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... Attached is a second draft of the overview paper on Canada/USA Trade in Services. This draft includes a preliminary list of U.S. barriers to services trade (pp. 23-31), compiled principally from information received from other divisions/departments. As well, there have been changes to the concluding section on how Canada might approach the negotiations.

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EXT 407

CANADA/USA - TRADE IN SERVICES

A. INTRODUCTION

When the Prime Minister of Canada met with the President of the United States in Quebec City in March 1985, their discussions covered short and medium term undertakings to explore means to expand trade, both bilaterally and through mutual support for a new round of multilateral trade negotiations, in recognition of the benefits of more rational and competitive production and distribution. In view of the importance of trade in services, these undertakings were extended to both goods and services. As a first step, they committed themselves to halt protectionism in cross-border trade in goods and services. They also announced the resolution of a number of irritants. On the services side, this included the tax-free treatment of certain tourist literature and cable/satellite retransmission. The Prime Minister and the U.S. President also agreed on a Canada-United States Work Plan on Trade, a number of elements of which would facilitate and enhance trade in services, e.g. standardization, reduction or simplification of regulatory requirements, improvement in the Canada/United States Air

Transport Agreement, and elimination or reduction of barriers to trade in high technology goods and related services.

The Canadian and U.S. economies both have an overwhelming percentage of gross domestic product accounted for by services (in 1983, approximately 63% in Canada, with government administration accounting for an additional 8.3%). Furthermore, the services sector has been the major source of new employment growth in the U.S. and Canada in recent years, especially during the recession period. This growth has come from several sources: technology-inspired new services, consumer demand for leisure services, producing industries' demand for competitive services needed for themselves (some of which were previously provided "in-house"), and foreign demand generated from increasing foreign production activities of multinational enterprises and from foreign firms seeking access to new services to increase their competitiveness.

In 1984, trade in services between Canada and the United States amounted to approximately $20 billion. Of the total 1984 Canadian revenue of approximately $14.1 billion generated by tradeable services exports, some 59% ($8.3 billion) is estimated as exports to the U.S. Of Canada's 1984 tradeable services imports of approximately $19.2 billion, 61% ($11.7 billion) is estimated as imports from the U.S. These figures represent the tradeable services exchanged between the two countries - they do not include returns on investment which are generally lumped into the services component of current account statistics. Examination of Canada's current account with the United States reveals that the deficit on services in the account is overwhelmingly a result of returns on investment. In 1984, returns on investment accounted for approximately three-quarters of the deficit in services ($9.8 billion of the $13.2 billion deficit) with the deficit in tradeable services ($3.4 billion) accounting for the remaining 25%.

The statistics available on tradeable services are unfortunately not very disaggregated. Nonetheless, they reveal that bilateral services trade between Canada and the United States encompasses *inter alia* financial services, transportation, communications and data processing, consulting, management and administrative services and other business and professional services. Canada's bilateral account with the United States reveals the following breakdown of services traded between the two countries in 1984:

	*Exports to the U.S.	*Imports from the U.S.
Travel	3,146	3,991
Freight and Shipping	2,497	2,481
Business Services	2,400	4,792
Government Transactions	272	400

*millions of dollars

The business services component of the current account is of most interest in examining trade in services between Canada and the United States because there are few barriers to travel, as well as little that can be done to change the length of the Canadian winter, and shipping is related directly to trade in goods. A comparison of 1981 and 1984 figures reveals that Canadian business service exports to the U.S. have increased from $2,050 million in 1981 to $2,400 million in 1984. The rise in business service imports from the U.S. is of a similar proportion, from $4,103 million in 1981 to $4,792 million in 1984. Unfortunately, the last year for which a detailed breakdown of business service exports and imports exists is 1981. Statistics Canada expects to have the 1983 figures in the near future.

By and large, there are few barriers to trade in services between the two countries. Those that do exist arise because of domestic socio-economic policies and regulation that by accident (or occasionally design)

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impact excessively on trade interests. For some services, such as commercial banking and life insurance, domestic policy for valid reasons requires establishment in order to extend the services generated.

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Further information on barriers for Canadian exports is located page 24 of this paper. Nevertheless, trade irritants have been quite frequent in Canada/U.S. relations in the service sector; these have ranged from border-broadcasting to trucking disputes. Such irritants have arisen in areas where either Canada or the United States has had more intense regulation (or recently engaged in de-regulation) in pursuit of social or economic objectives that have been at significant variance with the approach being followed at that point in time by the government of the other country.

B. JURISDICTION

In Canada, legislative jurisdiction over the field of services is divided between the federal and provincial levels of government by to the Constitution Act, 1867. Some service sectors are exclusively within federal jurisdiction, some are exclusively within provincial jurisdiction and some overlap the two levels of government. The possibility exists of overlapping jurisdiction since the Act expresses the federal and provincial categories of power in quite general terms. Thus, each level of government may make laws on similar matters as long as each is legislating within an area of jurisdiction for which it is responsible. For example, while "banking" lies within the federal government's exclusive jurisdiction, financial institutions other than "banks", e.g., trust companies, may fall within provincial jurisdiction. As well, provincial laws of general application will apply to "banks" under federal jurisdiction.

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The constitution of the United States divides jurisdiction between the federal Government and the states, and amongst the branches of the federal Government (Executive, Congress and the Judiciary). Under the Tenth Amendment to the Constitution, the states have powers over matters not reserved to Congress. Even where Congress has the power to legislate under the Constitution, its power may not be exclusive and the states may have concurrent power, at least where federal legislation has not occupied the field. However, if Congress constitutionally exercises its legislative power over a subject, any state law on that subject is invalidated to the extent that the state law conflicts with the federal statute.

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C. BACKGROUND

Toward the conclusion of the Kennedy Round in the late 1960s, U.S. engineer/procure/construct firms brought to the attention of the U.S. Government the potential that their services industry presented for generating follow-on sales of goods to foreign countries in which they were undertaking projects. With the growth of trade promotion by the U.S. in this area, both the Government and industry became more aware of barriers or impediments to doing international business. The U.S. made some minor effort during the Tokyo Round in the late 1970's to address these problems in discussions on government procurement, technical barriers and other negotiations. The result was that services ancillary to and of less value than goods are covered by the Government Procurement Code and the "re-opener" clause of the Code specifically mentions services as an area for potential coverage in further negotiations of the Code. Some U.S. objectives for facilitating high technology services trade are also considered to have been met in the Code on Technical Barriers to Trade (e.g., communications standards).

Following upon the engineer/procure/construct industries' efforts at attracting U.S. Government support and initiatives for their market access concerns, other service sectors, especially the financial industries, joined in lobbying the Administration and Congress for support for their cause. At the same time, the Government began to recognize the importance of services trade to the United States. The U.S. has been, and continues to be, the world's leading services trader. While the U.S. merchandise trade ran deficits in 10 of the 12 years between 1972 and 1983, the services account produced a surplus in every year. Moveover, in 1976, 1979, 1980 and 1981, the services surplus was sufficient to offset the merchandise deficit and pull the overall trade balance into surplus. However, as noted above, returns on investment are included in the services component of current account statistics. Thus, much of the services surplus may actually amount to returns on investment. It has been suggested, however, (see Economic Consulting

Services' 1981 report on services data collection and analysis, prepared for the U.S. Government), that the figures on investment income are disguising revenues from traded services because there is no appropriate way to list tradeable services under conventional statistical reporting systems.

With the broadening of the domestic U.S. interest in international trade in services, the work toward the liberalization of trade this area has become instrumental in the U.S. Administration's endeavours to maintain, or re-build, the domestic constituency for an open trading system. Congressional support for liberalization of trade in services, in which the U.S. is seen to have a comparative advantage and which is closely linked to U.S. advances in technology, is essential to support for engaging in a new round of multilateral trade negotiations that may limit protection of the range of action available to the U.S. for the goods-producing industries facing structural adjustment difficulties. It has also led to increased priority being given to bilateral services trade issues including the initiation of Section 301 cases which has, and continues to be, the principle means of recourse for service trading firms under U.S. trade law.

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Services have become fully embodied in the U.S. trade policy process. This is most clearly shown by the 1984 Trade and Tariff Act extension of Section 102 authority, (which permits the President to negotiate and enter into reciprocal trade agreements in respect of non-tariff barriers), to the reduction or elimination of barriers or other distortions to trade in services (including denial of national treatment and restrictions on establishment and operation in foreign markets) and the development of internationally agreed rules. The question for the U.S. is therefore not if negotiations should be held on services but how and in what <u>fora</u>: bilaterally, plurilaterally among a group of interested countries, multilaterally as part of a new round of trade negotiations under the aegis of the GATT, or all three simultaneously.

In the multilateral trade arena, the U.S. has been in the forefront in the drive to have trade in services included in a new round of multilateral trade negotiations (MTN), despite the strong objections of some developing countries, led by Brazil and India. The United States' objective, set out in the July 1985 U.S. submission to the GATT, is a general agreement that would set out rules and principles for conducting trade in services. The agreement would be based on a commitment to transparency of practices and the resolution of problems through consultation. Procedures would also be established for the negotiation of commitments dealing with the reduction of trade barriers, including provisions laying out the nature of these commitments.

In the U.S. view, the general agreement on services should be complemented by negotiations aimed at the removal of barriers in individual service industries. The United States also foresees negotiations in functional areas, such as standards, as well as the development of an understanding dealing with investment issues in services. As well, the U.S. maintains that priority should be given to developing a multilateral agreement on international information flows.

The most advanced U.S. bilateral initiative is the recently concluded Declaration on Trade in Services with Israel. This is a statement of general principles calling for a legally binding agreement to be negotiated during the next 18 months. It is a comprehensive document covering key service sectors and setting out the principles (such as national treatment and transparency) that the United States believes should be part of any services agreement. It was intended to serve as a model for a multilateral agreement.

D. USA OBJECTIVES

As indicated above, the U.S. is committed to negotiating a legal framework of rules that would, as a first step, prevent the introduction of new barriers to trade in services. The sectoral or functional negotiations could go further and attempt the reduction or elimination of existing barriers. In the Canada/United States context, the Americans indicated informally in July, 1985 that they would like to develop a bilateral agreement on trade in services over the next two years. The basic objectives of such an agreement would be:

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E. CANADIAN OBJECTIVES

In 1981, as a result of growing international discussion concerning the possibility of bringing trade in services under some kind of effective multilateral discipline, the Government set up a Task Force on Trade in Services to report on Canada's interests in regard to prospective multilateral negotiations on trade in services. Canadian interests in possible bilateral negotiations were not considered. The Task Force's conclusion was that Canada had a major interest in the service sector and that the lack of an effective overall instrument governing trade in services could work against a number of specific Canadian trade interests. The Task Force considered that it would appear to be in the Canadian interest to adopt a "bottom up" approach to services negotiations, i.e. that for specific service sectors note would be taken of each country's import regime and negotiations might then take place on transparency, harmonization and liberalization.

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Despite the contact we have had with interested firms and associations since the establishment of the Task Force on Trade in Services in 1981, we have only recently begun to receive an indication (via the Tom Burns consultations) from the private sector as to where it perceives its interests to lie in respect of bilateral services discussions with the United States. This probably results in large measure from a lack of understanding of what trade in services is all about. A more intensive dialogue with the service industries will be necessary in order to obtain informed views from them. This exchange of information and opinion could be promoted through the establishment of Special Advisory Groups on the key service industry sectors under the Minister's International Trade Advisory Committee.

The problem of a lack of understanding of trade in services holds true for the provinces as well as for the private sector.

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- 27 EXTERNAL AFFAIRS AFFAIRES EXTERIEURES
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legal services

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