Results of the Uruguay Round of Multilateral Trade Negotiations*.

¹¹ In a mutual recognition agreement on a professional service, the relevant licensing authorities accept, in whole or in part, education, experience, licensing or certification obtained in the territory of another party or parties to the agreement, in assessing the qualifications of a foreign applicant for licensing or certification.

¹² Official of the United States Trade Representative (USTR), interview with USITC staff, Apr. 23, 1998.

¹³ WTO, "WTO Adopts Guidelines for Recognition of Qualifications in the Accountancy Sector," press release, May 29, 1998.

quality, professional competence, and the profession's integrity. The disciplines apply both to governments and to professional associations. These disciplines, as well as others to be developed by the WPPS, are to be integrated into the GATS and made legally binding by the end of the next GATS negotiating round, scheduled to begin in January 2000.¹⁴ Until then, the decision by the Council on Trade in Services to adopt the accountancy regulation disciplines includes a provision under which all WTO members agree, to the fullest extent consistent with existing legislation, not to take measures inconsistent with the accountancy disciplines.

The working party has also monitored further development of internationally comparable accounting standards, by observing work underway elsewhere and encouraging WTO members to cooperate with relevant international organizations.¹⁵ The WPPS hosted informal briefing sessions on progress achieved by the International Accounting Standards Committee (IASC) in reconciling or drafting international accounting and financial reporting standards in the major areas of importance to general businesses.¹⁶ These standards, completed in 1998 and subject to review by the International Organization of Securities Commissions (IOSCO), are intended to achieve greater comparability in financial statements for cross-border transactions.¹⁷

As the WPPS prepares to pursue work beyond accountancy as outlined under its mandate, discussions continue on the scope and sequence of future work pertaining to other service industries, including professional services.¹⁸

Organization for Economic Cooperation and Development (OECD)

International trade restrictions encountered by professionals prompted the OECD to hold a series of workshops with business and government representatives, beginning in 1994. Results of these workshops were provided to the WTO for distribution to all WTO members. As an outgrowth of the first workshop, the OECD Secretariat began a study on professional services, focusing on accounting, architecture, engineering, and law. Following the second workshop in 1995, the OECD presented its findings. Designed to complement rather than duplicate activities of the WPPS, the finished work is considered the most comprehensive examination of the four professions ever conducted in OECD countries.¹⁹ The study examined professional activity in 25 member countries and compiled an inventory of regulatory measures.

¹⁴ WTO, "WTO Adopts Disciplines on Domestic Regulation for the Accountancy Sector," press release, Dec. 14, 1998.

¹⁵ The term "relevant international organizations" refers to international bodies whose membership is open to the relevant bodies of at least all WTO members. GATS, part II, art. VI (Domestic Regulation), para. 5(b).

¹⁶ International Accounting Standards Committee (IASC), "IASC Annual Review 1998: Accounting Standards Converging," found at Internet address <http://www.iasc.org.uk/>, retrieved Mar. 28, 1999.

¹⁷ For information on a comparative study of existing IASC international accounting standards and U.S. generally accepted accounting principles (GAAP) issued by the Financial Accounting Standards Board (U.S.) and others, see Internet address <http://www.rutgers.edu/accounting/>, retrieved Feb. 23, 1998.

¹⁸ Official of USTR, interviews with USITC staff, Jan. 1999.

¹⁹ Official of USTR, interview with USITC staff, Apr. 23, 1998.

At the third workshop, held in February 1997, participants analyzed regulations regarded as unnecessarily burdensome to trade in professional services. They also discussed how the regulations could be reformulated to reduce restrictiveness without sacrificing consumer protection. Workshop participants agreed on general principles, specific policy recommendations, and a work plan to advance the goal of liberalizing trade and investment in professional services. Recommendations included—

- Freedom of professional service providers to choose their own form of establishment, including incorporation, on a national treatment basis.
- Removal of restrictions on partnerships between foreign professionals and locally licensed professionals, starting with the right to form temporary associations for specific projects.
- Removal of restrictions on market access, based on nationality.
- Review and relaxation of restrictions on foreign participation in ownership of professional service firms.
- Review and relaxation of local-presence requirements, subject to adequate consumer information and professional liability guarantees.
- Cooperation of national regulatory bodies to promote recognition of foreign qualifications and competence and to develop arrangements upholding ethical standards.

Continuing joint discussions by the OECD Committee on Capital Movements and Invisible Transactions (CMIT) and the Committee on International Investment and Multinational Enterprises (CIME) focus on review of member country restrictions and reservations on cross-border trade in professional services²⁰ that may be inconsistent with the OECD Code of Liberalization of Current Invisible Operations.²¹ The OECD Secretariat agreed to prepare an outline of proposed review work, although each delegation reserved the right to decide whether to undertake such a review. Other activity may be conducted under the authority of the Working Party of the Trade

²⁰ Organization for Economic Cooperation and Development (OECD), “The OECD Codes of Liberalization,” found at Internet address <http://www.oecd.org/daf/cmim/codes/>, retrieved Sept. 30, 1998.

²¹ Under the code, OECD members agree to eliminate restrictions on current invisible transactions and transfers, referred to as current invisible operations, in a nondiscriminatory manner. Adopted December 18, 1961, the code is binding on OECD members. Additional detail about the code, including individual OECD members’ reservations to the liberalization obligations under the code, may be found at the OECD’s Internet address, <http://www.oecd.org/>.

Committee (TCWP), which is preparing papers cataloging and assessing barriers to trade and investment in professional services.²²

Beginning in 1995, OECD member countries attempted to negotiate a multilateral investment agreement (MAI), but suspended negotiations in October 1998. Although substantial progress had been made in refining basic investment principles, differences remained unresolved over the nature and extent of acceptable exceptions to the agreement, among other issues.²³ Subsequently, informal consultations continued among senior officials responsible for investment policy in OECD countries; however, there appears to be little current international consensus on a venue or timetable for future negotiations on multilateral investment. Nevertheless, a senior WTO official recently stated that it would be appropriate for WTO negotiators to consider pursuit of a framework of secure, predictable, and nondiscriminatory investment rules that could benefit both developing and developed countries.²⁴

Asia-Pacific Economic Cooperation

Beginning in 1996, Asia-Pacific Economic Cooperation (APEC) economies drafted individual action plans (IAPs) to implement objectives in 14 trade and trade-related areas, including services.²⁵ Subject to annual reviews by other APEC economies and revised continuously, the IAPs are expected to be instruments that help APEC members to establish open trade and investment in the region, by 2010 in industrialized economies and by 2020 in developing economies.²⁶

The individual action plans submitted in 1998 indicate that some countries recently have improved market access in their professional services sectors, providing U.S. firms with greater trading opportunities. Japan liberalized its legal services sector by allowing foreign legal consultants to practice third-country law, and by loosening regulations regarding the preparatory experience of such consultants.²⁷ Whereas foreign legal consultants were previously required to practice law for 5 years in one jurisdiction prior

²² U.S. Department of State telegram, "OECD Trade Working Party Sorts Out Priorities on E-Commerce, Services, and Non-Tariff Barriers," message reference No. 014081, prepared by U.S. Mission to the OECD, Paris, June 23, 1998.

²³ United States Trade Representative, "The President's 1998 Annual Report on the Trade Agreements Program," p. 152, found at Internet address <http://www.ustr.gov/>, retrieved Mar. 29, 1999.

²⁴ WTO, "The New Multilateral Trade Negotiations, the European Union, and its Developing Country Partners: An Agenda for Action," press release, Feb. 19, 1999, found at Internet address <http://www.wto.org/wto/new/>, retrieved Mar. 29, 1999.

²⁵ The 14 areas, as agreed in the Osaka Action Agenda in 1995 in Osaka, Japan, include tariffs, nontariff measures, services, investment, standards and conformance, customs procedures, intellectual property rights, competition policy, deregulation, government procurement, rules of origin, dispute mediation, mobility of business people, and implementation of Uruguay Round outcomes.

²⁶ APEC leaders reached agreement on the goal of free and open trade, known as the Bogor Declaration, in Indonesia in 1994.

²⁷ "SOM Chair's Summary Report on the 1998 Individual Action Plans--Implementation and Improvement to the IAPs," found at Internet address <http://www.apecsec.org.sg/>, retrieved Nov. 16, 1998.

to conducting business in Japan,²⁸ such lawyers are now required to have only 3 years of preparatory experience.²⁹ In Chinese Taipei, foreign attorneys will be permitted to practice international law or home-country law independently as “attorneys of foreign legal affairs.”³⁰ Such attorneys will be able to establish proprietorships, or partnerships with other attorneys of foreign legal affairs.³¹ Korea is planning to liberalize its accounting sector by modifying temporary entry restrictions that apply to CPAs, and by improving regulatory transparency. Singapore has eliminated a restriction on the foreign ownership of engineering and architectural firms. The restriction had required that not less than two-thirds of ownership in engineering and architectural firms in Singapore be held by such professionals registered in Singapore,³² which in turn required 2 years of experience there.³³

Activities scheduled by APEC for the latter half of 1999 with regard to IAPs could stimulate further consideration of liberalization in the professional services sector. By July 1, APEC economies are to submit plans to improve their IAPs. Moreover, the IAPs of five APEC economies -- the United States, Australia, Brunei, Japan, and the Philippines -- are scheduled to undergo peer review. Also, APEC senior officials are scheduled to assess the overall progress in implementing IAPs.³⁴ Accordingly, the Pacific Economic Cooperation Council (PECC)³⁵ is to review the IAP process and report to APEC ministers.³⁶

²⁸ USITC, *General Agreement on Trade in Services: Examination of Major Trading Partners' Schedules of Commitments*, USITC publication 2940, Dec. 1995, p. 7-28.

²⁹ “Japan’s Individual Action Plan (Revised Version) for Implementing the Osaka Action Agenda,” Oct. 1998, found at Internet address <http://www.apecsec.org.sg/>, retrieved Jan. 8, 1999.

³⁰ According to the individual action plan submitted by Chinese Taipei, this legal sector liberalization will occur during 1999-2000. “Chinese Taipei Individual Action Plan, Detailed Description of Actions in Specific Areas,” p. 18, found at Internet address <http://www.apecsec.org.sg/>, retrieved Jan. 12, 1998.

³¹ “Highlights of Chinese Taipei’s Individual Action Plan,” found at Internet address <http://www.apecsec.org.sg/>, retrieved Jan. 8, 1999.

³² “SOM Chair’s Summary Report on the 1998 Individual Action Plans Implementation and Improvement to the IAPs,” found at Internet address <http://www.apecsec.org.sg/>, retrieved Nov. 16, 1998.

³³ Professional registration is also open to engineers with a minimum of 10 years’ experience in any jurisdiction. “APEC Individual Action Plan, Singapore,” Oct. 1998, pp. 3(a)-5, 3(a)-6, found at Internet address <http://www.apecsec.org.sg/>, retrieved Jan. 11, 1999.

³⁴ United States Trade Representative, “The President’s 1998 Annual Report on the Trade Agreements Program,” p. 169.

³⁵ The PECC is an independent, policy-oriented organization of high-level business, academic, and government representatives from 23 Asia-Pacific economies. It is the only nongovernmental body among the official observers in APEC. For more information, see Internet address <http://www.pecc.net/>.

³⁶ U.S. Department of State telegram, “APEC Senior Officials and Related Meetings, Feb. 1-10,” message reference No. 217, prepared by U.S. Embassy, Wellington, New Zealand, Feb. 17, 1999.

North American Free Trade Agreement

The North American Free Trade Agreement (NAFTA) provides a framework intended to ensure that measures applied to members' professional services suppliers do not unnecessarily restrict trade among NAFTA countries.³⁷ Professional service providers may ultimately be affected by principles and provisions in chapters 12 and 16 of the agreement. Chapter 12 concerns, among other things, licensing and certification of professional service providers from another partner country.³⁸ Article 1210 of chapter 12 calls for the elimination of regulations that condition professional service licensing or certification on citizenship or permanent residency. Annex 1210.5 to chapter 12 calls on NAFTA partners to encourage relevant national professional bodies to develop mutually acceptable standards and criteria for licensing and certification of professional service providers and to make recommendations on mutual recognition of credentials. The annex also obligates each NAFTA partner to establish a schedule to begin work on liberalizing licensing procedures for foreign legal consultants and engineers. However, the agreement does not require harmonization of licensing procedures and qualification requirements.³⁹ Rather, providers are to be afforded the opportunity to prove that their qualifications meet those in the accreditation agreements signed with the other NAFTA members.⁴⁰

Chapter 16 provides for the temporary entry of business persons and establishes guidelines regarding measures affecting professionals, such as minimum education requirements and credentials.⁴¹ For example, NAFTA partners may not require labor market tests as a condition for temporary entry of professionals, provided that the professional complies with other existing immigration measures applicable to temporary entry and presents other documentation as required by all NAFTA partners.⁴²

As indicated below, experiences in applying NAFTA provisions to individual professional service sectors have varied. Nevertheless, the establishment of work schedules has begun to facilitate mutual recognition and the processes toward liberalizing licensing procedures in certain professions.⁴³

³⁷ Groundwork toward these steps predated NAFTA and is incorporated in the agreement, through work by various professions under the U.S.-Canada Free Trade Agreement.

³⁸ North American Free Trade Agreement Between the Government of Canada, the Government of the United Mexican States and the Government of the United States of America (NAFTA), ch. 12: Cross-Border Trade in Services, found at Internet address <http://www.sice.oas.org/trade/nafta/chap-12/>, retrieved Apr. 24, 1998.

³⁹ Officials of USTR, interviews with USITC staff, Oct. 14, 1997.

⁴⁰ Bernard Hoekman and Pierre Sauvé, "Liberalizing Trade in Services," discussion paper No. 243, World Bank, Washington, DC, 1994.

⁴¹ NAFTA, ch. 16: Temporary Entry for Business Persons, found at Internet address <http://www.sice.oas.org/trade/nafta/chap-16/>, retrieved Sept. 14, 1998.

⁴² Documents include proof of citizenship in a NAFTA country and demonstration that the professional will be engaged in the profession upon entry.

⁴³ U.S. industry representatives, interviews with USITC staff, Apr.-Sept. 1998.

Engineers--The engineering profession became the first professional service to agree on a mutual recognition document, signed by relevant bodies in June 1995.⁴⁴ Upon implementation by States and Provinces, the document would ultimately establish the basis for licensing authorities in each country to recognize temporary and permanent licensing of engineers in other partner countries. All Mexican States and Canadian Provinces reportedly have signaled their intent to implement the document, but in the United States, Texas alone has signed a letter of intent to implement the document.⁴⁵

Lawyers--In June 1998, representatives of the relevant professional bodies from each NAFTA partner⁴⁶ signed joint recommendations for the recognition of foreign legal consultants. The recommendations are intended to establish a basis for recognition of foreign legal consultants who would advise on their home country law. The recommendations also include, among other things, freedoms on associations or partnerships between lawyers practicing in their home country and foreign legal consultants.⁴⁷ The recommendations are currently under consideration by the U.S., Canadian, and Mexican Governments to determine whether the recommendations are consistent with NAFTA.

Architects--Representatives of the architectural profession agreed to develop mutually acceptable standards and criteria for recognizing the licensing and certification of architects. The objective is to attain portability of credentials such that qualified North American architects would be licensed to practice anywhere in the partner countries. As a start, a trinational team of architects was formed and visited several universities in an effort to determine the equivalence of education in the three countries. The negotiating group under NAFTA plans to build on the 1994 interrecognition agreement contained in the Architects' Annex of the U.S.-Canada Free Trade Agreement. Under the interrecognition agreement, U.S. or Canadian architects who meet certain requirements for certification of qualifications can use the certificate to prove professional competence to practice in the other country's jurisdiction, if that jurisdiction has agreed

⁴⁴ The relevant professional bodies included the United States Council for International Engineering Practice; the Canadian Council of Professional Engineers; and the Mexican Committee for the International Practice of Engineering. Industry representative, telephone interview with USITC staff, Sept. 22, 1998.

⁴⁵ Official of USDOC, telephone interview with USITC staff, Mar. 29, 1999; Steven T. Schenk, "Letter from the President, National Council of Examiners for Engineering and Surveying," *Licensure Exchange*, vol. 2, No. 4 (Aug. 1998) found at Internet address http://www.ncees.org/licensure_exchange/, retrieved Sept. 22, 1998; and industry representative, telephone interview with USITC staff, Sept. 22, 1998.

⁴⁶ The professional bodies included the Federation of Law Societies of Canada, NAFTA Committee; the Mexican Committee on the International Practice of Law; and the American Bar Association, Sections of International Law and Practice and Legal Education and Admissions to the Bar, and its affiliate, the National Conference of Bar Examiners.

⁴⁷ Industry representatives, telephone interviews with USITC staff, Sept. 22 and 23, 1998.

to register the other country's qualified applicants. As of May 1999, 41 U.S. States and 9 Canadian Provinces had filed "letters of undertaking" to accept the agreement.⁴⁸

Accountants--Initial discussions and information exchanges on education and qualifications among accounting professional bodies in the three countries have occurred for several years. Mexican professional bodies have begun to provide specific information on the preparation of Mexican students to become accountants. The information will be used to determine equivalence of education, experience, and examination relative to that in the United States and Canada.⁴⁹ Predating NAFTA activity, U.S. and Canadian accounting representatives signed a framework agreement on principles for reciprocity in 1991.⁵⁰ To date, 39 U.S. States and 9 Provinces have filed letters of intent to implement the agreement. According to the agreement, U.S. CPAs and Canadian chartered accountants are not required to take the entire professional uniform accountancy examination in the reciprocal jurisdiction, but may substitute an abbreviated examination to demonstrate knowledge of national and local legislation, standards, and practices for the jurisdiction in which licensure is sought.

Others--Surveyors, nurses, dietitians, psychologists, psychiatrists, and veterinarians are among the additional professions engaged in consultations to evaluate each NAFTA country's licensing requirements concerning education, experience, and other parameters important to mutual recognition.

Outlook

Working groups in other regional fora, such as the Association of Southeast Asian Nations (ASEAN), the Free Trade Area of the Americas (FTAA), and Mercosur, have reviewed regulatory measures affecting trade in professional services, encouraged efforts to increase mobility among business persons including professionals, or developed principles to assist the professions in gaining cooperation from regulators to speed recognition of foreign practitioners' qualifications. For example, in 1997, ASEAN economic ministers approved a protocol to implement initial commitments to provide one another preferential treatment on services trade under the 1995 ASEAN Framework Agreement on Services.

In addition, international and national bodies of professionals have begun to make significant progress in developing policies and standards for industry use in undertaking expansion of professional practice across borders. For the first time, the International

⁴⁸ Official of USTR, telephone interview with USITC staff, May 18, 1999. See also National Council of Architectural Registration Boards, "U.S.-Canadian Reciprocity," found at Internet address <http://www.ncarb.org/>.

⁴⁹ Official of USTR, telephone interview with USITC staff, July 1998.

⁵⁰ "Principles for Reciprocity" is a document signed Sept. 16, 1991, and submitted by the American Institute of Certified Public Accountants, the Canadian Institute of Chartered Accountants, and the National Association of State Boards of Accountancy, for consideration by the relevant State and Provincial licensing authorities in the United States and Canada.

Union of Architects is expected to approve such policies and standards at its conference in China in June 1999, culminating 5 years of work.⁵¹

Collectively, such activities could provide the basis for significant expansion of international trade in professional services, anticipating the next WTO multilateral trade negotiations on services beginning in year 2000. The work described above has begun to address and resolve numerous issues affecting trade in professional services, although developments to date are considered nascent and largely preliminary. From the outset, diversity among regulatory regimes has been evident at the most basic levels, such as the extent to which regulations may be publicly available, clear, based on well defined criteria, and noncontradictory.⁵² Moreover, issues of timeliness and predictability of regulatory implementation have arisen. There is concern, for instance, that administrative structures may not be suited for sophisticated regulation and monitoring of compliance.⁵³ Adding to the complexity of bilateral and multilateral discussions have been differences at subnational levels of government and among national professional bodies with respect to qualifications and other requirements affecting a professional's practice outside the home market. Additionally, national rules with respect to professionals seeking entry into foreign markets have been superimposed on complex issues other than those unique to each profession, such as most-favored-nation treatment, reciprocity, and movement of diverse categories of labor across borders.⁵⁴ These elements suggest that recognition and standards for regulation of foreign professional service providers are likely to evolve slowly.

⁵¹ U.S. industry representative, interview with USITC staff, Mar. 31, 1999.

⁵² Marina Fe B. Durano, "Barriers to Cross-Border Provision of Services within the APEC: Focus on the Movement of Persons," working paper series 96/97, No. 18, APEC Study Center, Institute of Developing Economies, Tokyo, Japan, Mar. 1997, p. 76.

⁵³ Ibid.

⁵⁴ Ibid., pp. 78-79.