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ADOPTION OF THE REPORT OF THE COMMISSION ON ITS TWENTIETH SESSION

Rapporteur: ...

Draft report

Chapter ...

ROLE OF TRANSNATIONAL CORPORATIONS IN SERVICE

Transnational corporations and services

1. The Commission considered item 4 of its agenda at its 5th and 6th meetings, on 4 May 1994. It had before it the report by the UNCTAD secretariat on experiences in the liberalization of foreign direct investment in services, entitled "Expansion of foreign direct investment and trade in services" (E/C.10/1994/4).

2. In introducing the item, the Assistant Director of the Research and Policy Analysis Branch, UNCTAD Division on Transnational Corporations and Investment, stated that service activities constitute the single most

important economic activity in all developed economies and the majority of developing economies, accounting on average for 47 per cent of gross domestic product in developing and 61 per cent of gross domestic product in developed countries, as well as for a steadily and rapidly growing share of employment in developed and most developing countries. This was reflected in the predominance of services in foreign direct investment. While international transactions in services markets could take place through any one of the following modes of delivery: cross-border trade, movement of consumers, movement of services providers and foreign direct investment, characteristically, services could not be transported and hence were difficult to trade at arm’s length across borders. Foreign direct investment was thus the principal mode of delivering services abroad. This was reflected by the fact that approximately 50 to 60 per cent of FDI flows were in services and that around 40 to 50 per cent of the worldwide stock of FDI was in services.

3. The Assistant Director of the Research and Policy Analysis Branch also noted that developing countries had become keenly aware of the importance of services such as tourism, labour services, harbour services, and transit-trade services, among others, as export earners as well as of the need to create an efficient pool of producer services as a requirement for competitive economic development. Contrary to conventional wisdom which saw growth in services mostly as a consequence of overall economic growth, the Director stated that there was a growing body of evidence suggesting that the development of service activities may not be a result of growth, but rather one of its pre-conditions. As a result, many developing countries were increasingly interested in fostering competition and improving productivity in their service industries, and towards that end, in opening their markets to foreign service providers. Experience regarding the benefits and costs of such opening and the policy options for countries that wish to liberalize their services sectors, including that of a technical assistance project currently being implemented in selected developing countries, suggested that inefficiency in producer services entailed significant economic costs for developing countries. That suggested that it would be useful to price the costs of inefficiencies as a first step in liberalizing the services sector, including foreign direct investment in services. Furthermore, to avoid policy conflicts within the services sector, it would be useful to carry out reform at the level of "service complexes" or groups of interrelated services.

However, an optimal sequencing of policy reform in liberalizing services required that some attention be paid to macro-regulatory issues prior to attempting reform at the level of particular service complexes. Complementary reforms, such as anti-trust or competition policies, were essential for the effective implementation of a liberalization programme. This was particularly true with respect to foreign direct investment in services where experience with competition was often even more limited than in goods industries.

4. Delegations taking the floor agreed that the issue of the role of services in economic development of developing countries was an important one, and that it was timely for the Commission and the secretariat to address this issue, especially in light of the successful conclusion of the Uruguay Round negotiations on a General Agreement on Trade in Services. They supported the findings of the report by the secretariat and found the experience of the UNCTAD/World Bank/UNDP project and the lessons based on it, contained in the secretariat document, very useful. Several delegations also emphasized that the secretariat’s project on the "Expansion of foreign direct investment and trade in services" constituted a unique and pioneering effort, a good example of how research leads to practical implementation of technical assistance in an area which was of importance to developing countries, and a welcome effort of coordination between international organizations.

5. All delegations agreed that the importance of services in today’s world economy could no longer be overlooked. However, it was pointed out by several delegations that there was still a clear gap between developed and developing countries in the area of services development and trade in services, and that the backwardness of developing countries in this regard operated as a constraint to their economic development. It was also stated by several delegations that, due to economic, cultural, legal and social reasons, and the relative backwardness of their services sectors, developing countries were constrained in their capacity to open up, and that this process should be implemented gradually and prudently. Economic reform, however, including as regards access of foreign service providers, should not be mistaken for deregulation, since regulation did not necessarily constitute protectionism. It was expressed that, in particular, recent privatization efforts in developing countries could result in a possible gap in regulation, which could place developing countries and firms originating there at a comparative disadvantage in an increasingly competitive global environment. In this

respect, one delegation stated that, in the Uruguay Round, the issue of domestic regulation had been a difficult issue and that the General Agreement on Services as concluded (Article VI) stated that regulatory measures such as licensing, standards and qualifications were legitimate for meeting certain domestic objectives.

6. While agreeing with the need and potential positive effects of the liberalization of foreign direct investment and trade in services, several delegations pointed out that liberalization of services in developing countries should proceed cautiously, especially in the realm of financial services. One delegation, quoting its own and other countries’ experience, stated that liberalization of the financial sector ought to be postponed until effective control over fiscal and supervisory systems had been established, in order to avoid accelerated outflows of capital. In the liberalization process, a balance should be found that would ensure the ability of developing countries to develop an indigenous banking system, while at the same time allowing for appropriate foreign presence. The need to develop indigenous capacity in the financial services sector in developing countries was stressed by several delegations.

7. The issue of unilateral versus multilateral liberalization was raised by several delegations. One delegation expressed the view that, while multilateral negotiations should not stifle liberalization on the basis that reciprocal concessions desired were not secured, the undertaking of bound commitments in multilateral negotiations would none the less secure concessions or credit for such liberalization since offers to undertake bound commitments would become grounds for return concessions. However, the rationale for liberalization should not be equated with such narrow short-term objectives. While one delegation emphasized that in order to ensure reciprocity and the balance of costs and benefits in trading arrangements, equitable reciprocity in the area of services needed to be ensured to increase the participation of developing countries in services trade, another delegation stated that domestic regulation of international service transactions should be based on the most-favoured-nation principle and not on the basis of reciprocity. Some delegations stressed the need for international disciplines that would ensure that domestic regulatory measures do not constitute unnecessary barriers to trade in services. In this respect, it was also pointed out that domestic reforms should be accompanied by an

effective competition policy, so as to assure that restrictive business practices were not resurrected by private action once they were removed by Governments. Another delegation stated that regulation in any case should not be discriminatory and that limitations on national treatment of foreign service providers should not be considered preferable to restrictions on market access.

8. Issues suggested for further study included the topic of human resource development and the formulation of appropriate policy reform in the services sector. It was stressed that without human resource development accompanying policy reform, even the best conceived policy could not be successfully implemented. The issue of the particular role of services transnational corporations in the transition process of formerly centrally-planned economies was also suggested as an important topic for further research, especially in light of the fact that transitional economies have not yet succeeded in attracting considerable foreign investment to their services sectors.

9. With regard to the importance of foreign direct investment in services, one delegation noted that the three other modes of delivery of services to foreign markets (movement of consumers, movement of services providers and cross-border trade) were more important in its country’s current account balance than foreign direct investment (in terms of outflows). The secretariat emphasized in its reply that the significance of foreign direct investment in the international transactions of a country would not be visible so much in the actual flows of FDI as, rather, in the resulting sales of foreign affiliates in services.

Action taken by the Commission

10. The Commission took note of the report by the UNCTAD secretariat on the "Expansion of foreign direct investment and trade in services" (E/C.10/1994/4). It welcomed the efforts of the secretariat in the area of services, in particular regarding technical assistance related to the liberalization of foreign direct investment and trade in services. It encouraged the secretariat to extend the project on "Expansion of foreign direct investment and trade in services" to other countries that request

assistance, to make every effort to secure appropriate funds, and it encouraged countries in a position to do so to provide extra-budgetary funds for that purpose. It also requested that the secretariat conduct further research and analysis on the role of transnational service corporations in transitional economies.
