

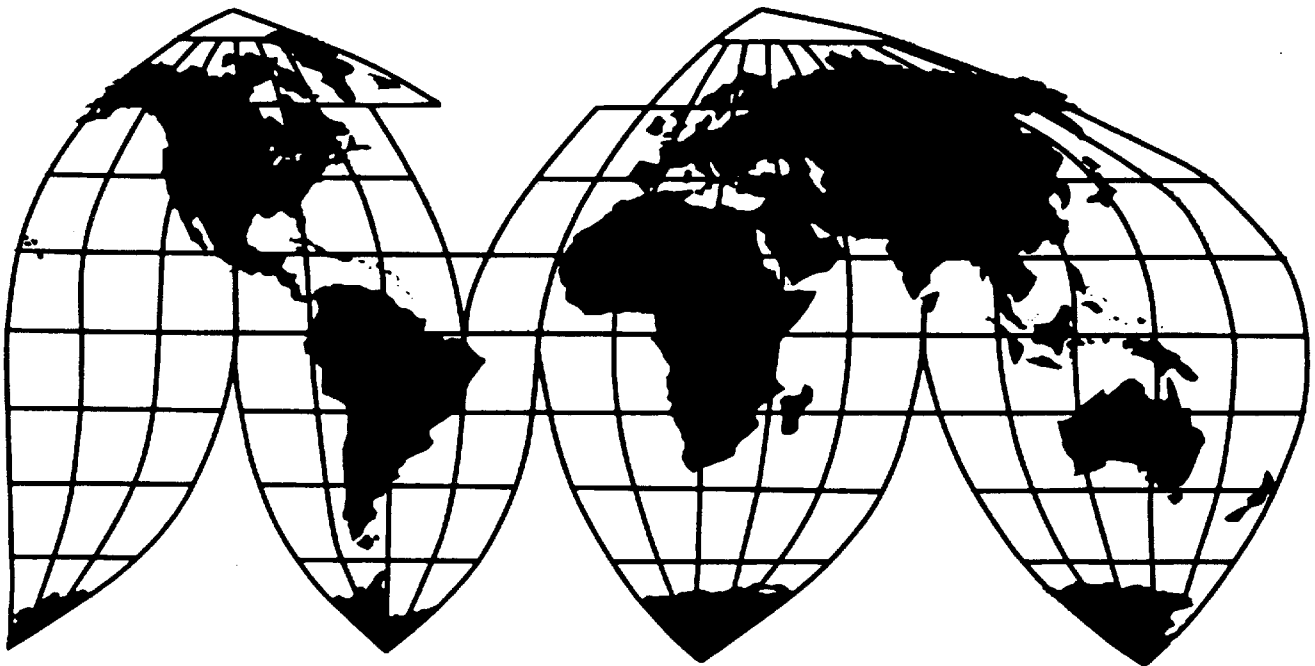
# Recent Trends in U.S. Services Trade

2000 Annual Report  
Investigation No. 332-345

**Publication 3306**

**May 2000**

**U.S. International Trade Commission**



Washington, DC 20436

# U.S. International Trade Commission

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## **Recent Trends in U.S. Services Trade**



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# Preface

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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 or Commission) instituted investigation No. 332-345, *Annual Reports on U.S. Trade Shifts in Selected Industries*. The 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: *Shifts in U.S. Merchandise Trade* (July) and *Recent Trends in U.S. Services Trade*<sup>1</sup> (May). Services trade is presented in a separate report in order to provide more comprehensive and timely coverage of sector 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 1993-98 for cross-border trade, and during 1992-97 for affiliate transactions. Industry-specific analyses also identify major trading partners during the subject period. The report concludes with an examination of the General Agreement on Trade in Services (GATS), recent efforts to renew services trade negotiations under the auspices of the World Trade Organization (WTO), and some of the major objectives of these negotiations.

Further USITC analyses of trade in services include a series of reports on U.S. trading partners' schedules of commitments under the GATS administered by the WTO. 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. These 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 Services: Examination of the Schedules of Commitments Submitted by African Trading*

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<sup>1</sup> 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*.

*Partners* (USITC publication 3243, Oct. 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

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### 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 trade 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).<sup>1</sup> Comparable annual data regarding cross-border services trade are available and reported for the period 1989-98. In addition, comparable data pertaining to sales by foreign-based affiliates of U.S. firms are reported for the period 1988-97. However, it is not feasible to compare sales by U.S.-based affiliates of foreign firms in 1997 with such sales reported for earlier years, because the methodology for classifying such affiliates changed substantially, beginning with data reported for 1997.<sup>2</sup> Since most BEA data pertaining to trade in environmental services are reported as part of trade in various other service industries, trade data regarding environmental services were drawn from reports published by Environmental Business International (EBI), and other industry sources.

Chapter 2 of this report describes the nature and extent of cross-border trade and affiliate transactions in the service sector and provides an overview of U.S. services trade by industry and by trading partner. Chapters 3 through 21 discuss U.S.

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<sup>1</sup> Periodically, BEA changes its methodology to enhance annual reporting. This year, BEA revised estimates of cross-border trade in services to incorporate reclassifications and improvements in source data. Modifications included a redefinition of services by reclassifying employee compensation as income instead of cross-border trade in services, beginning with estimates for 1986. Moreover, revisions to estimates for 1995-98 were made for medical services provided to foreign residents at U.S. hospitals, and to estimates for 1997-98 concerning U.S. imports of travel and tourism services. For more information, see U.S. Department of Commerce (USDOC), Bureau of Economic Analysis (BEA), *Survey of Current Business*, Oct. 1999, p. 53.

<sup>2</sup> For more information regarding this change in methodology, see box 2-1 in ch. 2.

international trade in intangible intellectual property and in selected service industries, including accounting and management consulting; advertising; air transportation; architectural, engineering, and construction; audiovisual; banking and securities; computer and data processing; education; energy; environmental; health care; insurance; legal; maritime transportation; retail trade; telecommunication; travel and tourism; and wholesale trade services. Each discussion compares cross-border trade performance in 1998 to trends evident during 1993-97, and/or sales by foreign-based affiliates of U.S. firms in 1997 to trends during 1992-96. However, the reclassification of U.S.-based affiliates of foreign firms precludes meaningful comparison of data reflecting sales of such affiliates in 1997 with data reported for previous years, and with data on sales by foreign-based affiliates of U.S. firms during 1997. Thus, sales by U.S.-based affiliates of foreign firms are reported for 1997 only, and no balance on affiliate transactions is presented. These chapters also review the principal factors underlying the volume and direction of recent trade, and identify factors likely to influence future trade performance, such as electronic commerce. 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 22 of the report examines the General Agreement on Trade in Services (GATS), recent efforts to renew services trade negotiations under the auspices of the World Trade Organization (WTO), and some of the major objectives of these negotiations.

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 1998 (figure 1-1).<sup>3</sup> U.S. cross-border trade in services generated an \$83-billion surplus in 1998, in contrast to a U.S. merchandise trade deficit of \$247 billion.<sup>4</sup> Further, the service sector accounted for 77 percent of U.S. private-sector gross domestic product (GDP) in 1997 (figure 1-2).<sup>5</sup> By comparison, manufacturing accounted for 19 percent of GDP, and mining and agriculture together accounted for 4 percent. Similarly, the service sector provided 79 percent of total private-sector employment in 1998, while the manufacturing sector provided 18 percent, and the mining and agriculture sectors together provided 3 percent (figure 1-3).<sup>6</sup>

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<sup>3</sup> Total trade volume is the sum of imports and exports.

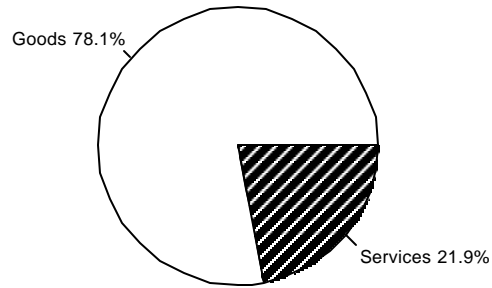
<sup>4</sup> USDOC, BEA, *Survey of Current Business*, Oct. 1999, p. 20.

<sup>5</sup> USDOC, BEA, *Survey of Current Business*, Oct. 1999, p. D-28. The data for 1997 are the latest available.

<sup>6</sup> USDOC, BEA, *Survey of Current Business*, Jan. 2000, p. D-35.



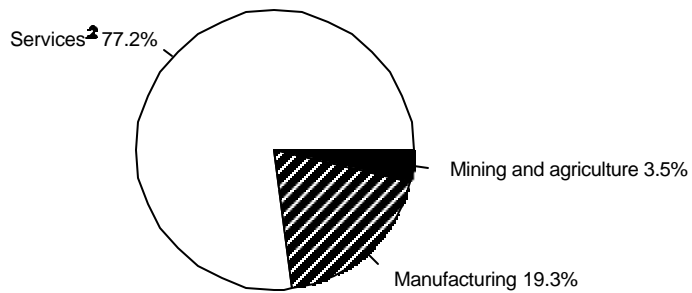
**Figure 1-1**  
**U.S. cross-border trade volume, by sector, 1998**



**Total trade volume = \$2 trillion**

Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, p. 20.

**Figure 1-2**  
**U.S. private-sector gross domestic product, by sector, 1997<sup>1</sup>**



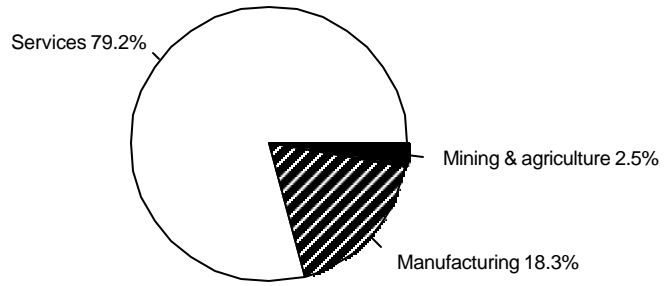
**Total private-sector GDP = \$7.1 trillion**

<sup>1</sup> Data for 1997 are the latest available.

<sup>2</sup> For the purpose of this figure, 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*, Oct. 1999, p. D-28.

**Figure 1-3**  
**U.S. private-sector employment, by sector, 1998**



**Total full-time equivalent employees = 101.2 million workers**

**Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Jan. 2000, p. D-35.**

# CHAPTER 2

## U.S. TRADE IN SERVICES

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### 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.<sup>1</sup> The current account of the United States<sup>2</sup> 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.<sup>3</sup> 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

---

Cross-border services trade, as reported in the current account, includes both private- and public-sector transactions. The latter principally stem from the operations of the U.S. military and embassies abroad. The current account reported a U.S. services trade surplus of \$83 billion in 1998 (figure 2-1), which offset 33 percent of the merchandise trade deficit (figure 2-2).<sup>4</sup> However, because public-sector transactions are not considered to reflect U.S. service industries' competitiveness, and introduce anomalies resulting from events such as international peace-keeping missions, it is most appropriate to focus solely on private-sector transactions in this report. When public-sector transactions are removed from 1998 data, the value of service exports still exceeds that of imports, but the value of the surplus is reduced to \$80 billion (table 2-1).<sup>5</sup>

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<sup>1</sup> Employing terminology found in the General Agreement on Trade in Services (GATS), this channel encompasses modes of supply one (cross-border supply), two (consumption abroad), and four (movement of natural persons).

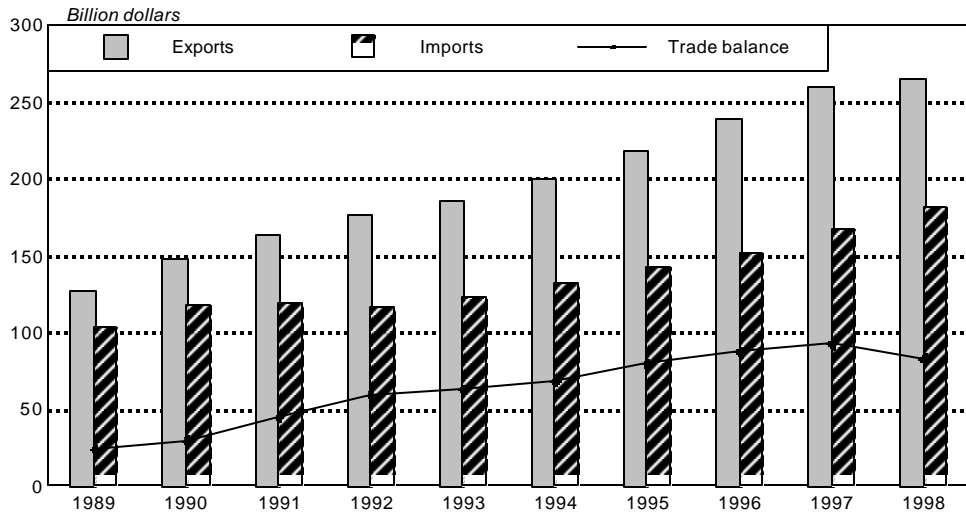
<sup>2</sup> The current account of the U.S. balance of payments reports trade in goods and services, flows of investment income, and unilateral transfers of funds (e.g., U.S. Government grants, pensions, and other funds).

<sup>3</sup> Employing terminology found in the GATS, this channel encompasses mode of supply three (commercial presence).

<sup>4</sup> 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.

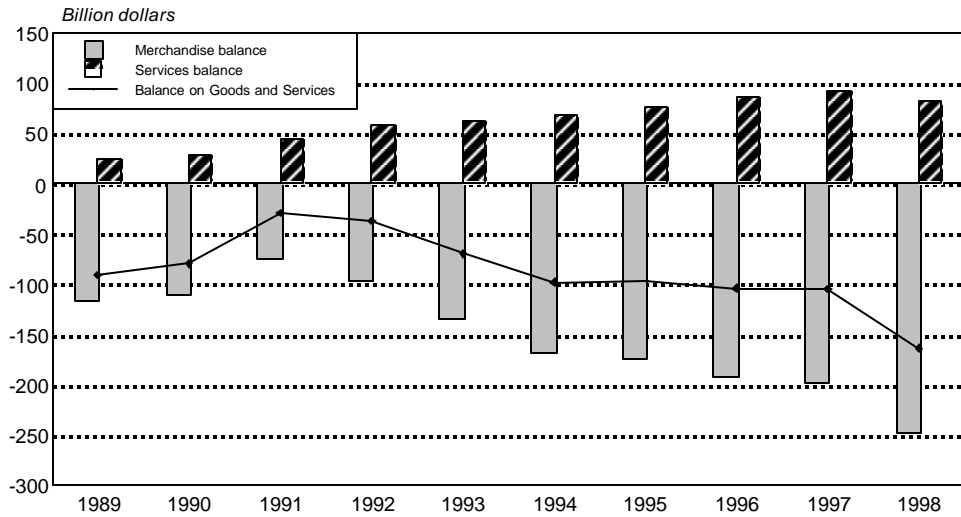
<sup>5</sup> USDOC, BEA, *Survey of Current Business*, Aug. 1999, p. D-51.

**Figure 2-1**  
**U.S. cross-border trade in services: Exports, imports, and trade balance, 1989-98<sup>1</sup>**



<sup>1</sup> 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 1999, pp. 84-85.

**Figure 2-2**  
**U.S. merchandise and services trade balances, 1989-98<sup>1</sup>**



<sup>1</sup> 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 1999, pp. 84-85.

**Table 2-1**  
**Derivation of U.S. private-sector, cross-border services trade balance, 1989-98**

(Million dollars)

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
Total exports .....	126,216	146,751	163,043	175,557	184,951	199,675	217,637	237,749	258,828	263,661
Public-sector exports ....	(9,151)	(10,600)	(11,825)	(13,228)	(14,354)	(13,674)	(15,461)	(16,629)	(18,385)	(17,973)
Private-sector exports ...	117,065	136,151	151,218	162,329	170,597	186,001	202,176	221,120	240,443	245,688
Total imports .....	(102,479)	(117,659)	(118,459)	(116,476)	(122,281)	(131,878)	(141,447)	(150,797)	(166,907)	(181,011)
Public-sector imports ....	17,184	19,450	18,525	16,098	14,341	12,777	12,666	13,716	14,460	15,690
Private-sector imports ...	(85,295)	(98,209)	(99,934)	(100,378)	(107,940)	(119,101)	(128,781)	(137,081)	(152,447)	(165,321)
Private-sector trade balance	31,770	37,942	51,284	61,951	62,657	66,900	73,395	84,039	87,996	80,367

Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, July 1999, p. 85, and Oct. 1999, pp. 64-65.

The cross-border services trade surplus, which grew at an average annual rate of 14 percent during 1989-97, fell by 9 percent in 1998.<sup>6</sup> In 1998, private-sector, cross-border service exports grew more slowly than cross-border service imports. Exports increased by 2 percent, to \$246 billion, slower than the average annual growth rate of 9 percent experienced during 1989-97. In comparison, private-sector, cross-border service imports increased by 8 percent in 1998, to \$165 billion, almost identical to the average annual rate of increase registered during 1989-97.<sup>7</sup>

## ***Cross-Border Trade by Industry***

In 1998, travel and tourism services accounted for 29 percent of U.S. service exports, the largest share of total service exports accounted for by a single industry (figure 2-3). Other services accounting for large shares of total U.S. exports were services related to intangible intellectual property (reported as royalties and license fees), representing 15 percent; business, professional, and technical services (hereafter, professional services), 10 percent; maritime and air freight transportation services (including port services), 9 percent; and passenger fares (airline and maritime), 8 percent. With respect to imports, travel and tourism, maritime and air freight transportation, and passenger fares also figured prominently in 1998, accounting for 34 percent, 17 percent, and 12 percent of total service imports, respectively.<sup>8</sup> The table in appendix A delineates, where applicable, the activities reflected in official cross-border services trade data.

In 1998, as in most other years, all U.S. service industries registered cross-border trade surpluses, with the exception of advertising, maritime and air transportation (excluding passenger fares), telecommunication, and insurance services. The trade deficits posted by transport, telecommunication, and insurance industries, however, largely reflect accounting conventions and trade estimation methodologies, rather than unfavorable competitive positions. For instance, the shortfall in maritime and air freight transportation services mirrors the deficit in U.S. merchandise trade in large part, as payments for such transportation services are, by convention, 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.

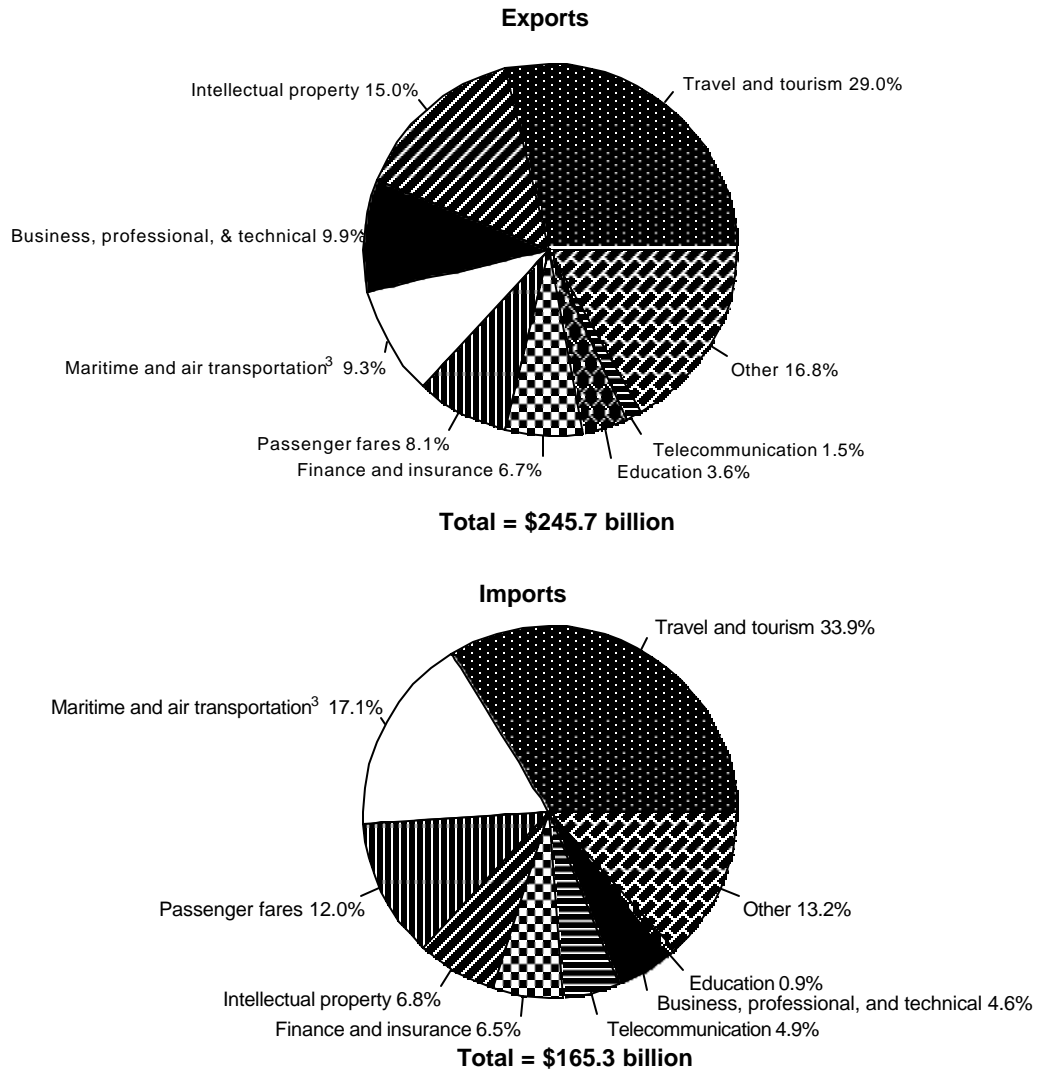
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<sup>6</sup> USDOC, BEA, *Survey of Current Business*, Oct. 1999, pp. 64-65.

<sup>7</sup> Percentage values have been rounded to the nearest whole number.

<sup>8</sup> *Ibid.*, p. 65.

**Figure 2-3**  
**U.S. cross-border service exports and imports,<sup>1</sup> by industry, 1998<sup>2</sup>**



<sup>1</sup> Trade data exclude public-sector trade.

<sup>2</sup> Totals may not equal 100 percent due to rounding.

<sup>3</sup> Reflects freight transport and port services only. Excludes ground transportation services.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, pp. 64-65 and 71.

## ***Cross-Border Trade by Trading Partner***

In 1998, the European Union (EU) was the largest market for U.S. cross-border exports of services, accounting for 34 percent (figure 2-4). Japan, Canada, and Mexico were the next most significant U.S. export markets, accounting for 13 percent, 8 percent, and 5 percent, respectively. With regard to U.S. imports of services, the EU supplied the dominant share (36 percent), followed by Canada (9 percent), Japan (8 percent), and Mexico (6 percent). Jointly, these four major trading partners accounted for 59 percent of both U.S. cross-border service exports and imports.

In 1998, the United States registered cross-border trade surpluses in services with all major trading partners. Surpluses measured \$23.9 billion with the EU, \$17.0 billion with Japan, \$4.5 billion with Canada, and \$1.8 billion with Mexico.<sup>9</sup> Compared to 1997, the surplus with the EU increased by \$410 million (2 percent) in 1998, while surpluses with Japan and Canada decreased by \$3.3 billion (16 percent) and \$2.5 billion (36 percent), respectively, owing to the Japanese recession and the relatively weak Canadian currency. The surplus with Mexico registered in 1998 followed 3 consecutive years of bilateral deficits.

## **Affiliate Transactions**

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Data on affiliate transactions track majority-owned affiliates' sales to unaffiliated foreigners in the host market.<sup>10</sup> 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 hotel 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 the establishment of a commercial presence in a foreign market 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'

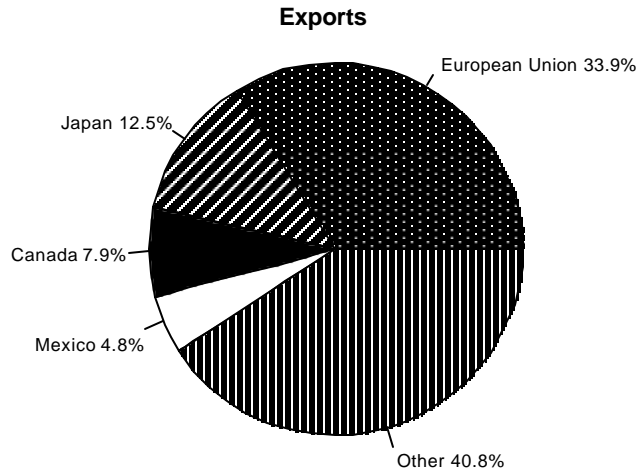
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<sup>9</sup> Ibid., pp. 66-67.

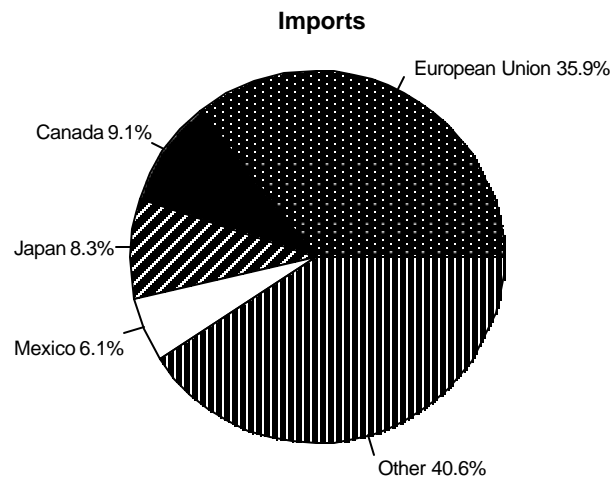
<sup>10</sup> Majority-owned foreign affiliates of U.S. firms are defined as foreign affiliates for which the combined direct and indirect ownership interest of all U.S. parents exceeds 50 percent. Majority-owned U.S. affiliates of foreign firms are U.S.-based affiliates for which the combined direct 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.



**Figure 2-4**  
**U.S. cross-border service exports and imports,<sup>1</sup> by selected trading partners, 1998<sup>2</sup>**



**Total = \$245.7 billion**



**Total = \$165.3 billion**

<sup>1</sup> Trade data exclude public-sector trade.

<sup>2</sup> Totals may not equal 100 percent due to rounding.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, pp. 66-67.

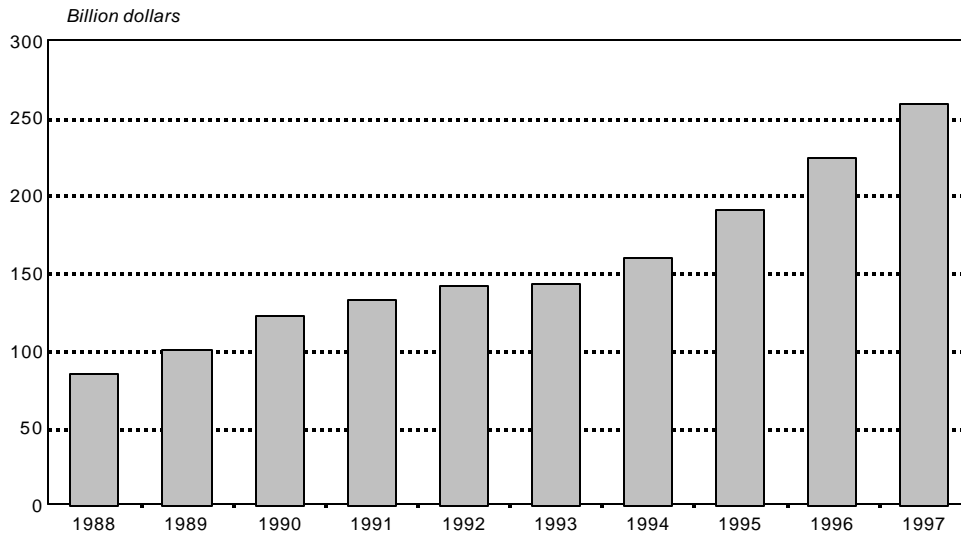
shares of profits from sales through affiliates are reported as investment income in the balance of payments.<sup>11</sup>

In 1997, sales by foreign-based affiliates of U.S. companies totaled \$258 billion (figure 2-5). This reflected 16-percent growth, faster than the 13-percent average annual growth posted during 1988-96. Sales in the EU grew by 16 percent in 1997,

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<sup>11</sup> 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.

**Figure 2-5**  
**Affiliate service transactions: U.S. sales,<sup>1</sup> 1988-97**



<sup>1</sup> Sales of services by majority-owned foreign affiliates of U.S.-parent firms.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, pp. 48 and 92.

principally as a result of a 42-percent increase in sales by British-based affiliates of U.S. firms.<sup>12</sup> In 1997, purchases from U.S.-based affiliates of foreign firms amounted to \$206 billion. The change in BEA data collection methodology precludes a comparison of this figure to those of previous years (box 2-1).

## *Affiliate Transactions by Industry*

In 1997, sales by U.S.-owned insurance affiliates in foreign markets accounted for 18 percent of total sales of services by foreign affiliates of U.S. firms, representing the largest share identified for any single industry (figure 2-6).<sup>13</sup> U.S.-owned affiliates in the public utilities industry accounted for approximately 8 percent of total service sales; those in the computer and data processing industry for approximately 6 percent; those in the wholesale industry for 6 percent; and those in the finance industry (principally securities firms) for approximately 5 percent.<sup>14</sup> A number of other industries--namely, transportation; communication; architectural, engineering, and surveying services; accounting, research, management, and related services; and motion pictures, including tapes and films only--each accounted for 3 percent or 4 percent of global affiliates' sales of services in 1997.

<sup>12</sup> USDOC, BEA, *Survey of Current Business*, Oct. 1999, p. 92.

<sup>13</sup> *Ibid.*, p. 93.

<sup>14</sup> BEA suppressed data reflecting total sales by U.S.-owned affiliates in the public utilities, computer and data processing, advertising, and finance industries so as not to disclose information about the operations of individual firms. However, data that BEA elected to publish on sales by such affiliates in select countries allow computation of the shares reported above.

**Box 2-1****U.S. Purchases from Affiliates: Changes in Definition and Classification in 1997**

BEA's estimates for 1997 on sales of services by U.S. affiliates of foreign companies (described in this report as *U.S. purchases* from U.S.-based majority-owned affiliates of foreign-parent firms) are based on industry classifications derived from the 1997 North American Industry Classification System (NAICS).<sup>1</sup> The NAICS is the newly instituted classification system for all economic activities, developed by the United States, Canada, and Mexico.<sup>2</sup> The estimates on U.S. purchases from affiliates of foreign firms for years prior to 1997 are based on industry classifications derived from the 1987 U.S. Standard Industrial Classification (SIC).<sup>3</sup>

Adoption of the NAICS system required a redefinition of purchases of services from U.S.-based affiliates of foreign firms. The use of NAICS-based definitions and classifications in redefining service industries created a discontinuity between estimates for U.S. purchases in 1997 and such purchases recorded for earlier years. Moreover, comparability is reduced between data on U.S. purchases and data on sales of services to foreign persons by foreign-based affiliates of U.S.-parent firms, for which data are still collected using SIC-based classifications. Beginning with data for 1999, scheduled for publication in preliminary form in 2001, estimates on U.S. sales by foreign affiliates will be collected using NAICS-based classifications and definitions.

The redefinition of U.S. purchases of services from affiliates under the NAICS system is believed to raise the estimated value of such purchases. The reason for this increase is that those transactions defined as purchases of services under the NAICS that were previously defined as purchases of goods under the SIC system exceed purchases of goods under the NAICS that were formerly defined as purchases of services under the SIC system. Examples of purchases newly classified as transactions in service industries under the NAICS include purchases from publishers of newspapers, periodicals, books, and records, and purchases from restaurants. Alternatively, NAICS-based definitions of purchases of services exclude some purchases that SIC-based definitions include, such as purchases from firms that reproduce software and video, and from dental laboratories.<sup>4</sup>

The conversion to NAICS-based classifications is likely to provide certain advantages over the SIC-based classifications, such as greater industry detail, better reflection of new and emerging technologies, and a more logical distinction between goods and services.<sup>5</sup> For example, restaurants are included in retail trade in the SIC; accordingly, sales by restaurants are treated as sales of goods. Under the NAICS classification, restaurants are included in the service industry "accommodation and food services," and their sales are classified as sales of services. The treatment under NAICS better reflects meal preparation, table service, and the provision of facilities for on-site meal consumption, which differentiate restaurants from grocery stores and other establishments providing unprepared food to retail customers, whose sales are treated as sales of goods.

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<sup>1</sup> Office of Management and Budget, *North American Industry Classification System: United States, 1997* (Washington, DC, 1998).

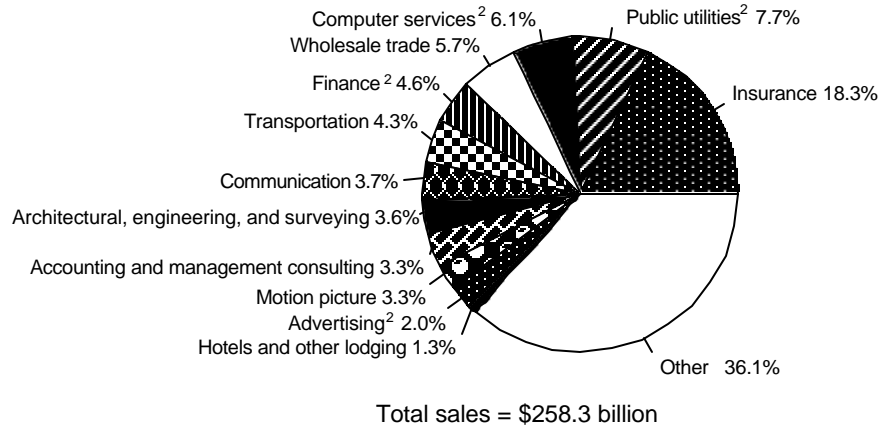
<sup>2</sup> *Ibid.*, p. 11.

<sup>3</sup> Office of Management and Budget, *Standard Industrial Classification Manual, 1987* (Washington, DC: U.S. Government Printing Office, 1987).

<sup>4</sup> For additional information on differences in classifications between NAICS and SIC systems, see *NAICS: United States, 1997*, and Bureau of the Census, *1997 Economic Census, Core Business Statistics Series, Advance Report* (Washington, DC, Mar. 1999), which may be found at Internet address <http://www.census.gov/epcd/www/econ97.html>.

<sup>5</sup> USDOC, BEA, *Survey of Current Business*, Oct. 1999, p. 61.

**Figure 2-6**  
**Affiliate service transactions: U.S. sales,<sup>1</sup> by industry, 1997**



<sup>1</sup> Sales of services by majority-owned foreign affiliates of U.S.-parent firms.

<sup>2</sup> The Bureau of Economic Analysis (BEA) suppressed global sales data for U.S.-owned affiliates in the public-utilities, computer and data processing, advertising, and finance industries so as not to disclose information about the operations of individual firms. However, data that BEA elected to publish on sales by such affiliates in select countries allows computation of the shares reported above. Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, p. 93.

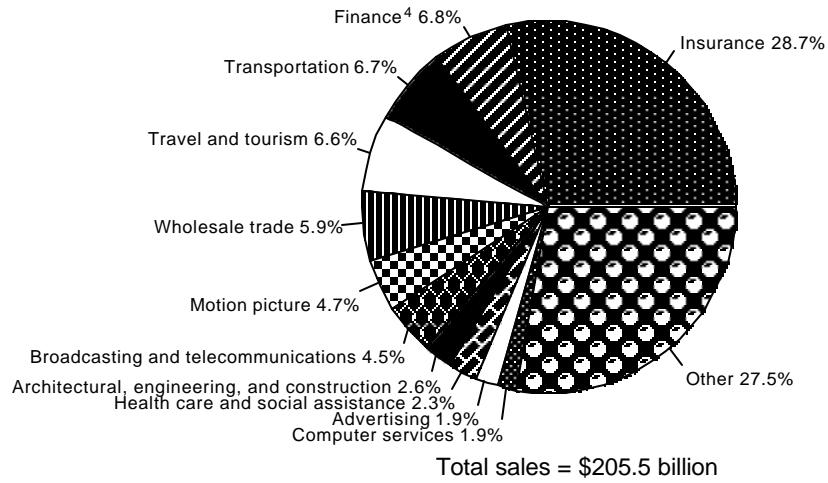
Purchases of services from U.S.-based insurance affiliates of foreign parents accounted for 29 percent of total U.S. purchases of services from foreign-owned affiliates in 1997, reflecting the large presence of foreign insurance companies in the U.S. market (figure 2-7).<sup>15</sup> Purchases from banking and securities affiliates, transportation affiliates, and travel and tourism affiliates of foreign firms each represented 7 percent of total purchases, while purchases from wholesale trade, motion picture and sound recording, and broadcasting and telecommunications affiliates of foreign parents accounted for between 4 percent and 6 percent each. The table in appendix B delineates, where applicable, the activities reflected in official data regarding affiliate transactions.

### ***Affiliate Transactions by Trading Partner***

The majority of U.S. affiliate sales and purchases are transacted with EU Member States, in particular the United Kingdom. In 1997, U.S.-owned affiliates located in the EU accounted for 54 percent of sales, while those in Canada and Japan each accounted for 9 percent (figure 2-8). Growth in foreign affiliates' sales in the EU reflected a 147-percent increase in sales by public utility affiliates in the United Kingdom. Sales also increased among U.S.-owned affiliates in the United Kingdom in a wide range of other industries, such as architectural, engineering, and construction services; accounting and management consulting; wholesale trade; and insurance. Sales of services by affiliates in Canada increased by 15 percent in 1997, while such sales by affiliates in Japan were virtually unchanged due to Japan's continued economic difficulties.

<sup>15</sup> USDOC, BEA, *Survey of Current Business*, Oct. 1999, p. 95.

**Figure 2-7**  
**Affiliate service transactions: U.S. purchases,<sup>1</sup> by industry,<sup>2</sup> 1997<sup>3</sup>**



<sup>1</sup> Purchases of services from majority-owned U.S. affiliates of foreign-parent firms.

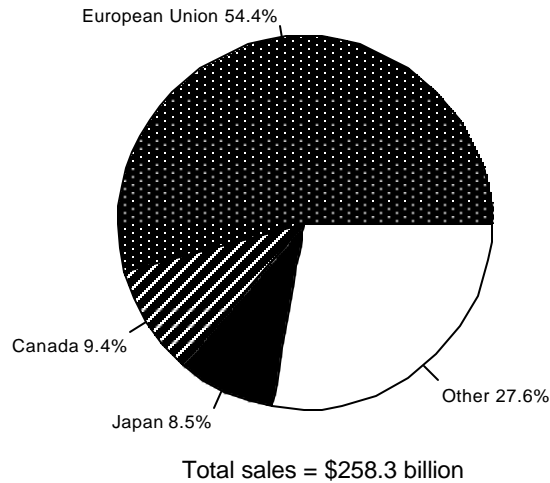
<sup>2</sup> See table 2-3 for description of service industries.

<sup>3</sup> Total may not equal 100 percent due to rounding.

<sup>4</sup> Does not include depository institutions.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, p. 95.

**Figure 2-8**  
**Affiliate service transactions: U.S. sales,<sup>1</sup> by selected trading partners, 1997<sup>2</sup>**

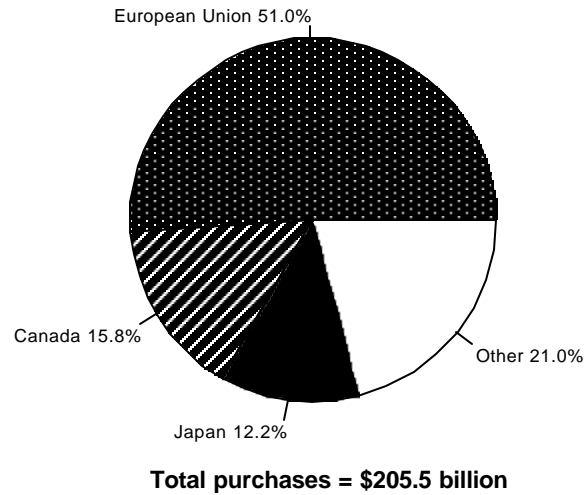


<sup>1</sup> Sales of services by majority-owned foreign affiliates of U.S.-parent firms.

<sup>2</sup> Total may not equal 100 percent due to rounding.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, p. 92.

**Figure 2-9**  
**Affiliate service transactions: U.S. purchases,<sup>1</sup> by selected trading partners, 1997**



<sup>1</sup> Purchases of services from majority-owned U.S. affiliates of foreign-parent firms.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, p. 92.

U.S.-based affiliates owned by EU-parent companies accounted for 51 percent of total U.S. purchases from foreign-owned affiliates in 1997 (figure 2-9). Purchases from British-owned affiliates alone accounted for 24 percent of U.S. purchases, representing almost half of EU-parent firms' share of U.S. purchases. Affiliates of Canadian and Japanese parent firms accounted, respectively, for 16 percent and 12 percent of U.S. purchases. The largest share of U.S. purchases from European- and Canadian-owned affiliates was accounted for by affiliates classified in the insurance industry. By contrast, the largest portions of U.S. purchases from Japanese-owned affiliates were accounted for by affiliates providing wholesale services, financial services other than insurance, and travel and tourism services.

# CHAPTER 3

## ACCOUNTING AND MANAGEMENT CONSULTING SERVICES

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### Introduction

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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.<sup>1</sup> 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 regulations that proscribe transmitting sensitive financial data across borders,<sup>2</sup> 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

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#### *Cross-Border Trade, 1993-98*

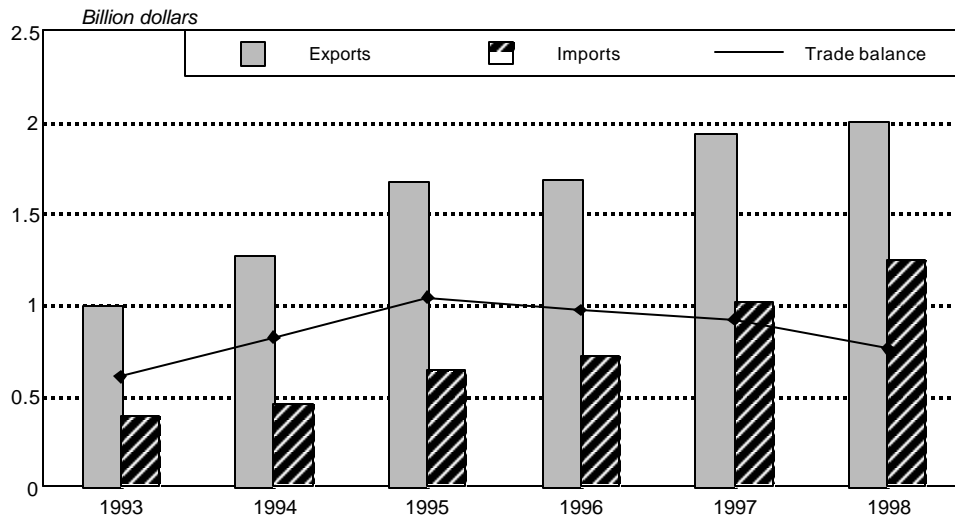
U.S. cross-border exports of accounting and management consulting services totaled \$2.0 billion in 1998, while imports amounted to \$1.2 billion (figure 3-1). Exports grew by 4 percent in 1998, slower than the 18-percent average annual rate of increase during 1993-97, as demand for such services slumped during economic downturns especially in Japan and Brazil. Imports increased by 23 percent in 1998, slightly slower than the 27-percent growth recorded during 1993-97. The trade surplus in such services increased at an 11-percent average annual rate during 1993-97, rising rapidly through 1995 before subsiding in 1996 and 1997. In 1998, the surplus registered \$758 million, a 17-percent reduction compared to the previous year.

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<sup>1</sup> 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 data on accounting, auditing, and bookkeeping services, and data on management, consulting, and public relations services. Affiliate transaction data reported by BEA comprise accounting, research, management, and related services, except for data on U.S. purchases in 1997, which comprise accounting, tax preparation, bookkeeping, and payroll services; management, scientific, and technical consulting; and management of companies and enterprises (for more information, see footnote 4, this chapter).

<sup>2</sup> Usually, there are fewer legal restrictions on servicing clients after an affiliate is established, than on providing such services across borders.

**Figure 3-1**  
**Accounting and management consulting services: U.S. cross-border exports, imports, and trade balance, 1993-98**



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, pp. 64-65.

In 1998, Canada and the United Kingdom appeared to be the largest U.S. export markets for accounting and management consulting services, respectively absorbing 13 percent and 11 percent of exports (figure 3-2).<sup>3</sup> Other major U.S. export markets for such services were Japan and Germany (5 percent each) and Australia (4 percent). With respect to the origin of U.S. imports, the United Kingdom and Canada appeared to lead, respectively accounting for 20 percent and 15 percent of U.S. imports. Other notable suppliers of such imports included Japan and Germany (4 percent each) and Australia and Brazil (3 percent each). The United States generated a surplus on trade in such services with each of these trading partners except the United Kingdom, with which it recorded a \$1-million deficit.

### ***Affiliate Transactions, 1992-97***

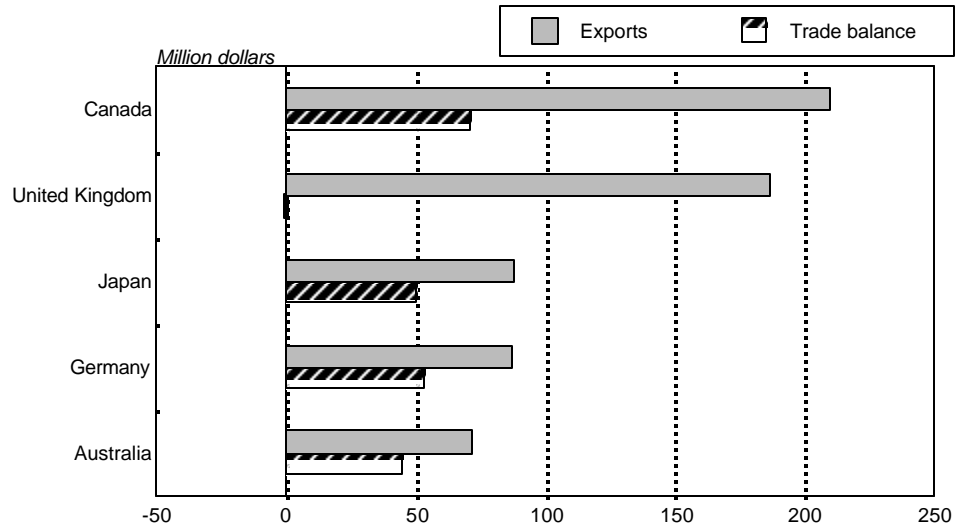
In 1997, U.S.-owned foreign affiliates in accounting and management consulting services generated sales of \$8.5 billion to foreign consumers (figure 3-3). Sales of such services by foreign-based affiliates of U.S. firms rose by 10 percent in 1997, up slightly from the average increase of 9 percent per year during 1992-96 (despite a 5-percent decline in 1993). Meanwhile, foreign-owned accounting and management

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<sup>3</sup> 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.

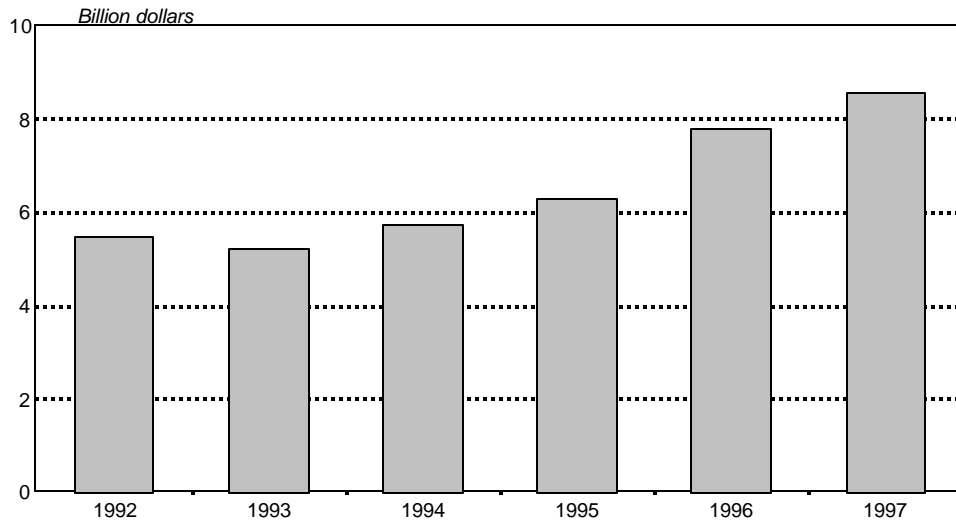


**Figure 3-2**  
**Accounting and management consulting services: U.S. cross-border exports and trade balance, by major trading partners, 1998**



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, p. 91.

**Figure 3-3**  
**Accounting and management consulting affiliates: Sales of services by majority-owned affiliates of U.S. firms, 1992-97**



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, p. 93; Oct. 1998, p. 115; Oct. 1997, p. 137; Nov. 1996, p. 111; and Sept. 1995, p. 104.

consulting affiliates in the United States sold services totaling \$559 million to U.S. consumers in 1997.<sup>4</sup>

The United Kingdom accounted for 20 percent of sales by U.S.-owned affiliates of accounting and management consulting services in 1997, followed by Germany (13 percent), Canada (10 percent), and Switzerland (9 percent) (figure 3-4). As for U.S. purchases from affiliates of foreign-owned firms in 1997, U.S.-based affiliates owned by French parent firms supplied the largest share, 33 percent, followed by affiliates of British firms, with 10 percent.<sup>5</sup>

## Summary and Outlook

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In 1998, the U.S. cross-border surplus of accounting and management consulting services fell by 17 percent, to \$758 million, as the percentage growth of imports exceeded that of exports. The value of the cross-border surplus in such services has eroded annually since 1996. Meanwhile, in 1997, sales to foreign consumers by foreign affiliates of U.S. firms, constituting the dominant means of trade in such services, grew by 10 percent, to \$8.5 billion, slightly surpassing the 9-percent average annual growth rate during 1992-96.

The international accounting and management consulting industry comprises tens of thousands of firms, though a handful of major firms dominate the global market. Among the top 40 international accounting firms, worldwide fee income<sup>6</sup> rose by 14 percent, to \$77.3 billion, growing approximately twice as fast as in the previous year.<sup>7</sup> The five largest accounting firms (the “Big Five”)<sup>8</sup> reported fee income totaling \$60 billion in fiscal 1998, with individual firm income ranging from \$9 billion to \$15 billion. In contrast, the remaining 35 of the top 40 firms reported fee income ranging from \$115 million to \$2 billion each.<sup>9</sup> In the aggregate, the Big Five firms’ fee income grew by 20 percent in fiscal 1998, propelled mostly by growth in these firms’ global consulting revenues, which increased by 30 percent. Seventeen

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<sup>4</sup> BEA reported data on 1997 affiliate purchases using the NAICS (North American Industry Classification System), not the SIC (Standard Industrial Classification) system used to report 1997 affiliate sales data and all affiliate transactions data prior to 1997. As a result, it is not feasible to calculate an analytically sound affiliate transactions balance or the growth rate of affiliate purchases in 1997. For more information on the transition from the SIC to the NAICS, see box 2-1.

<sup>5</sup> Data on affiliates of Japanese and Canadian firms were suppressed by BEA in order to avoid disclosure of individual company data.

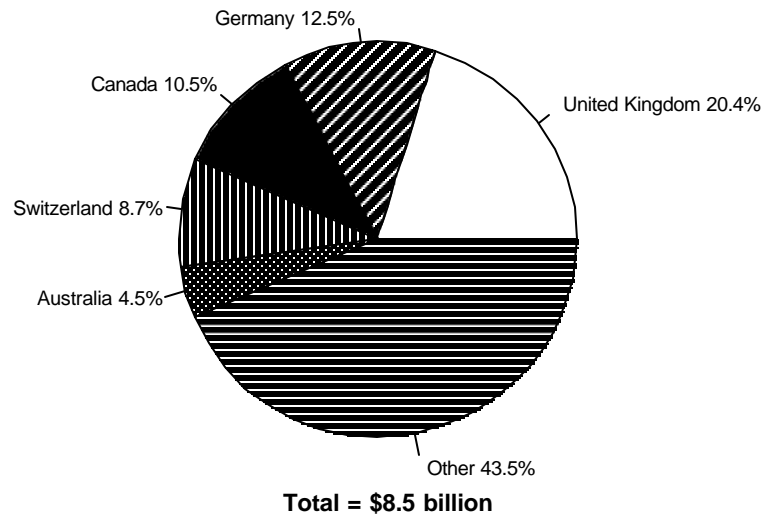
<sup>6</sup> Fee income is income derived from providing certain services, for which a fee is paid.

<sup>7</sup> “Higher Growth All Round,” *Accountancy International*, Aug. 1999.

<sup>8</sup> The Big Five firms are Andersen Worldwide (umbrella entity for Arthur Andersen and Andersen Consulting), Deloitte Touche Tohmatsu, Ernst & Young, KPMG, and PricewaterhouseCoopers.

<sup>9</sup> “Higher Growth All Round.”

**Figure 3-4**  
**Accounting and management consulting affiliates: Sales by majority-owned affiliates of U.S. firms, by principal markets, 1997<sup>1</sup>**



<sup>1</sup> Total may not equal 100 percent due to rounding.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, p. 93.

U.S. firms, including the Big Five accounting firms, numbered among the top 20 firms providing such services globally.<sup>10</sup>

U.S. firms appear to face declining growth in domestic demand for traditional accounting, auditing, and bookkeeping services, while demand for management consulting services has grown at an accelerated pace in recent years.<sup>11</sup> The average price for an audit has declined since 1985,<sup>12</sup> as computerized audit software has proliferated. To remain competitive, accounting firms are shifting resources into consulting services in an effort to help clients understand and improve their business performance. According to U.S. industry sources, accountants are spending nearly 40 percent of their time currently on nontraditional services, such as business strategy and information technology consulting.<sup>13</sup> Such emphasis reinforces foreign perceptions that U.S. accounting and management consulting firms are competitive suppliers of information technology consulting services.

Demand for integrated consulting services from accounting firms, although considerable, has led regulators and legislators to questions compliance with rules

<sup>10</sup> Kennedy Information Research Group, *Consultants News*, June 1999.

<sup>11</sup> The McGraw-Hill Companies and U.S. Department of Commerce, "Professional Business Services," *U.S. Industry and Trade Outlook '99* (New York: McGraw-Hill, 1999), pp. 49-3 and 49-11.

<sup>12</sup> *Ibid.*, p. 49-2.

<sup>13</sup> "No Surprise: CFOs Want More Than Tax Return From Accountants," *Public Accounting Report*, May 31, 1999.

requiring auditors' independence.<sup>14</sup> As a result, several major accounting firms have initiated, or are considering, separation of consulting services from traditional audit and accounting services. Technology companies are leading beneficiaries of opportunities to participate in, or acquire the rapidly growing consulting business of, several leading accounting firms. In February 2000, PricewaterhouseCoopers announced plans to spin off management consulting, business process outsourcing, human resource consulting, and certain corporate finance activities into one or more separate businesses.<sup>15</sup> In the same month, Ernst & Young and information technology firm Cap Gemini agreed, subject to respective approval by partners and shareholders, that Cap Gemini would acquire almost all of Ernst & Young's consulting business.<sup>16</sup> Moreover, KPMG incorporated its consulting entity as KPMG Consulting in January 2000. The consulting firm is to be 80.1 percent owned by KPMG, and 19.9 percent owned by Cisco Systems, Inc., which in August 1999 agreed to invest \$1 billion in KPMG Consulting.<sup>17</sup>

Proposed changes to U.S. accounting rules and methods may affect domestic accounting revenues, as well as legal and financial services revenues. Accounting industry representatives and regulators have criticized the latitude provided to corporate clients in reporting quarterly financial performance data under U.S. generally accepted accounting principles (GAAP).<sup>18</sup> Accordingly, the Securities and Exchange Commission (SEC), in conjunction with stock exchange officials, has proposed tougher corporate disclosure rules to strengthen the qualifications, independence, and diligence of corporate audit committees in reviewing financial statements.<sup>19</sup> Moreover, in a development that could slow the growth of mergers and acquisitions by U.S. clients of accounting firms, the U.S. Financial Accounting Standards Board has proposed abolition of pooling-of-interest bookkeeping, beginning on January 1, 2001.<sup>20</sup> Under pooling-of-interest bookkeeping, a firm making an acquisition may avoid having to write off against profits the usually substantial amount attributed to goodwill, or the premium that an acquirer pays over the acquired firm's book value, which tends to inflate the acquirer's reported earnings. If implemented,

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<sup>14</sup> PricewaterhouseCoopers, "PricewaterhouseCoopers Will Restructure Its Businesses To Create Several Separate Operating Units," press release, found at Internet address <http://www.pwcglobal.com>, posted Feb. 17, 2000, retrieved Mar. 7, 2000.

<sup>15</sup> Ibid.

<sup>16</sup> Cap Gemini, "Cap Gemini and Ernst & Young Have Agreed Terms for the Acquisition of Ernst & Young Consulting," press release, found at Internet address <http://www.capgemini.com/>, posted Feb. 29, 2000, retrieved Mar. 7, 2000.

<sup>17</sup> KPMG, "KPMG LLP Incorporates Consulting Practice," press release, found at Internet address <http://www.kpmg.com/>, posted Jan. 31, 2000, retrieved Mar. 7, 2000.

<sup>18</sup> "Where Are the Accountants?" *Business Week*, Sept. 24, 1998.

<sup>19</sup> U.S. Securities and Exchange Commission, *Fact Sheet: SEC Proposals Implementing Blue Ribbon Committee's Recommendations Regarding Audit Committee Effectiveness*, press release 99-127, Oct. 6, 1999, found at Internet address <http://edgar.sec.gov/news/press/>, retrieved Dec. 9, 1999.

<sup>20</sup> Financial Accounting Standards Board, *FASB Proposes to Eliminate Pooling of Interests for Business Combinations*, press release, Sept. 8, 1999, found at Internet address <http://www.rutgers.edu/accounting/raw/fasb/news/>, retrieved Dec. 9, 1999; and "Accounting Rule Makers Unveil Plan to Abolish Pooling of Interest for M&A," *Wall Street Journal*, Sept. 9, 1999.

such a change would align U.S. accounting practice with that used in certain foreign countries.

U.S. accounting and management consulting firms are likely to benefit from growing demand for management consulting services among foreign governments and newly privatized firms in telecommunication, financial, and energy service markets, and firms facing more stringent regulatory scrutiny. For example, PricewaterhouseCoopers recently expanded its staff in Japan to help Japanese banks appraise and liquidate nonperforming loans. Japanese Government incentives could stimulate more such liquidations, providing a considerable revenue stream to Big Five firms with the capability to provide such services. Additional accounting and consulting revenues derived from the Japanese market are likely to accrue to large U.S. accounting firms skilled at mergers and acquisitions in financial and other service industries.<sup>21</sup> In many foreign markets, local management consulting firms focus on specialized niche markets, and tend not to compete with U.S. firms in arranging mergers, acquisitions, and privatizations.

Explosive growth in the information technology (IT) consulting industry will likely continue to drive change in the accounting and consulting industry. IT transforms a client's business processes by supporting corporate-wide planning, execution, and performance monitoring with regard to supply-chain management, logistics, and customer relationship management.<sup>22</sup> Accounting firms are in the forefront of efforts to develop a single set of industry standards designed to protect the security of electronic transactions such as stock trades, wireless communications, and electronic payment systems.<sup>23</sup> Looking ahead, numerous accounting and management consulting firms anticipate that "knowledge management"<sup>24</sup> may be the next major application of information technology in their industry. One such service, begun in 1997 by Arthur Andersen, allows subscribers to access industry-specific resources and interact with other executives in the same field.<sup>25</sup> Consumers of such services are likely to include firms seeking mergers and acquisitions, Fortune 500 firms, and newly established firms that have not developed a strong business support structure.<sup>26</sup>

In addition to providing consulting services to clients seeking to implement advanced technology systems, accountants and management consultants are using electronic commerce and information technology more extensively in their own businesses. For example, PricewaterhouseCoopers recently consolidated numerous Internet sites to provide basic answers, benchmark information, and consulting advice to clients, especially regarding telecommunication issues. The firm intends to vastly expand the

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<sup>21</sup> "Firms Cash in on Japanese Crisis," *Public Accounting Report*, July 31, 1999.

<sup>22</sup> Ibid.

<sup>23</sup> "Top Secret," *Public Accounting Report*, Jan. 31, 1999.

<sup>24</sup> Although definitions vary, consultants generally view knowledge management as the way a firm employs information-sharing to transform intellectual capital into business value.

<sup>25</sup> "Consultants in the Know," *Public Accounting Report*, Jan. 31, 1999.

<sup>26</sup> Ibid.

use of electronic commerce in all segments of its management consulting practice.<sup>27</sup> Arthur Andersen provides information to clients via its Global Best Practices site for executives, and Ernst & Young provides information for middle managers on its tax site.<sup>28</sup>

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<sup>27</sup> “PwC Commits to E-Business Focus” and “PwC Integrates Consulting Websites,” *Public Accounting Report*, Aug. 31, 1999.

<sup>28</sup> “PwC Integrates Consulting Websites,” *Public Accounting Report*, Aug. 31, 1999.

# CHAPTER 4

## ADVERTISING SERVICES

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### Introduction

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Advertising services include the preparation of advertisements<sup>1</sup> and their placement in various media. Preparatory services encompass the development of advertising plans and the production of creative work, whereas placement services involve the negotiation and purchase of space or time in either print or broadcast media.<sup>2</sup> The U.S. advertising industry accounts for roughly 50 percent<sup>3</sup> of all expenditures on advertising services 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 reportedly cultivate knowledge critical to the successful creation and administration of advertising services, including an understanding of the local media environment, as well as familiarity with consumer tastes, language, and culture. Consequently, foreign-based affiliates tend to develop a competitive advantage over agencies attempting to export advertising services from home offices. In 1997, sales by U.S.-owned advertising affiliates abroad totaled approximately \$5.6 billion,<sup>4</sup> compared to \$624 million earned through cross-border exports of advertising services.<sup>5</sup>

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

<sup>2</sup> 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.

<sup>3</sup> This ratio is calculated by dividing advertising expenditures in the United States (\$214 billion) by total worldwide expenditures (\$426 billion). Advertising expenditures comprise the money that all firms spend to promote their goods and services. *Insider's Report: Robert Coen Presentation on Advertising Expenditures*, McCann-Erickson Worldwide, June 1999, p. 9.

<sup>4</sup> Data on Africa and the Middle East were suppressed by BEA in order to avoid disclosure of individual company data. U.S. Department of Commerce (USDOC), Bureau of Economic Analysis (BEA), *U.S. Direct Investment Abroad: Operation of Parent Companies and Their Foreign Affiliates*, Preliminary 1997 Estimates, Oct. 1999, Table III.F 22.

<sup>5</sup> USDOC, BEA, *Survey of Current Business*, Oct. 1999, p. 90.

## Recent Trends

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### *Cross-Border Trade, 1993-98*

The U.S. cross-border trade deficit in advertising services doubled from \$235 million in 1997 to \$471 million in 1998 (figure 4-1). In 1998, U.S. exports of advertising services equaled \$575 million, an 8-percent decrease from the previous year. This contrasted sharply with the 17-percent average annual rate of growth recorded during 1993-97. Imports, on the other hand, totaled \$1.0 billion in 1998, reflecting 22-percent growth, or roughly three times the 7-percent average annual rate of growth recorded during 1993-97. The sharp increase in U.S. imports of advertising services in 1998 was most likely due to a vibrant U.S. economy and a consequent increase in U.S. demand for advertising services.<sup>6</sup>

The United States' five largest trading partners in advertising services remained unchanged from those of previous years. The five top export markets for advertising services were Canada, accounting for 18 percent of total U.S. advertising exports; the United Kingdom, 11 percent; France, 9 percent; Japan, 7 percent; and Germany, 6 percent. At the same time, U.S. imports of advertising services were highest from Japan and the United Kingdom, comprising 31 percent and 14 percent of total U.S. advertising service imports, respectively. These were followed by Germany, accounting for 8 percent, and France and Canada, each accounting for 5 percent of total U.S. advertising service imports.

Country-specific data indicate that the U.S. trade deficit in advertising services in 1998 was most significantly affected by trade with the United Kingdom and Japan (figure 4-2). In 1998, U.S. exports of advertising services to the United Kingdom decreased by 6 percent, while U.S. imports of advertising services from that country increased by 31 percent, resulting in an \$87-million bilateral deficit. Similarly, U.S. advertising service exports to Japan fell by nearly 26 percent in 1998, whereas U.S. imports of advertising services from Japan rose by 11 percent. This spawned a \$283-million bilateral deficit. The decrease in U.S. advertising exports to Japan most likely derived from the ill effects of the country's financial crisis and a resultant decline in Japanese corporate advertising expenditures.<sup>7</sup>

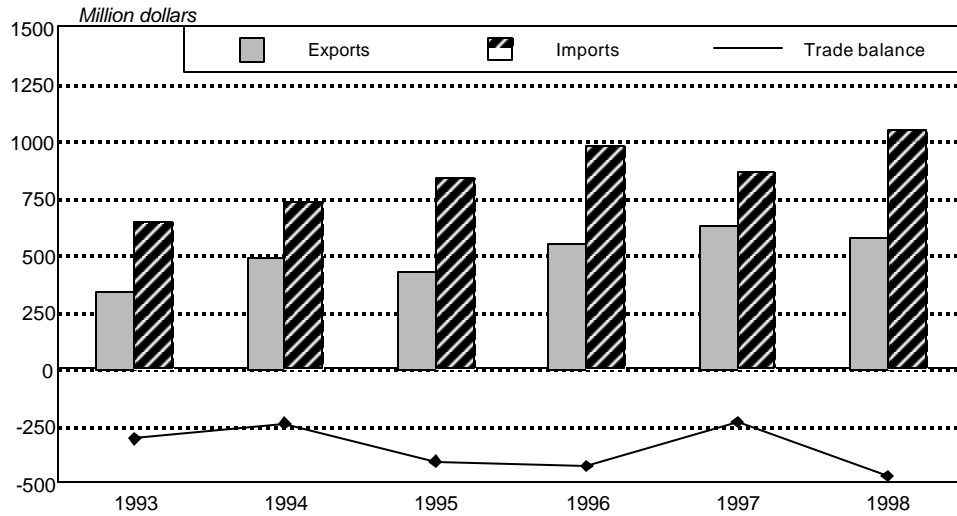
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<sup>6</sup> U.S. advertising expenditures increased by 6.6 percent during 1996-97, and by 7.5 percent during 1997-98. *Insider's Report: Robert Coen Presentation on Advertising Expenditures*, McCann-Erickson Worldwide, Dec. 1997, p. 7, and June 1999, p. 8.

<sup>7</sup> "Professional Business Services," *U.S. Industry & Trade Outlook '99*, p. 49-8.

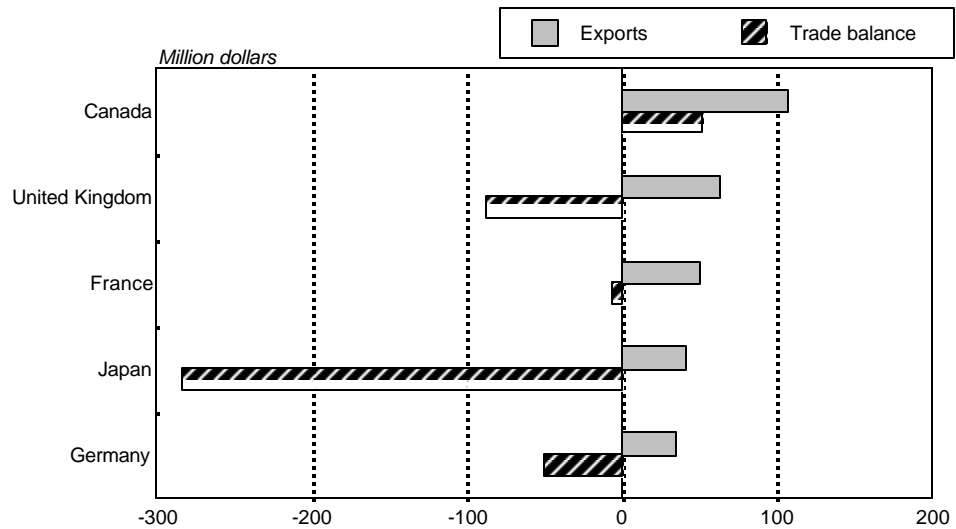


**Figure 4-1**  
**Advertising services: U.S. cross-border exports, imports, and trade balance, 1993-98**



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, pp. 64-65.

**Figure 4-2**  
**Advertising services: U.S. cross-border exports and trade balance, by major trading partners, 1998**



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, p. 91.

## *Affiliate Transactions, 1992-97*

Sales by foreign-based affiliates of U.S. advertising firms amounted to no less than \$5.6 billion in 1997.<sup>8</sup> Overall, U.S.-owned advertising firms in Europe accounted for the largest proportion of such transactions. The sales of British affiliates of U.S. advertising firms amounted to \$966 million, up by 29 percent from the previous year. Similarly, affiliate sales by U.S. advertising firms in France reached \$618 million, an increase of 33 percent over 1996. At the same time, sales by Germany-based affiliates of U.S. advertising firms declined by 12 percent in 1997, to \$752 million. Affiliate sales of U.S. advertising firms in Australia decreased by 2 percent, to \$210 million, and in Japan, by 4 percent, to \$171 million.

Purchases of advertising services from foreign affiliates<sup>9</sup> based in the United States registered \$4.0 billion in 1997. U.S. affiliates of European advertising firms accounted for transactions valued at nearly \$3.9 billion, or 97 percent of total purchases (figure 4-3). U.S. purchases from British-owned affiliates alone amounted to \$2.4 billion. At least one British advertising organization ranks among the top 10 advertising organizations worldwide (see table 4-1),<sup>10</sup> and services from their subsidiary agencies are often procured by some of the largest U.S. firms. For instance, Ford procures advertising services from British-owned agencies J. Walter Thompson and Ogilvy & Mather, and both Eastman Kodak and Proctor & Gamble employ British advertising agency Saatchi & Saatchi.<sup>11</sup>

## **Summary and Outlook**

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In 1998, the U.S. cross-border trade deficit in advertising services reached \$471 million, twice its level in 1997. The U.S. trade deficit in advertising services was most affected by trade with Japan and the United Kingdom. Specifically, U.S. exports of advertising services to Japan decreased by 26 percent in 1998, whereas imports from the United Kingdom increased by 31 percent. Sales by overseas affiliates of U.S. advertising firms appeared to post strong growth in 1997, with U.S. affiliate sales in France and the United Kingdom exhibiting the highest gains. At the same time, U.S. purchases of advertising services were largest from British-owned affiliates, which accounted for 62 percent of such transactions in 1997.

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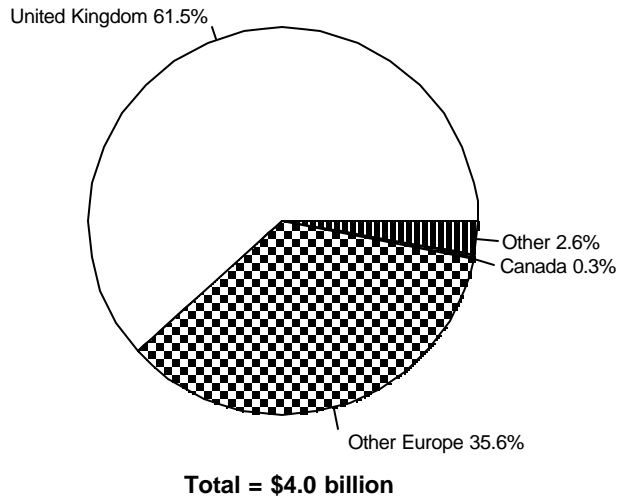
<sup>8</sup> Data on Africa and the Middle East were suppressed by BEA in order to avoid disclosure of individual company data. USDOC, BEA, *U.S. Direct Investment Abroad: Operation of Parent Companies and Their Foreign Affiliates*, Table III.F 22.

<sup>9</sup> BEA reported data on 1997 affiliate purchases using the NAICS (North American Industry Classification System), not the SIC (Standard Industrial Classification) system used to report 1997 affiliate sales data and all affiliate transactions data prior to 1997. As a result, it is not feasible to calculate an analytically sound affiliate transactions balance or the growth rate of affiliate purchases in 1997. For more information on the transition from SIC to the NAICS, see text box 2-1.

<sup>10</sup> "World's Top 50 Advertising Organizations," *Advertising Age*, Apr. 19, 1999, p. s18.

<sup>11</sup> Joy Dietrich, "World Brands," *Ad Age International*, Sept. 1999, pp. 36-42.

**Figure 4-3**  
**Advertising affiliates: Purchases from majority-owned affiliates of foreign firms, by country of ultimate beneficial owner,<sup>1</sup> 1997**



<sup>1</sup> 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.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, p. 95.

**Table 4-1**  
**Top ten global advertising organizations**

Advertising Organization	Headquarters	1998 Gross Income	Largest Subsidiary Network
		<i>(Millions of dollars)</i>	<i>(By gross income)</i>
Omnicom Group	New York	4,812.0	BBDO Worldwide
Interpublic	New York	4,304.5	Amirati Puris Lintas
WPP Group	London	4,156.8	Ogilvy & Mather
Dentsu	Tokyo	1,786.0	DCA Advertising
Young & Rubicam	New York	1,659.9	Young & Rubicam
Havas Advertising	Paris	1,297.9	Euro RSCG Worldwide
True North Communications	New York	1,242.3	Foote, Cone & Belding
Grey Advertising	New York	1,240.4	( <sup>1</sup> )
Leo Burnett Co. <sup>2</sup>	Chicago	949.8	( <sup>1</sup> )
Publicis	New York	930.0	Publicis

<sup>1</sup> None listed.

<sup>2</sup> In November 1999, Leo Burnett Co. (now a subsidiary of the Leo Group) announced plans to merge with U.S. advertising organization, McManus Group. The newly merged firm will have estimated annual revenues of \$1.7 billion.

Source: "Top 25 Global Advertising Organizations" and "World's Top 50 Advertising Organizations," *Advertising Age*, Apr. 19, 1999, p. s18 and pp. s28-s29; and Kathryn Kranhold and Steven Lipin, "Leo, McManus Merge to Form New Ad Giant," *The Wall Street Journal*, Nov. 3, 1999, p. B1.

Robust demand for advertising services in the United States contributed to the strong performance of U.S. advertising organizations and their associated firms in 1998. During that year, 6 of the top 10 global advertising organizations<sup>12</sup> were U.S.-owned (table 4-1).<sup>13</sup> Further, among the top 25 U.S. advertising agencies in 1998, 6 firms posted annual revenue growth from U.S. operations exceeding 20 percent during 1997-1998, while an additional 9 firms registered U.S. revenue gains of over 10 percent.<sup>14</sup> Strong U.S. demand for advertising services has led some non-U.S. advertising organizations to establish headquarters in the United States.<sup>15</sup> For example, Publicis, a French advertising organization, has located its headquarters in New York.<sup>16</sup> Similarly, the British firm Saatchi & Saatchi claims dual headquarters in New York and London.<sup>17</sup>

U.S.-owned advertising organizations remain highly competitive domestically and internationally as they strengthen their subsidiary networks and diversify their roster of in-house expertise. However, increasing demand for cost-effective advertising has encouraged U.S. advertising organizations to restructure their operations. For example, U.S. advertising organization True North Communications plans to combine its two advertising agencies, Foote, Cone & Belding and Bozell Worldwide, to form a large agency network with broad geographic coverage and a diverse collection of specialty shops. The merger would also enable True North to reduce overhead expenditures.<sup>18</sup> Leo Burnett Co.,<sup>19</sup> a Chicago-based advertising organization, has consolidated its media operations under one global company, Starcom Worldwide. Starcom provides services to the organization's multinational clients, including Coca-Cola and Kellogg.<sup>20</sup>

U.S. advertising firms continue to enhance their presence in foreign countries. For instance, Grey Advertising purchased the remaining stake of its joint venture with Japan's Daiko Advertising in 1999. The new firm is reportedly one of the largest

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<sup>12</sup> An advertising organization consists of a holding company and its subsidiaries. Subsidiaries include individual advertising agencies, as well as direct marketing, sales promotion, and other specialty advertising firms.

<sup>13</sup> "World's Top 50 Advertising Organizations," p. s18.

<sup>14</sup> "Top U.S. Consolidated Agencies," *Advertising Age*, Apr. 19, 1999, p. s47.

<sup>15</sup> Industry representative, telephone interview by USITC staff, Sept. 17, 1999.

<sup>16</sup> "World's Top 50 Advertising Organizations," p. s18.

<sup>17</sup> "Saatchi & Saatchi Worldwide Network," found at Internet address <http://www.saatchi-saatchi.com/>, retrieved Sept. 22, 1999.

<sup>18</sup> John Tylee, "FCB and Bozell to Merge Worldwide," *Campaign*, Sept. 10, 1999, p. 1.

<sup>19</sup> In October 1999, Leo Burnett Co. became part of the newly established Leo Group advertising holding company. "Leo Burnett U.S.A. Announces Organizational Changes, Wolf Elevated to Chief Executive Officer and Berman to Chairman of U.S. Agency," Leo Burnett Press Release, Oct. 22, 1999, found at Internet address <http://www.leoburnett.com/>, retrieved Nov. 16, 1999.

<sup>20</sup> Starcom Worldwide provides media services to Coca-Cola in 9 countries, to Kellogg in 45 countries, and to Procter & Gamble in 61 countries. Sally Beatty, "Interpublic Buying Stake in Icon MediaLab," *The Wall Street Journal*, Mar. 25, 1999, and "Leo Burnett Company to Launch Starcom Worldwide," Leo Burnett press release, Mar. 24, 1999, found at Internet address <http://www.leoburnett.com/>, retrieved Sept. 21, 1999.

U.S.-owned advertising agencies in Japan.<sup>21</sup> AdForce, an agency which specializes in the management of online advertising services, recently opened new offices in Beijing and Hong Kong. Anticipating a sharp rise in the demand for online advertising services in other parts of Asia, the agency also plans to establish operations in Japan, Singapore, and South Korea.<sup>22</sup> Similarly, U.S. interactive agency<sup>23</sup> APL Digital soon intends to open its first foreign affiliates in Mexico and Brazil to meet an increasing demand for online advertising services in those countries.<sup>24</sup>

Some countries have recently moved to dismantle, or formally consider dismantling, regulatory barriers imposed on foreign advertising firms, but there are few results as yet. In the European Union (EU), disparate regulations among member states on the advertisement of certain products have historically complicated efforts to develop regional advertising campaigns. For instance, while Sweden prohibits advertising directed toward children, France and Greece proscribe advertisements pertaining to alcohol and toys, respectively.<sup>25</sup> Although a legal framework to harmonize advertising regulations across EU Member States was approved by the European Parliament in 1997, no progress has been made in implementing the attending legislation.<sup>26</sup> In Asia, Vietnamese national laws have historically allowed foreign advertising agencies to establish as representative offices only. However, Vietnam has recently considered relaxing this restriction, and may permit foreign firms to establish joint ventures with local Vietnamese advertising agencies.<sup>27</sup> In addition, the South Korean Government has encouraged industrial conglomerates, or chaebol, to auction in-house advertising agencies for the purpose of raising capital.<sup>28</sup>

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<sup>21</sup> "Grey, FCB Boost Clout in Japan, Youth Market," *Advertising Age*, Aug. 9, 1999, p. 24.

<sup>22</sup> Connie Ling, "AdForce Opens Offices in Beijing and Hong Kong," *The Wall Street Journal*, Sept. 3, 1999, found at Internet address <http://nrstg1s.djnr.com>, retrieved Sept. 14, 1999.

<sup>23</sup> Interactive advertising agencies help advertisers set up their own sites on the Internet and aid them in placing advertising on web sites operated by other companies.

<sup>24</sup> Jeffrey D. Zbar, "Web Hot: Net Marketing Surges in Latin America," *Ad Age International*, Mar. 8, 1999, p. 30.

<sup>25</sup> Juliana Korenteng, "Ad Groups Push for Single EU Ad Market," *Ad Age International*, June 1999, p. 48.

<sup>26</sup> The initiative, entitled the Green Paper on Commercial Communication, is designed to eliminate restrictions on cross-border advertising among EU-member states. Industry representative, correspondence via electronic mail with USITC staff, Sept. 17, 1999; and Korenteng, "Ad Groups Push for Single EU Ad Market," p. 48.

<sup>27</sup> In March 1998, the Vietnamese Government permitted U.S. advertising agency Leo Burnett to form a Business Cooperation Contract (BCC) with a local advertising firm. Reportedly, under BCC arrangements, foreign firms retain neither control nor ownership rights. Will Conroy and Normandy Madden, "Foreign Ad Agencies May Lose Vietnam Loopholes," *Advertising Age*, Feb. 8, 1999, p. 9; and Harry Knowles, "Vietnam Nears Approval of Int'l Agency Ventures," *Ad Age International*, Aug. 1999, p. 13.

<sup>28</sup> The chaebol do not appear willing to place advertising agencies for sale, and few foreign advertising organizations seem interested in purchasing such firms. "Networks Not Jumping at Rare Opportunity in Korea," *Ad Age International*, July 1999, p. 24.

The U.S. advertising industry appears poised to benefit from the global growth of electronic commerce and a resultant increase in demand for online advertising services.<sup>29</sup> U.S. online advertising expenditures are forecasted to grow from \$2.8 billion in 1999 to \$22 billion in 2004. During the same period, online advertising expenditures in Europe are anticipated to reach \$5.5 billion; in the Asia Pacific region, \$3.3 billion; and in Latin America, \$1.6 billion.<sup>30</sup> U.S. advertising firms have prepared themselves to meet the rapid growth in demand for online advertising services either by acquiring independent online advertising shops or by establishing their own interactive agencies. For example, each of the four largest U.S. advertising organizations, including Omnicom Group, Ha-Lo, Grey Advertising, and True North Communications, have purchased at least one agency dedicated to Internet advertising.<sup>31</sup> At the same time, U.S. agency networks, such as BBDO, have developed their own online advertising shops.<sup>32</sup>

Already, electronic commerce has altered the types of services procured by companies that wish to run advertisements. While some companies are turning to specialty online advertising agencies with expertise in web site development, others are procuring services from Internet-ad management firms that distribute online advertisements. For example, U.S. advertising shops iXL and Strategic Interactive Group employ engineers who provide technological assistance to the agencies' clients.<sup>33</sup> DoubleClick Inc., a U.S. Internet advertising firm, has developed a proprietary system to target advertisements to specific online consumers.<sup>34</sup> To the extent that U.S. advertising agencies continue to build the capabilities required of them by firms engaged in electronic commerce, they will likely strengthen their overall strategic position in the global advertising industry. At the same time, however, such firms will be challenged to overcome barriers affecting the provision of online advertising services in foreign countries. These barriers include lack of telecommunication infrastructure, high telecommunication costs, and government restrictions on data exchange.<sup>35</sup>

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<sup>29</sup> For further information, see USITC, "Internet Advertising," *Industry, Trade, and Technology Review*, USITC publication 3134, Sept. 1998.

<sup>30</sup> By 2004, online advertising expenditures are projected to account for roughly 8 percent of total advertising expenditures in the United States, 5 percent in Europe, 6 percent in the Asia Pacific region, and 11 percent in Latin America. Michael Pastore, "Global Ad Spending: \$33 Billion by 2004," *Ad Resource*, Aug. 13, 1999, found at Internet address <http://www.adres.internet.com>, retrieved Sept. 9, 1999.

<sup>31</sup> "Top 25 Global Advertising Organizations," *Advertising Age*, Apr. 19, 1999, pp. s28-s29; and "Grey Advertising Acquires Beyond Interactive," *PR Newswire*, July, 27, 1999, found at Internet address <http://www.newscast.com/>, retrieved Sept. 8, 1999.

<sup>32</sup> Patricia Winters Lauro, "BBDO New York Enters Cyberspace in a Big Way," *The New York Times*, Aug. 31, 1999, found at Internet address <http://www.pointcast.com/>, retrieved Sept. 10, 1999.

<sup>33</sup> Jennifer Gilbert, "Web Shops Savor Their Differences from Ad Agencies," *Advertising Age*, July 26, 1999, p. s14.

<sup>34</sup> "DoubleClick Receives Patent on Technology to Deliver Web Ads," *The Wall Street Journal*, Sept. 13, 1999, p. B3.

<sup>35</sup> For example, the European Union's Data Protection Directive prohibits the transfer of data gathered on consumers inside the EU to third-party countries. Industry representative, telephone interview by USITC staff, Sept. 17, 1999.

# CHAPTER 5

## AIR TRANSPORTATION SERVICES

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### Introduction

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For the purpose of this discussion, air transportation services include passenger transportation, freight transportation, and port services. Exports of passenger transportation services arise when U.S. carriers transport foreign residents to and from the United States or between two foreign points of travel. Conversely, imports occur when foreign carriers transport U.S. residents between the United States and foreign countries.<sup>1</sup> Trade in freight transportation and port services predominantly stems from merchandise trade. For instance, exports of freight transportation services take place when U.S. airlines transport U.S. merchandise exports to foreign destinations, or when U.S. carriers convey cargo between two foreign ports.<sup>2</sup> Imports of freight transportation services, on the other hand, occur when foreign airlines transport foreign merchandise imports to the United States.<sup>3</sup> Finally, exports of port services encompass the value of goods and services procured by foreign airlines at U.S. airports, whereas imports of port services comprise the value of goods and services procured by U.S. carriers in airports of foreign countries.

Trade in airline transportation services is predominantly a cross-border transaction. For this reason, the following discussion will focus on cross-border trade in air transportation services.

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<sup>1</sup> Payments by U.S. residents to foreign carriers for travel between two foreign points are not incorporated in passenger fare data. Rather, such payments are recorded in the travel and tourism data prepared by the Bureau of Economic Analysis (BEA). BEA official, telephone interview by USITC staff, Nov. 16, 1998.

<sup>2</sup> 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, bears all subsequent transportation costs. Therefore, receipts of U.S. carriers for the transport of U.S. imports are excluded from U.S. transportation exports because, by this convention, they represent transactions between U.S. parties. By the same token, payments to foreign carriers for transporting U.S. exports are not included in U.S. transportation imports because they represent transactions between foreign residents and foreign airline, vessel, and truck operators. U.S. Department of Commerce (USDOC), BEA, *Survey of Current Business*, Oct. 1998, p. 78.

<sup>3</sup> 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, telephone interview by USITC staff, Nov. 16, 1998.

## **Recent Trends in Cross-Border Trade, 1993-98**

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The U.S. trade balance in air transport services shifted from a surplus of \$2.1 billion in 1997 to a deficit of \$494 million in 1998 (figure 5-1). The fall in the U.S. trade balance was due largely to an increase in imports of air passenger transport services and a concurrent decrease in exports of such services. Specifically, U.S. cross-border exports of air transport services totaled \$31.9 billion in 1998, a decrease of 3 percent from the previous year. This decrease contrasted with an average annual growth rate of 7 percent recorded during 1993-97. At the same time, U.S. cross-border imports of air transport services reached \$32.4 billion, a gain of 5 percent over 1997. This growth rate was slower than the 9-percent average annual increase registered during 1993-97.

In 1998, the largest U.S. export markets for air transport services included Japan, accounting for 16 percent of total U.S. exports; the United Kingdom, 11 percent; Canada, 6 percent; and Germany and Brazil, each accounting for 5 percent (figure 5-2). The overall U.S. trade balance in air transport services was most significantly affected by trade with Japan and the United Kingdom. The U.S. trade surplus in air transport services with Japan fell by 44 percent to \$2.1 billion in 1998, primarily due to a 34-percent drop in U.S. passenger fare receipts. The decline principally reflected a reduction in the number of Japanese citizens traveling to the United States on U.S. airlines. The U.S. trade deficit in air transport services with the United Kingdom grew by 53 percent in 1998 to \$2.2 billion, due largely to a 17-percent increase in U.S. imports of air passenger transport services and a 16-percent increase in U.S. imports of port services.<sup>4</sup> The growth in U.S. port service payments to the United Kingdom corresponded with an increase in U.S. freight service exports to that country.

## **Summary and Outlook**

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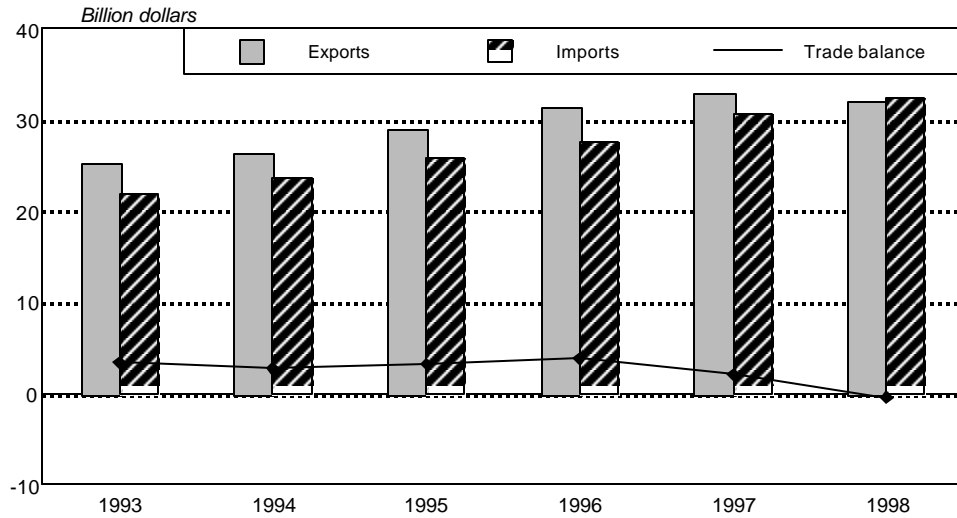
In 1998, the U.S. trade balance in air transport services registered its only deficit during 1993-98. This trade deficit, which totaled \$494 million, resulted from a 3-percent decline in U.S. exports and a 5-percent rise in U.S. imports. The decrease in U.S. exports of air transport services derived partly from reductions in both the number of Japanese passengers and the amount of U.S. merchandise exports transported to Japan on U.S. airlines. Conversely, the increase in U.S. imports was affected significantly by a rise in the number of U.S. citizens traveling on British airlines and in the value of services procured by U.S. airlines at British ports.

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<sup>4</sup> 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 Surveys Conducted by the Bureau of Economic Analysis," Mar. 1998, p. 117.

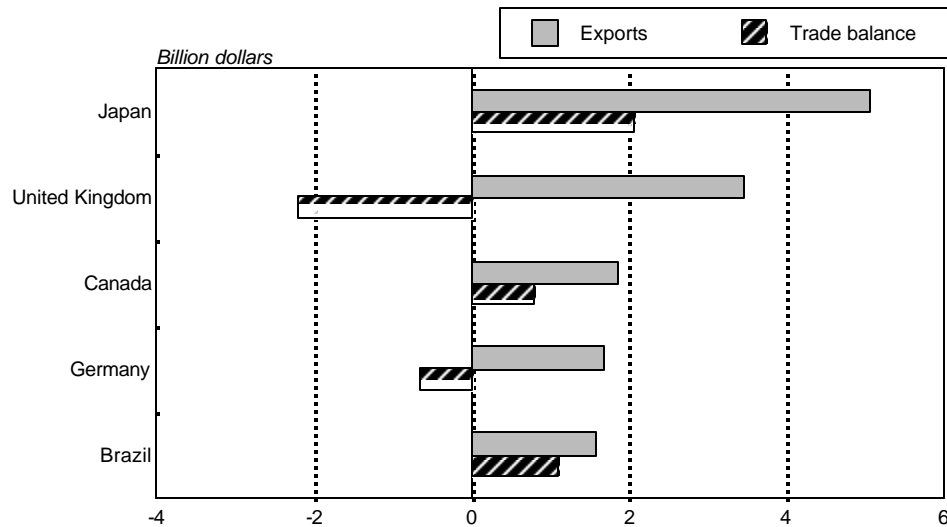


**Figure 5-1**  
**Air transportation services: U.S. cross-border exports, imports, and trade balance, 1993-98**



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, pp. 68-71; Oct. 1998, p. 90; and Oct. 1997, p. 112.

**Figure 5-2**  
**Air transportation services: U.S. cross-border exports and trade balance, by major trading partners, 1998**



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, p. 71.

Industry representatives indicate that during 1998-2010, passenger traffic between the United States and foreign countries is expected to increase at an average annual rate of 5 percent.<sup>5</sup> These representatives assume that the U.S. economy will remain strong and that Asia and Latin America will experience economic recovery.<sup>6</sup> At the same time, air cargo traffic between the United States and foreign countries is expected to increase at an average annual rate of 7 percent during 1998-2010.<sup>7</sup> As with air passenger travel, expectations of growth in air cargo will rely on favorable worldwide economic conditions and a resultant increase in demand for the international transport of goods.<sup>8</sup> In addition, the air transport industry will likely benefit from the continued liberalization of international aviation markets and from cost efficiencies achieved through global consolidation of the airline industry.

The strong competitive position of U.S. airlines, combined with the robust demand for international air transport services, have encouraged the United States to continue to negotiate open skies agreements.<sup>9</sup> In 1999, the United States concluded new open skies agreements with Argentina, Bahrain, the Dominican Republic, Pakistan, Portugal, Qatar, Tanzania, and the United Arab Emirates, bringing the total number of such agreements to 39.<sup>10</sup> During the same year, the United States negotiated more liberal bilateral arrangements with China, Mexico, and Russia. The agreements permit U.S. air carriers to operate additional flights between the United States and these three countries or to increase code-sharing opportunities.<sup>11</sup>

It is not clear how much more the U.S. industry may gain from further open skies agreements. Some industry experts note that the United States has already negotiated open skies agreements with nearly all of the largest countries that support international air transport liberalization. The United States now endeavors to negotiate open skies agreements with those countries that traditionally have been reluctant to engage in an open skies regime. Such countries include Brazil, with which an open skies agreement remains elusive due to the country's precarious

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<sup>5</sup> In particular, passenger traffic between the United States and Latin America, the Asia Pacific region, and Europe is projected to grow at average annual rates of 6.3 percent, 5.8 percent, and 4.4 percent, respectively, during 1998-2010. U.S. Department of Transportation, Federal Aviation Administration, *Aerospace Forecasts: Fiscal Years 1999-2010*, Mar. 1999, pp. I-11 and I-12.

<sup>6</sup> *Ibid.*, p. I-12.

<sup>7</sup> U.S. Dept. of Transportation, *Aerospace Forecasts*, p. I-14.

<sup>8</sup> *Ibid.*, p. III-40.

<sup>9</sup> 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.

<sup>10</sup> U.S. Department of Transportation, Office of the Assistant Secretary for Aviation and International Affairs, "U.S. Bilateral Aviation Agreements: New/Expanded Agreements in the Current Administration," updated Nov. 1999; and U.S. Department of Transportation, "United States, Dominican Republic Reach Open Skies Agreement," News Release, Dec. 16, 1999, found at Internet address <http://www.dot.gov/affairs/dot21699.htm>, retrieved Dec. 20, 1999.

<sup>11</sup> 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. Office of the Assistant Secretary for Aviation and International Affairs, "U.S. Open Skies Agreements," found at Internet address <http://ostpxweb.dot.gov/aviation/IntAv/OpenSky.htm/>, retrieved July 21, 1999.

economic situation;<sup>12</sup> and the United Kingdom, with which open skies negotiations have been postponed.<sup>13</sup> Both the United States and its trading partners have considered alternatives to the bilateral open skies framework. In particular, some countries have proposed the establishment of regional agreements that liberalize the provision of air transport services between the United States and multiple foreign countries.<sup>14</sup> Others have proposed the negotiation of a multilateral aviation agreement under the auspices of the World Trade Organization.<sup>15</sup>

The formation of global alliances remains an ongoing trend within the airline industry. Through the establishment of global alliances, airlines can achieve economies of scale and extend the geographic scope of their networks.<sup>16</sup> Currently, there are four major air carrier alliances, each with a minimum of four member airlines. The four alliances include Atlantic Excellence/Qualiflyer, Northwest/KLM, Star Alliance, and oneworld.<sup>17</sup> The most developed of these alliances have received antitrust immunity, enabling members to coordinate flight schedules, combine frequent flyer plans, and share revenues and profits.<sup>18</sup> In June 1999, Delta Air Lines and Air France announced that they would form a new global alliance which would link Delta's Atlanta hub with Air France's Paris hub. The alliance would enable both carriers to transport passengers between the United States and cities in Africa, Asia, Europe, and the Middle East.<sup>19</sup>

According to some industry experts, however, the current trend toward alliances may

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<sup>12</sup> Karen Walker, "A World Apart," *Airline Business*, Aug. 1999, pp. 28-29.

<sup>13</sup> Negotiations pertaining to the open skies agreement were postponed in July 1999 when the United States rejected an application for antitrust immunity submitted by American Airlines and British Airways. U.S. Department of Transportation, Office of the Assistant Secretary for Public Affairs, "Statement of Transportation Secretary Rodney E. Slater on American/British Airways," news release, July 30, 1999, found at Internet address <http://www.dot.gov/affairs/dot11299.htm>, retrieved Sept. 27, 1999; and Karen Walker, "AA/BA Antitrust Crumbles," *Airline Business*, Sept. 1999, p. 11.

<sup>14</sup> For example, one proposal considers the formation of a "transatlantic common aviation area" between the United States and member states of the EU. Another proposal considers liberalizing air transport services among members of the Asia-Pacific Economic Cooperation (APEC) forum. U.S. Dept. of Transportation official, correspondence via electronic mail with USITC staff, July 28, 1999; and Karen Walker, "Sans Frontiers," *Airline Business*, Feb. 2000, pp. 34-35.

<sup>15</sup> Industry representative, telephone interview by USITC staff, Sept. 28, 1999.

<sup>16</sup> Alliance members achieve economies of scale through jointly purchasing goods and services, such as aircraft, and maintenance and repair services. Nicolas Ionides, "Two Years Old and Still Growing," *Airline Business*, June 1999, pp. 34-35.

<sup>17</sup> Core members of the Atlantic Excellence/Qualiflyer alliance include Austrian Airlines, Delta Airlines, Sabera, and Swissair, among others; members of the Northwest/KLM alliance include KLM, Northwest, Alitalia, and Continental; members of the Star Alliance include Air Canada, Lufthansa, SAS, and United Airlines, among others; and members of the oneworld alliance include American Airlines, British Airways, Canadian Int'l, Cathay Pacific, and Qantas. Kevin O'Toole, "The Major Airline Alliance Groupings," *Airline Business*, July 1999, p. 37.

<sup>18</sup> *Ibid.*, pp. 36-37.

<sup>19</sup> "Air France and Delta Air Lines Forge Global Alliance," *Business Wire*, June 22, 1999.

be short-lived.<sup>20</sup> They suggest that if countries relax foreign ownership restrictions on national airlines, alliance formation would likely be superseded by a wave of mergers and acquisitions.<sup>21</sup> Historically, governments have restricted foreign ownership of national flag carriers out of concern that such ownership would compromise passenger safety and national security. The United States currently prohibits foreign investors from holding more than a 25-percent equity stake in an U.S. airline.<sup>22</sup>

Although U.S. passenger airlines have benefitted from the opening of air transportation markets and the emergence of cross-border alliances, the impact of such trends on the cross-border provision of air cargo services is mixed. In some cases, bilateral agreements have not expanded the rights of all-cargo carriers sufficiently.<sup>23</sup> In other instances, allied passenger carriers have chosen not to integrate their air cargo operations.<sup>24</sup> For example, a bilateral aviation agreement between the United States and the United Kingdom prohibits U.S. express carrier FedEx from flying between the United Kingdom and third-party countries.<sup>25</sup> Similarly, the Star Alliance only provides limited opportunity for member airlines to streamline their cargo operations. Although two of the Star Alliance members, United Airlines and Lufthansa, share cargo-handling facilities, no agreement exists among all eight members regarding the combination of warehousing facilities or the integration of cargo management systems.<sup>26</sup> Nonetheless, as air carriage plays an increasingly important role in the international transport of goods,<sup>27</sup> air cargo services will likely receive broader coverage in future bilateral agreements and global

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<sup>20</sup> Industry representative, telephone interview by USITC staff, Sept. 28, 1999.

<sup>21</sup> Karen Walker, "The Great Global Debate," *Airline Business*, Sept. 1999, pp. 96-97; and Perry Flint, "Alliance Paradox," *Air Transport World*, Apr. 1999, p. 34.

<sup>22</sup> Joan M. Feldman, "Empty Gesture?" *Air Transport World*, May 1999, p. 47.

<sup>23</sup> Industry representative, telephone interview by USITC staff, Sept. 28, 1999. All-cargo carriers include express delivery service providers such as FedEx, and non-express cargo airlines such as U.S. cargo carrier Polar Air.

<sup>24</sup> Passenger carriers, such as Northwest Airlines and United Airlines, transport cargo either in the "belly" of passenger planes or in "freighters", which are aircraft designed to carry heavy cargo. Chris Isidore, "Airline Alliances Are Leaving Cargo Out of the Hold," *Journal of Commerce*, Feb. 2, 1999, found at Internet address <http://www.joc.com/>, retrieved Sept. 23, 1999.

<sup>25</sup> Bruce Barnard, "FedEx Denies Charges of 'Blackmailing' Britain," *Journal of Commerce*, Mar. 18, 1999, found at Internet address <http://www.joc.com/>, retrieved Sept. 23, 1999.

<sup>26</sup> Cargo management systems are electronic networks which track shipments, book cargo space on airlines, and bill customers. Each carrier has its own cargo management system which may or may not be compatible with that of another airline. Isidore, "Airline Alliances Are Leaving Cargo Out of the Hold;" and Douglas W. Nelms, "Close, But No Cigar," *Air Transport World*, Sept. 1999, pp. 75-76.

<sup>27</sup> According to MergeGlobal Inc., a consulting firm specializing in the air freight industry, the proportion of cargo transported by air will have doubled between the years 1993 and 2003. By 2003, air freight will account for an estimated 41.4 percent of the total volume of freight transported worldwide. David Hoppin and Brian Clancy, "Turbulence Ahead: The 1999 MergeGlobal World Air Cargo Forecast," *Air Cargo World*, May 1999, p. 26.

alliances.<sup>28</sup> In December 1999, the United States and Australia signed an open skies agreement that applies exclusively to air cargo services.<sup>29</sup> At the same time, the newly-formed alliance between Delta Air Lines and Air France reportedly will include cooperative arrangements between the two carriers' cargo operations.<sup>30</sup>

Both the passenger and cargo segments of the U.S. air transportation industry are anticipated to benefit from the further development of electronic commerce. Passenger carriers achieve a cost savings of nearly 75 percent each time they sell a ticket through a proprietary Internet site rather than through a travel agent.<sup>31</sup> Such cost savings will likely encourage airlines to shift a larger proportion of their sales from travel agents to Internet sites.<sup>32</sup> For example, although United Airlines currently sells only 3 percent of its tickets online, the airline forecasts that its Internet sales will account for nearly 20 percent of total ticket sales by 2003.<sup>33</sup> Overall, it is estimated that total online travel sales will increase from \$2 billion in 1998 to \$12 billion in 2002.<sup>34</sup> Given the high brand awareness and competitive fares of U.S. airlines, online ticket distribution will likely enable U.S. airlines to generate increased sales in foreign markets.

U.S. air cargo carriers also are expected to benefit from the growth of online retailing.<sup>35</sup> For instance, Dell Computer currently derives 20 percent of its revenues from product sales over the Internet, and frequently ships its goods to consumers by air. As manufacturers sell an increasing proportion of their products through the Internet, they will require the services of air cargo carriers to transport smaller, more frequent shipments directly to customers.<sup>36</sup> Given the strength of U.S. cargo carriers such as DHL, FedEx, and UPS, U.S. airlines will likely provide a progressively larger volume of express cargo services worldwide.

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<sup>28</sup> Industry representative, telephone interview by USITC staff, Sept. 28, 1999.

<sup>29</sup> U.S. Department of Transportation, Office of the Assistant Secretary for Public Affairs, "United States, Australia Agree to Open Skies for Cargo," news release, Dec. 14, 1999, found at Internet address <http://www.dot.gov/affairs/dot21599.htm>, retrieved Dec. 20, 1999.

<sup>30</sup> Chris Isidore, "Cargo Part of Equation for Delta, Air France," *Journal of Commerce*, June 23, 1999, found at Internet address <http://www.joc.com/>, retrieved Sept. 23, 1999.

<sup>31</sup> This percentage was calculated using data provided on travel agent and proprietary web site bookings. While the former is estimated to cost \$23 per transaction, the latter is estimated to cost just \$6. Flint, "Alliance Paradox," p. 36.

<sup>32</sup> Airlines have two options for distributing tickets via the Internet: they may use online booking services such as Expedia, Travelocity, or Priceline.com, or, as mentioned above, they may sell tickets through their own Internet sites. Nancy Fonti, "Airlines Aim to Reroute Ticket Buyers to the Web," *The Wall Street Journal*, Apr. 19, 1999, p. B3E.

<sup>33</sup> Dennis Blank, "Raising the Internet Stakes," *Airline Business*, Sept. 1999, p. 92.

<sup>34</sup> Although travel sales are comprised primarily of airline ticket sales, they also include hotel reservations and car rentals. Fiona Swerdlow, "Disintermediation Challenges in the Online Travel Market," presentation made at the 24th Annual Commercial Aviation Forecast Conference, sponsored by U.S. Department of Transportation, Federal Aviation Administration, Washington, DC, Mar. 24-25, 1999.

<sup>35</sup> Satish Jindel, "Delivering E-Commerce," *Air Cargo World*, found at Internet address <http://www.aircargoworld.com/>, retrieved Sept. 27, 1999.

<sup>36</sup> *Ibid.*

# CHAPTER 6

## ARCHITECTURAL, ENGINEERING, AND CONSTRUCTION SERVICES

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### Introduction

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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.<sup>1</sup> Engineering firms provide planning, design, construction, and management services for projects such as civil engineering works and residential, commercial, industrial, and institutional buildings.<sup>2</sup> 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 AEC services is predominantly undertaken by affiliates in foreign markets.<sup>3</sup> 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 items such as blueprints and designs across national boundaries via mail, telecommunication networks, or other means.

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

<sup>2</sup> 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.

<sup>3</sup> 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

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### *Cross-Border Trade, 1993-98*

In 1998, U.S. cross-border exports of architectural, engineering, and construction services totaled \$4.1 billion, up 16 percent from 1997 (figure 6-1). This single-year growth rate easily exceeds the 10-percent average annual growth rate registered during 1993-1997. In 1998, exports to Europe, Latin America, and Africa grew by 25 percent, 36 percent, and 28 percent, respectively. These increases, combined with a smaller increase in receipts from Asian markets, account for the increase in the export growth rate.<sup>4</sup>

Similarly, U.S. cross-border imports of AEC services increased by 52 percent in 1998, rising to \$699 million. This reverses the 2-percent decline recorded in 1997 and resumes the growth trend apparent since 1994. During 1993-1997, imports of AEC services increased at an average annual rate of 10 percent. Despite the increase in imports, however, the trade surplus grew by 10 percent to \$3.4 billion in 1998. This increase is consistent with the 10-percent average annual increase in the AEC trade surplus recorded during 1993-1997.

In 1998, Indonesia remained the largest market for cross-border trade of AEC services (figure 6-2). Exports to Indonesia rose by 4 percent to \$627 million in 1998, despite the country's continued political and economic difficulties. U.S. exports to the United Kingdom, Saudi Arabia and China rose by 24 percent, 13 percent, and 21 percent, respectively. Venezuela moved ahead of South Korea to become the fifth-largest U.S. export market for AEC services. Specifically, U.S. exports to Venezuela increased by 62 percent to \$160 million in 1998, while U.S. exports to Korea decreased by 15 percent to \$123 million.

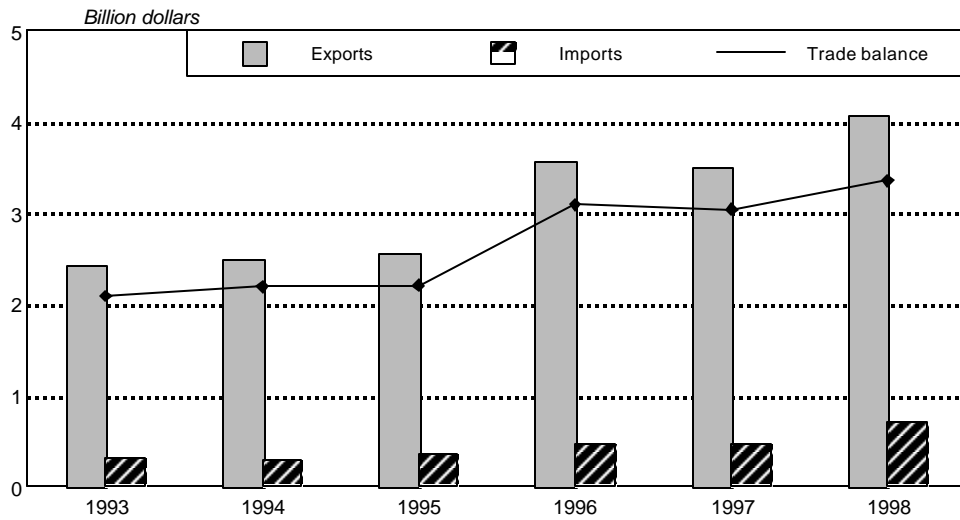
### *Affiliate Transactions, 1992-97*

In 1997, sales of AEC services to foreign persons by U.S. majority-owned affiliates increased by 2 percent to \$9.6 billion (figure 6-3). This increase was well below the 12-percent average annual growth rate recorded during 1992-1996. The United Kingdom, the Netherlands, and Canada accounted for over one-half of all sales of services by foreign-based AEC affiliates of U.S. firms in 1997 (figure 6-4). The United Kingdom was by far the largest foreign market for U.S. affiliate sales of AEC services in 1997, accounting for \$3.7 billion, or 39 percent, of such sales, while the Netherlands and Canada respectively accounted for 11 percent and 5 percent of U.S. AEC affiliate sales. France and Germany, the fourth- and fifth-largest markets for sales by foreign-based AEC affiliates of U.S. firms, accounted for 4 percent and 1 percent of such sales, respectively.

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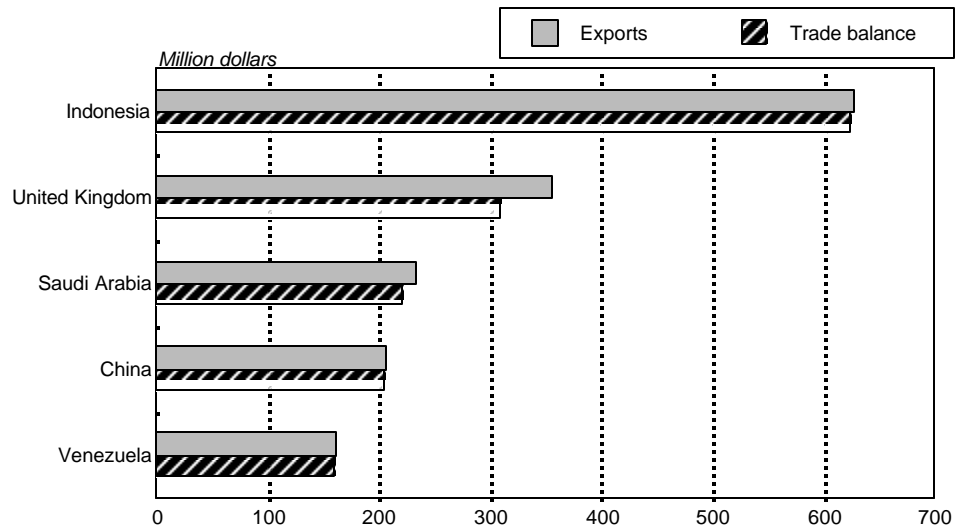
<sup>4</sup> USDOC, BEA, *Survey of Current Business*, Oct. 1999, p. 56. All subsequent data is taken from the tables and related discussions in the same issue.

**Figure 6-1**  
**Architectural, engineering, and construction services: U.S. cross-border exports, imports, and trade balance, 1993-98**



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, pp. 64-65.

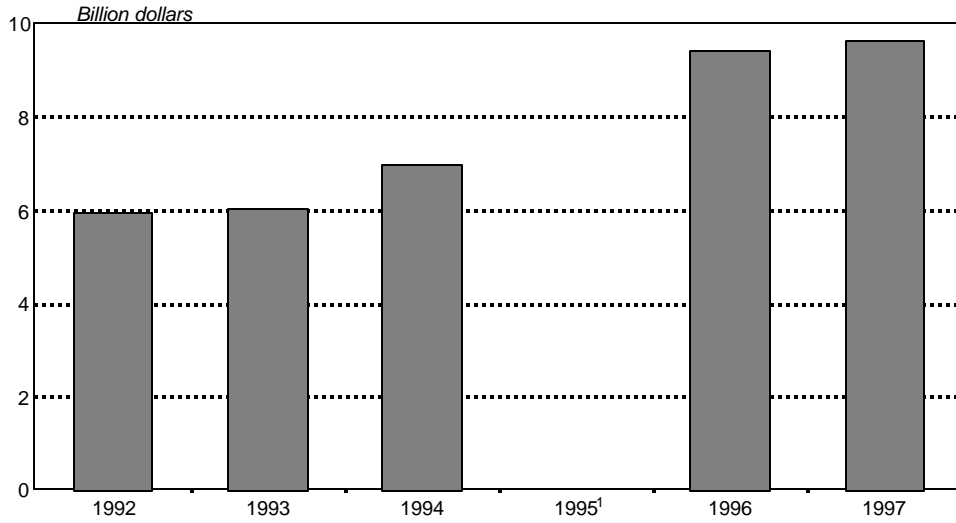
**Figure 6-2**  
**Architectural, engineering, and construction services: U.S. cross-border exports and trade balance, by major trading partners, 1998**



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, p. 91.



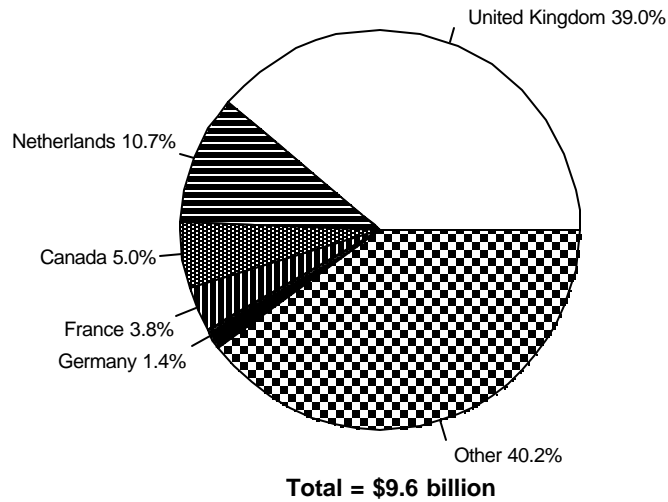
**Figure 6-3**  
**Architectural, engineering, and construction affiliates: Sales of services by majority-owned affiliates of U.S. firms, 1992-97**



<sup>1</sup> Not available.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, p. 93.

**Figure 6-4**  
**Architectural, engineering, and construction affiliates: Sales by majority-owned affiliates of U.S. firms, by principal markets, 1997<sup>1</sup>**



<sup>1</sup> Total may not equal 100 percent due to rounding.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, p. 93.

In 1997, U.S. purchases from U.S.-based affiliates of foreign firms totaled \$5.3 billion.<sup>5</sup> Among individual countries, Japanese affiliates accounted for 13 percent, or \$694 million of U.S. affiliate purchases (figure 6-5), followed by France and the Netherlands, which respectively accounted for 10 percent and 6 percent of such purchases.<sup>6</sup>

## Summary and Outlook

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Robust domestic economic conditions, application of the latest communication technology, and a high level of regard for U.S. firms' professional capabilities continue to have a positive effect on the competitive position of U.S. architecture, engineering and construction service providers in the global market.<sup>7</sup> U.S. AEC service providers are particularly competitive in foreign markets with regard to design and construction of commercial properties (such as the trading floors of financial markets), health care facilities, educational facilities, and high technology manufacturing complexes. To a lesser degree, U.S. AEC firms also design and construct housing, multi-use facilities, shopping malls and retail premises, theaters, and leisure and travel related structures for clients in overseas markets.

U.S. AEC firms are re-engaging in Asia, as countries in that region recover from the recent financial crisis. Projects put on hold as a result of the financial crisis are being resumed, and new projects are being initiated. This is especially true in Japan. Economic growth has also resumed in countries such as Hong Kong and South Korea.<sup>8</sup>

Consolidation of the AEC industry continued during 1998. One notable example was the merger of U.S. firms, Brown & Root and M.W. Kellogg, two major design firms. Another example was the formation of a confederation among 15 U.S. and 1 Mexican construction firms in 1999. This Global Design Alliance, as the confederation is to be called, is a mechanism through which member firms can cooperate on certain

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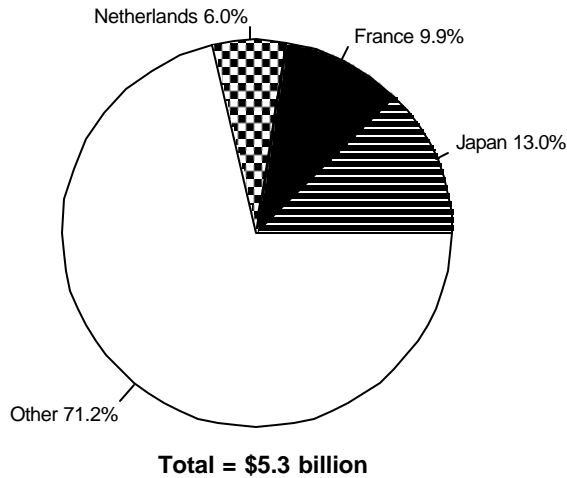
<sup>5</sup> BEA reported data on 1997 affiliate purchases using the NAICS (North American Industry Classification System), not the SIC (Standard Industrial Classification) system used to report 1997 affiliate sales data and all affiliate transactions data prior to 1997. As a result, it is not feasible to calculate an analytically sound affiliate transactions balance or the growth rate of affiliate purchases in 1997. For more information on the transition from the SIC to the NAICS, see text box 2-1.

<sup>6</sup> Data on purchases from U.S.-based AEC affiliates of Canadian, German, and British firms have been suppressed by BEA in order to avoid disclosures of individual company data.

<sup>7</sup> Industry representative, telephone interview by USITC staff, Sept. 27, 1999.

<sup>8</sup> Ibid.

**Figure 6-5**  
**Architectural, engineering, and construction affiliates: Purchases from majority-owned affiliates of foreign firms, by country of ultimate beneficial owner,<sup>1</sup> 1997<sup>2</sup>**



<sup>1</sup> 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.

<sup>2</sup> Total may not equal 100 percent due to rounding.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, p. 95.

projects.<sup>9</sup> This trend toward consolidation will likely continue during the coming year.<sup>10</sup>

U.S. AEC firms face certain obstacles in foreign markets. For example, U.S. firms that continue to use English measurements rather than metric measurements may be required to develop a separate set of plans and related documents for their foreign clients. In addition, U.S. providers of AEC services continue to experience difficulties with regard to obtaining government recognition of their professional credentials in some foreign countries.<sup>11</sup>

The advent of electronic commerce has transformed the way in which AEC firms undertake projects. Computerized communication has enabled firms with offices around the world to institute a 24-hour working day. Under these operations, design and engineering work on a project never ceases, as the project is continually forwarded to a new team in another city as the work day ends in one location and begins in another. This reduces the number of days required to complete a project. Advanced communications have also allowed many U.S. firms that find themselves understaffed to cope with increasing workloads. Rapid communication via electronic mail has enabled firms to assign discrete portions of a single project to partners,

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<sup>9</sup> William G. Krizan, "Design Alliance Has Big Plans," *Engineering News-Record*, Jan. 4, 1999, pp. 32-34.

<sup>10</sup> Gary J. Tulacz, Mary B. Powers, and Debra Rubin, "It Doesn't Get Any Better Than This," *Engineering News-Record*, Apr. 19, 1999, pp. 52-60.

<sup>11</sup> Industry representative, telephone interview by USITC staff, Sept. 27, 1999.

affiliates, or independent contractors. This has become increasingly important as workloads continue to increase and new skilled employees become harder to find.

Recently, an existing computer language has been adapted in the United States for use in the construction industry. This language, the Extensible Markup Language, will reportedly fulfill a need for electronic communication among separate firms cooperating on a project involving work at multiple sites.<sup>12</sup> This development may increase the efficiency of product delivery, allowing firms to expand their business and enhancing the strategic position of U.S. AEC firms.

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<sup>12</sup> "E-Commerce Standard Offered," *Engineering News-Record*, Aug. 23, 1999, p. 19.

# CHAPTER 7

## AUDIOVISUAL SERVICES

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### Introduction

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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 service transactions take the form of royalties, rental fees, license fees, or other funds received or paid, including those from outright sales, for the rights to display, reproduce, or distribute material prerecorded on motion picture film or television tape.<sup>1</sup> The global industry currently earns almost three times as much in video rentals and sales as at the box office.<sup>2</sup> 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 U.S.-owned affiliates' sales 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.<sup>3</sup> Data on U.S. purchases reflect the sales to U.S. persons by U.S.-based motion picture and sound recording affiliates of foreign companies.<sup>4</sup>

### Recent Trends

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#### *Cross-Border Trade, 1993-98*

As noted, available data on cross-border trade in audiovisual services are limited to transactions in film and tape rentals. In 1998, U.S. cross-border exports of

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

<sup>2</sup> *Titanic* was the top selling video in 1998, with more than 20 million copies distributed worldwide. Sony, *Annual Report 1998: Year Ended March 31, 1999*, found at Internet address <http://www.world.sony.com/IR/AnnualReport98/>, retrieved Nov. 12, 1999.

<sup>3</sup> USDOC, BEA representative, interview by USITC staff, Washington, D.C., Dec. 10, 1998.

<sup>4</sup> BEA reported data on 1997 affiliate purchases using the NAICS (North American Industry Classification System), not the SIC (Standard Industrial Classification) system used to report 1997 affiliate sales data and all affiliate transactions data prior to 1997. As a result, it is not feasible to calculate an analytically sound affiliate transactions balance or the growth rate of affiliate purchases in 1997. For more information on the transition from the SIC to the NAICS, see text box 2-1, and USDOC, BEA, "International Sales and Purchases of Private Services," *Survey of Current Business*, Oct. 1999, p. 95.

audiovisual services increased by 7 percent to \$6.5 billion (figure 7-1). During 1993-97, exports increased more rapidly at a 16-percent average annual rate.<sup>5</sup> U.S. imports grew by 11 percent to \$176 million, slowing from the 21-percent average annual growth recorded during 1993-97.<sup>6</sup> The United States registered a \$6.3-billion surplus on trade in audiovisual services in 1998, reflecting a 7-percent increase from the previous year. This was slower than the 16-percent average annual growth in the surplus registered during 1993-97.

The major U.S. export markets for cross-border audiovisual services in 1998 were in Europe-- notably Germany, the Netherlands, the United Kingdom, and France--and Japan (figure 7-2). Germany was the largest single U.S. export market, with film and tape rental exports valued at \$848 million; followed by the Netherlands, \$766 million; the United Kingdom, \$737 million; and France, \$559 million.<sup>7</sup> Cross-border exports to Japan amounted to \$553 million. U.S. productions claimed large shares of the European motion picture markets in 1998, ranging from 92 percent in Iceland to 64 percent in France.<sup>8</sup> Moreover, in contrast to movies from other non-European sources, U.S. movies increased their share of almost every market in Western Europe during 1998.<sup>9</sup> U.S. exports were likely dominated by rentals of the motion pictures *Titanic*, *Armageddon*, and *Saving Private Ryan*.<sup>10</sup> These movies earned \$1.8 billion, \$555 million, and \$479 million in worldwide box office receipts, respectively.<sup>11</sup> U.S. cross-border imports from the United Kingdom totaled \$53 million in 1998; followed by Japan, with \$15 million; and Switzerland and Germany, with \$11 million each.<sup>12</sup>

## ***Affiliate Transactions, 1992-97***

In 1997, foreign-based motion picture affiliates of U.S. firms generated sales totaling \$8.4 billion (figure 7-3), representing a 1-percent decrease from the year before. This decrease was in sharp contrast to the 12-percent average annual growth rate recorded during 1992-96. The United Kingdom, accounting for \$1.4 billion in sales, was by far the largest market for foreign motion picture sales by U.S.-owned affiliates, followed by France, Japan, and Canada, which accounted for sales of \$753 million, \$748 million, and \$708 million, respectively (figure 7-4).<sup>13</sup>

Data on 1997 U.S. purchases of audiovisual services reflect purchases by U.S. residents from U.S.-based motion picture and sound recording affiliates of foreign

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<sup>5</sup> USDOC, BEA, "International Sales and Purchases of Private Services," *Survey of Current Business*, Oct. 1999, pp. 77-83.

<sup>6</sup> Ibid.

<sup>7</sup> Ibid., p. 82.

<sup>8</sup> Media Salles, *1999 European Cinema Yearbook*, 8th ed., Milano, 1999, p. 90.

<sup>9</sup> Ibid., p. 91.

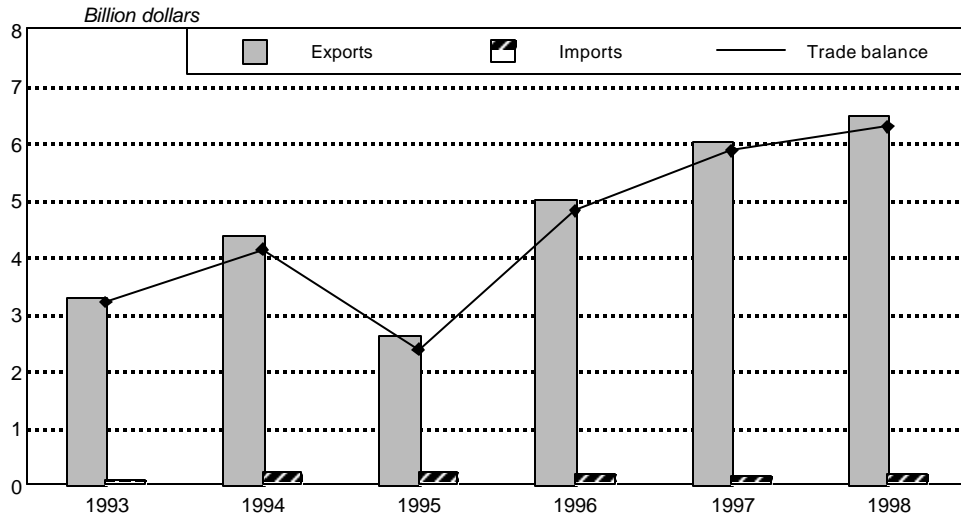
<sup>10</sup> Ibid.

<sup>11</sup> "Box-Office Statistics in Millions of U.S. Dollars," found at Internet address <http://www.vex.net/~odin/Gross/>, retrieved Nov. 9, 1999.

<sup>12</sup> USDOC, BEA, "International Sales and Purchases of Private Services," p. 83.

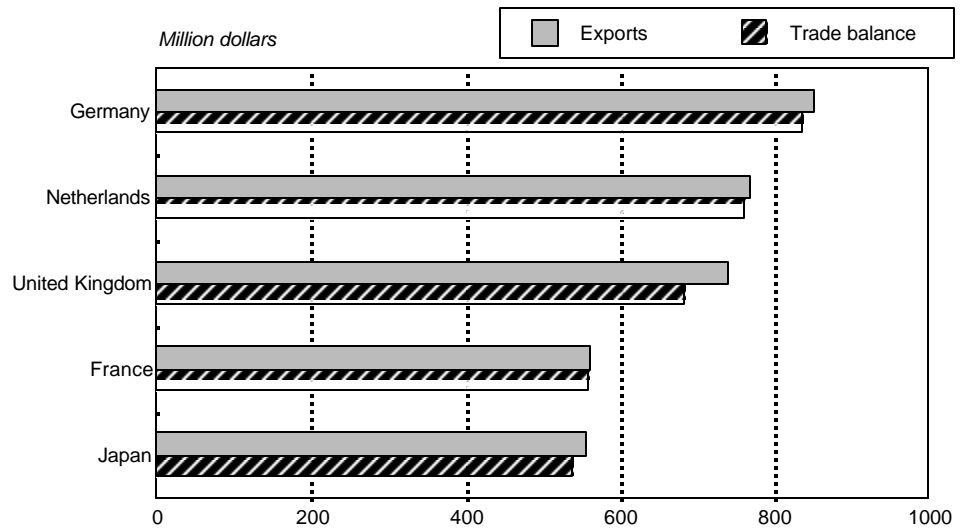
<sup>13</sup> Ibid., p. 93.

**Figure 7-1**  
**Audiovisual services: U.S. cross-border exports, imports, and trade balance, 1993-98**



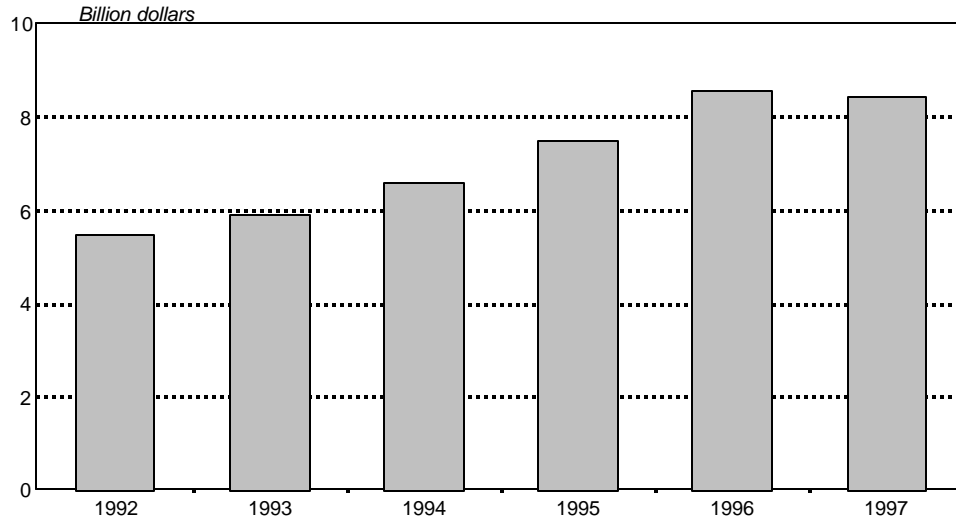
Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, pp. 64-65.

**Figure 7-2**  
**Audiovisual services: U.S. cross-border exports and trade balance, by major trading partners, 1998**



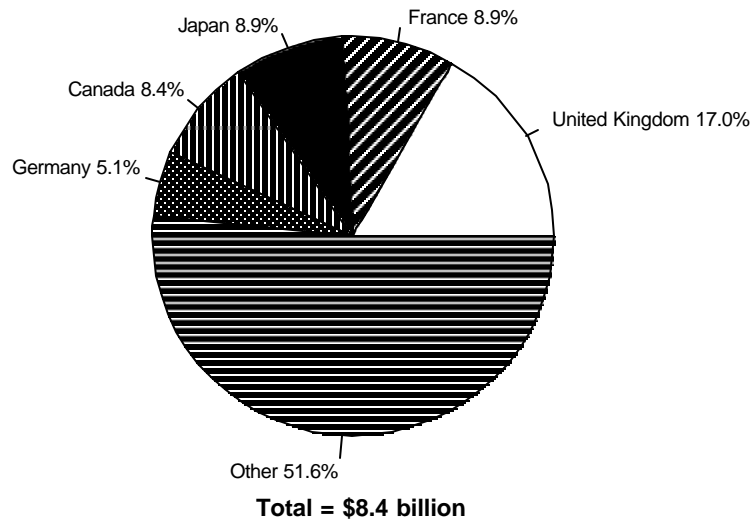
Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, p. 91.

**Figure 7-3**  
**Audiovisual affiliates: Sales of services by majority-owned affiliates of U.S. firms, 1992-97**



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, p. 93; Oct. 1998, p. 115; Oct. 1997, p. 137; Nov. 1996, p. 111; and Sept. 1995, p. 104.

**Figure 7-4**  
**Audiovisual affiliates: Sales by majority-owned affiliates of U.S. firms, by principal markets, 1997<sup>1</sup>**



<sup>1</sup> Total may not equal 100 percent due to rounding.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, p. 93.



companies.<sup>14</sup> These purchases amounted to \$9.6 billion in 1997.<sup>15</sup> U.S. affiliates of Canadian and British parent firms constituted the largest foreign-owned suppliers of motion pictures to the U.S. market, representing 34 percent and 32 percent of U.S. purchases, respectively, in 1997 (figure 7-5).<sup>16</sup> U.S. entertainment affiliates of foreign companies produced five of the ten highest grossing movies in 1997. For example, Sony Entertainment, a U.S. affiliate of Sony (Japan), produced four leading movie titles including *Men In Black*, *Air Force One*, *As Good As It Gets*, and *My Best Friend's Wedding*.<sup>17</sup> Fox, a U.S. affiliate of News Corp., an Australian corporation, released a special edition of *Star Wars*, which earned the sixth-highest receipts in 1997.<sup>18</sup> In addition, Sony Music, which is the largest recording company operating in the United States, had the most successful year in its history in 1997, due partly to the release of the soundtracks of *Titanic* and *Men In Black*. Sony Music, through its Columbia Records and Epic Records labels, represents many U.S. artists who sold several million albums in 1997, including Mariah Carey, Celine Dion, Will Smith, Barbra Streisand, and The Fugees.<sup>19</sup>

## Summary and Outlook

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The most recent data on trade in audiovisual services indicate that U.S. cross-border exports totaled \$6.5 billion in 1998, and that sales through U.S.-owned audiovisual affiliates amounted to \$8.4 billion in 1997. U.S. audiovisual services are expected to remain competitive in the global market partly because they are in the English language, which is spoken in many parts of the world. In addition, the growing number of pay television broadcast outlets facilitates consumption of U.S. audiovisual services. For example, between July 1998 and July 1999, cable TV subscriptions in the United Kingdom grew by 18 percent, to 4.3 million households.<sup>20</sup> U.S. firms also own cable and satellite channels in markets worldwide. The Walt Disney Company operates its Disney Channel in numerous markets, including Australia, France, Malaysia, Spain, Taiwan, and the United Kingdom.<sup>21</sup> Viacom, the parent company of Paramount Pictures, broadcasts its

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<sup>14</sup> As a result of the change in classification systems for data on 1997 affiliate purchases, it is not feasible to calculate an analytically sound affiliate transactions balance or the growth rate of affiliate purchases during 1996-1997. For more information on the transition from the SIC to the NAICS, see text box 2-1, and USDOC, BEA, "International Sales and Purchases of Private Services," p. 95.

<sup>15</sup> USDOC, BEA, "International Sales and Purchases of Private Services," p. 95.

<sup>16</sup> Ibid.; data on U.S. purchases of audiovisual services from affiliates of most countries were suppressed by BEA in order to avoid disclosure of individual company data.

<sup>17</sup> Box Office Guru, found at Internet address <http://www.boxofficeguru.com/top50gross.htm>, retrieved Nov. 12, 1999.

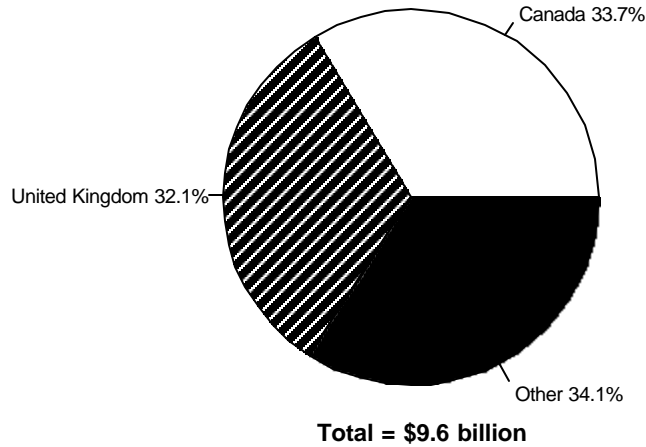
<sup>18</sup> Ibid.

<sup>19</sup> Ibid.

<sup>20</sup> "UK Cable Keeps Growing at a Faster Rate," *Inside Cable & Telecoms Europe*, Oct. 3, 1999, found at Internet address <http://www.inside-cable.co.uk/>, retrieved Oct. 7, 1999.

<sup>21</sup> "U.S. Network Connections," Global Resource Guide, supplement to *Multichannel News International*, July/Aug. 1999.

**Figure 7-5**  
**Audiovisual affiliates: Purchases from majority-owned affiliates of foreign firms, by country of ultimate beneficial owner,<sup>1</sup> 1997<sup>2</sup>**



<sup>1</sup> 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.

<sup>2</sup> Total may not equal 100 percent due to rounding.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, p. 95.

MTV channel on cable TV affiliates in India, Brazil, Japan, New Zealand, and Australia, among others.<sup>22</sup>

The audiovisual services affiliates of foreign companies are also expected to maintain their competitiveness in the U.S. market. In a move that could increase Japanese audiovisual affiliates' revenues, Sony plans to merge Loews Theaters with Cineplex Odeon Corporation to form the Loews Cineplex Entertainment Corporation. The new theater company, with over 2,700 screens at 425 locations planned in North America, will increase the outlets for Sony's motion pictures.<sup>23</sup>

U.S. firms face a changing competitive environment in Europe. Some European firms have expanded their holdings in audiovisual services to compete more effectively with their U.S. counterparts, whereas others have opted to concentrate their activities in selected core business areas. For example, in 1999, Vivendi, a French conglomerate with preexisting interests in the telecommunication and media industries, purchased 49 percent of Canal+, Europe's largest pay television firm, and Pathé, a film company. Vivendi also acquired a 24.5-percent stake in British Sky Broadcasting Group (BSkyB), a satellite TV service provider in the United Kingdom owned by News Corp.<sup>24</sup> In contrast, Germany's multimedia conglomerate, Bertelsmann, withdrew from the pay television business to concentrate on Internet-

<sup>22</sup> Ibid.

<sup>23</sup> Sony, *Annual Report 1998: Year Ended March 31, 1999*, found at Internet address <http://www.world.sony.com/IR/AnnualReport98/>, retrieved Nov. 12, 1999.

<sup>24</sup> "Face Value: Neat But Not Yet Tidy," *The Economist*, Sept. 25, 1999, found at Internet address <http://www.economist.com/>, retrieved Oct. 7 1999.

related services.<sup>25</sup> PolyGram, a Dutch audiovisual company, exited the market in 1998.<sup>26</sup>

Internet technology has the potential to transform and expand trade in motion pictures and recorded music. Retail sales of recorded music over the Internet are well established. The Internet accounted for an estimated \$200 million in music sales in 1998,<sup>27</sup> and it is estimated that digital downloads will generate \$1.1 billion in annual sales in 2003.<sup>28</sup> CDnow Inc. and N2K Inc. appeared to account for half of these sales in 1998.<sup>29</sup> Through the use of new technology such as MP3,<sup>30</sup> the Internet also allows consumers to build their own CDs and download songs on personal computers.<sup>31</sup> For example, the customers of Musicmaker.com can download songs or build their own CDs from an on-line library of about 100,000 songs. Established recording artists, including David Bowie and Alanis Morissette, independently released their works on the Internet as downloadable files using digital compression technology.<sup>32</sup>

Motion picture releases are increasingly promoted on the Internet. For example, in 1999, the release of *American Beauty* was promoted on Amazon.com, which offered information on the movie and related merchandise on its web portal.<sup>33</sup> *Star Wars: The Phantom Menace* was also successfully promoted on the Internet in 1999.<sup>34</sup> The Internet reduces the cost of production and distribution, thus challenging the traditional role of movie studios and distributors.<sup>35</sup> Consequently, independent artists

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<sup>25</sup> "Bertelsmann's Big Leap," *The Economist*, Apr. 24, 1999, found at Internet address <http://www.economist.com/>, retrieved Oct. 7, 1999.

<sup>26</sup> The company was divided and its music and film subsidiaries sold to Seagram, a Canadian company. Metro-Goldwyn-Mayer Inc., a U.S. company, acquired PolyGram's movie library. "Lights, Camera, Cut," *The Economist*, Sept. 26, 1998, found at Internet address <http://www.economist.com/>, retrieved Oct. 7, 1999; and Metro-Goldwyn-Mayer Inc., *1998 Annual Report*, found at Internet address <http://www.mgm.com/>, retrieved Oct. 7, 1999.

<sup>27</sup> Standard & Poor's Industry Surveys, "Movies and Home Entertainment," May 20, 1999, p. 2.

<sup>28</sup> Ibid.

<sup>29</sup> Ibid.

<sup>30</sup> MP3 is a digital format which compresses the size of audio files for Internet distribution while maintaining high sound quality.

<sup>31</sup> PR Newswire, "TVT Records and Musicmaker.com Sign Exclusive 5-year License Agreement," Sept. 8, 1999, found at Internet address <http://www.globalarchive.ft.com/>, retrieved Sept. 24, 1999.

<sup>32</sup> Sue Cummings, "The Flux in Pop Music Has Distinctly Download Beat to It," *New York Times*, Sept. 22, 1999, found at Internet address <http://www.nytimes.com/>, retrieved Sept. 22, 1999.

<sup>33</sup> PR Newswire, "Amazon.com and DreamWorks Announce Promotional and Merchandising Agreement," Aug. 18, 1999, found at Internet address <http://www.globalarchive.ft.com/>, retrieved Sept. 24, 1999.

<sup>34</sup> "QuickTime Gets Lucas' Endorsement," *Computer Dealer News*, Apr. 3 1999, found at Internet address <http://proquest.umi.com/>, retrieved Sept. 21, 1999.

<sup>35</sup> Joshua Quittner and David E. Thigpen, "Movies Hit the Net," *New York Times*, Sept. 6,

(continued...)

and producers of low-budget audiovisual works increasingly market their works on the Internet through their own web pages. One such independent movie, *The Blair Witch Project*, was almost entirely promoted on Internet sites, which cumulatively attracted an average of 3.5 million visitors a day.<sup>36</sup> The film earned more than \$100 million, making it one of the top independent movies ever produced in terms of gross receipts.<sup>37</sup>

Internet broadcasts of full-length motion pictures are still at the trial stage. The delivery of full-length movies over the Internet is limited because the transmission of large audiovisual files requires more bandwidth than most Internet connections to homes currently provide, and also because picture quality on computer screens is low.<sup>38</sup> Only about 2 million, or 6 percent of subscribers in the United States, currently have broadband access to the Internet,<sup>39</sup> although the number is projected to increase to 26 million by 2003.<sup>40</sup> Consequently, new technology to enable faster transmission on narrow bandwidth lines is being developed at present.<sup>41</sup> Wider use of digital television sets is also expected to improve the video quality of webcasts.<sup>42</sup> Through greater broadband access and new technologies, industry observers expect that on-line trade of motion pictures will become commercially viable in about 5 years.<sup>43</sup> Toward this end, a few companies currently offer motion pictures for viewing or downloading on their Internet sites on an experimental basis. For example, Broadcast.com and Turner Classic Movies broadcasted the Internet premiere of the motion picture *Casablanca* in December 1998.<sup>44</sup> Kanakaris Communications Inc.

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<sup>35</sup> (...continued)

1999, found at Internet address <http://www.nytimes.com/>, retrieved Sept. 20, 1999.

<sup>36</sup> PR Newswire, "Communities.com and Artisan Entertainment Team Up To Create The Blair Witch Palace Visual Chat Site," Aug. 18, 1999, found at Internet address <http://www.globalarchive.ft.com/>, retrieved Sept. 24, 1999.

<sup>37</sup> Michael Stroud, "Blair Witch Stuck at No. 2," *Wired News*, Aug. 9, 1999, found at Internet address <http://www.wired.com/news/news/story/21170.html>, retrieved Nov. 16, 1999.

<sup>38</sup> Karen Brown, "Internet Video on Demand Won't Strangle Its TV Sibling," *Cable World*, Sept. 27, 1999, p. 30.

<sup>39</sup> Luciano Siracusano, "Industry Review: Internet Infrastructure," *Value Line Selection & Opinion*, Aug. 20, 1999, p. 5389.

<sup>40</sup> Ibid.

<sup>41</sup> One such innovation proposes to break up film files into discrete components for transmission, and to reconstitute them for viewing. Michel Marriott, "Movies on the Net: Downloading Films May be Coming Up to Speed," *New York Times*, Jan. 7, 1999, found at Internet address <http://www.nytimes.com/>, retrieved Sept. 22, 1999.

<sup>42</sup> The United States has adopted a digital standard for television broadcasting. The conversion started in Nov. 1998 and access to digital television is expected to be available nationwide in 2002. The Federal Communication Commission has set 2006 as the target date for cessation of analog broadcasts, but only if 85 percent of households in a market are able to receive digital signals, and if all of the largest TV stations in the market are able to begin broadcasting digital signals. Federal Communication Commission (FCC), Mass Media Bureau, "Digital Television Tower Siting Fact Sheet and Frequently Asked Questions," found at Internet address <http://www.fcc.gov/mmb/prd/dtv/>, retrieved Nov. 15, 1999.

<sup>43</sup> Brown, "Internet Video on Demand," p. 30.

<sup>44</sup> PR Newswire, "Turner Classic Movies and Broadcast.com Team Up for Live Internet

(continued...)

(www.kkrs.com), in partnership with Microsoft, has introduced 114 full-length motion pictures on its Internet site, which consumers can download for viewing on computer screens. MovieFlow.com plans to offer eight continuous real-time video channels to viewers around the world.<sup>45</sup>

While the provision of audiovisual services over the Internet is increasing, on-line international trade remains small mainly because Internet penetration around the world is still low. For example, approximately 9 percent<sup>46</sup> and 10 percent<sup>47</sup> of the populations in Europe and Japan, respectively, had access to the Internet in 1999, compared to 32 percent in the United States.<sup>48</sup> In 1998, 62 percent<sup>49</sup> of Internet users worldwide were located in the United States, compared to 18 percent in Western Europe, 11 percent in Japan and the Asia Pacific region, and 5 percent in Canada.<sup>50</sup> All other countries account for only 4 percent of Internet users.<sup>51</sup>

Internet transmission enhances the risk of unauthorized, high-quality duplication and transmission of proprietary products. The U.S. sound recording industry is reportedly channeling most of its anti-piracy resources to combat Internet piracy.<sup>52</sup> In addition, the industry opposes deployment of MP3 on the ground that the technology facilitates piracy.<sup>53</sup> The industry estimates that thousands of sites on the Internet currently offer music titles for both legal and unauthorized downloading using MP3. The motion picture industry is also concerned about Internet-based piracy. The Motion Picture Association of America (MPAA) estimates that the U.S. creative industries lose a significant amount of revenue each year to digital theft,<sup>54</sup> which may increase as broadband capability and more powerful computers become more accessible. It

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<sup>44</sup> (...continued)

Broadcast Premiere of Casablanca,” Dec.17, 1998, found at Internet address <http://www.globalarchive.ft.com/>, retrieved Sept. 24, 1999.

<sup>45</sup> PR Newswire, “Movieflow.com Inc. Announces Full Length Movies on the Internet,” July 30, 1999, found at Internet address <http://www.globalarchive.ft.com/>, retrieved Sept. 24, 1999.

<sup>46</sup> Morgan Stanley Dean Witter, “The European Internet Report,” June 1999, found at Internet address <http://www.ms.com/>, retrieved Sept. 27, 1999.

<sup>47</sup> Izumi Aizu, “Internet in Japan in Asian Context,” Nov. 1998, found at Internet address <http://www.anr.org/>, retrieved Sept. 27, 1999.

<sup>48</sup> Morgan Stanley Dean Witter, “The European Internet Report.”

<sup>49</sup> eMarketer, “Net Geography: Overview & Projections,” in *eStats*, found at Internet address <http://www.emarketer.com/estats/>, retrieved Sept. 28, 1999.

<sup>50</sup> Mary Meeker, “Internet Overview/Update,” in *The Technology Primer Vol.4*, Morgan Stanley Dean Witter, May 1999, p. 320, found at Internet address <http://www.ms.com/>, retrieved Sept. 28, 1999.

<sup>51</sup> Ibid.

<sup>52</sup> The Recording Industry Association of America (RIAA), homepage, found at Internet address <http://www.riaa.com/>, retrieved Oct. 5, 1999.

<sup>53</sup> “The Economist Review of Books and Multimedia: Roll-Your-Own CDs Roll On,” *The Economist*, Apr. 10, 1999, found at Internet address <http://www.economist.com/>, retrieved Sept. 21, 1999.

<sup>54</sup> MPAA, “Comments of The International Intellectual Property Alliance on Draft Strategy Paper: A Framework for Global Electronic Commerce,” Jan. 28, 1997, found at Internet address <http://www.mpaa.org/>, retrieved Oct. 7, 1999.

has been reported that hackers in Europe were able to download and watch the movie *Star Wars: The Phantom Menace* one month before it was released.<sup>55</sup> The protection of intellectual property rights, licensing, and compensation must be addressed before industries that trade in copyrighted material embrace widespread use of the Internet for trade in motion pictures and recorded music.

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<sup>55</sup> “How a Community of Internet Pirates May Mean Big Trouble for the Film Industry,” *The Economist*, Sept. 6, 1999, found at Internet address <http://www.economist.com/>, retrieved Sept. 20, 1999.

# CHAPTER 8

## BANKING AND SECURITIES SERVICES

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### Introduction

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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;<sup>1</sup> credit card services; and other credit-related services, such as provision of standby letters of credit for trade financing.<sup>2</sup> Securities-related services include securities lending services;<sup>3</sup> mutual fund services; securities clearance and settlement services; securities trading services; private placements;<sup>4</sup> and securities underwriting services.<sup>5</sup> Banks' deposit-taking and lending services are excluded from this discussion.<sup>6</sup> Both fee-based commercial banking services and securities-related services can be traded across borders or sold through foreign affiliates.

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<sup>1</sup> A custodian holds securities under a written agreement for a client and buys and 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.

<sup>2</sup> 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. Fitch, *Dictionary of Banking Terms*, 1990, p. 591.

<sup>3</sup> A securities loan is a loan made by broker-dealers, banks, or other organizations to finance the purchase of securities. Fitch, *Dictionary of Banking Terms*, 1990, p. 552.

<sup>4</sup> A private placement is the sale of an entire issue of securities to a small group of investors. Fitch, *Dictionary of Banking Terms*, 1990, pp. 481-482.

<sup>5</sup> Data on transactions of finance affiliates reflect the operations of financial holding companies, franchises, and other financial companies, including securities and commodities brokers. The latter 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.

<sup>6</sup> BEA does not report data on trade in deposit-taking and lending services as provided by banks.

## Recent Trends

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### *Cross-Border Trade, 1993-98*

During 1993-98, the United States consistently maintained a trade surplus in cross-border banking and securities services. In 1998, U.S. banking and securities firms recorded cross-border exports of \$13.7 billion and cross-border imports of \$3.8 billion, resulting in a \$9.9 billion surplus (figure 8-1). U.S. exports increased by 19 percent in 1998, slower than the average annual growth rate of 23 percent recorded during 1993-97. By comparison, imports increased by only 6 percent, substantially slower than the average annual growth rate of 27 percent recorded during 1993-97. Slower-than-average growth in cross-border exports and imports during 1998 can largely be attributed to ongoing global financial disturbances, as well as sluggish growth in the Asian and Latin American markets.<sup>7</sup>

Export growth decelerated as greatly reduced foreign activity in U.S. financial markets during the second half of the year more than offset strong foreign activity during the first half of the year.<sup>8</sup> Slower export growth is evidenced by reduced net foreign purchases of U.S. securities, which declined by 23 percent in 1998, from \$343.5 billion to \$265.4 billion. Although net foreign purchases of U.S. corporate bonds increased by 31 percent, to a record \$171 billion, steep declines in foreign purchases of U.S. Treasury securities and U.S. stocks more than offset this increase. Net foreign purchases of U.S. Treasury securities fell by 67 percent, to \$48.1 billion, as foreign investors sought higher yields on U.S. corporate securities and European investments. Meanwhile, net foreign purchases of U.S. stocks decreased by 30 percent, to \$46.2 billion, as foreign investors reacted to the Russian debt moratorium and the continued financial distress of several emerging markets.<sup>9</sup>

Import growth decelerated as U.S. activity in foreign financial markets fell in response to turmoil in the global financial market. Slower import growth is evidenced by anemic growth in U.S. purchases of foreign securities.<sup>10</sup> In 1998, net U.S. purchases of foreign securities increased by less than 2 percent, to \$89.4 billion. Net U.S. purchases of foreign stocks totaled \$75.9 billion, registering an 84-percent increase, but net U.S. purchases of foreign bonds fell to \$13.5 billion, registering a 71-percent decrease.<sup>11</sup> In response to the lingering effects of the 1997 Asian financial crisis, together with Russian and Latin American financial shocks that surfaced during the second quarter of 1998, U.S. investors demonstrated a cautious attitude toward overseas markets, leading to net sales of foreign securities, particularly those from emerging markets. The share of U.S. pension fund assets

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<sup>7</sup> USDOC, BEA, *Survey of Current Business*, Oct. 1999, pp. 56, 82-83.

<sup>8</sup> USDOC, BEA, *Survey of Current Business*, Apr. 1999, p. 36.

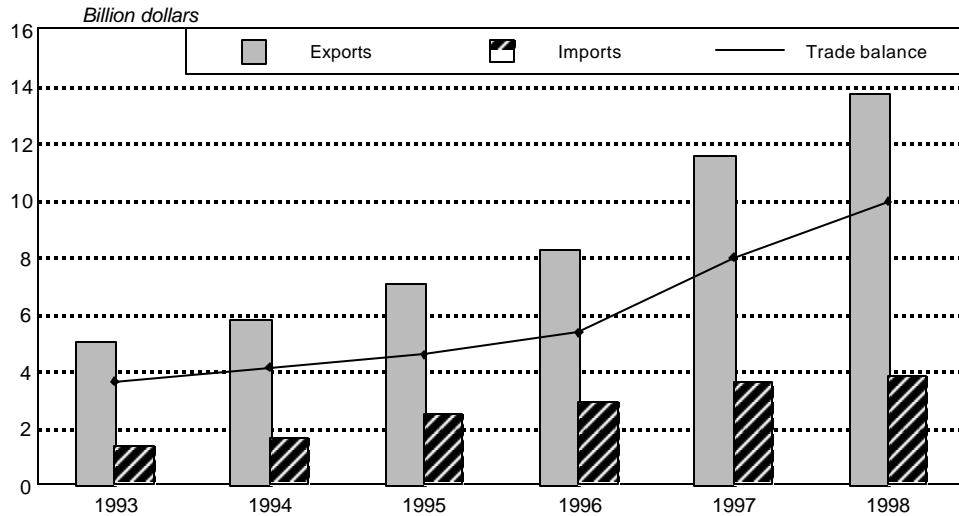
<sup>9</sup> *Ibid.*, pp. 42-46.

<sup>10</sup> *Ibid.*

<sup>11</sup> *Ibid.*, p. 40.



**Figure 8-1**  
**Banking and securities services: U.S. cross-border exports, imports, and trade balance, 1993-98**



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, pp. 64-65.

invested abroad fell from 18 percent in 1997 to 14 percent in 1998, while the share of U.S. mutual fund assets invested abroad fell from 15 percent to 5 percent.<sup>12</sup>

The United Kingdom is the largest U.S. export market for banking and securities services. In 1998, cross-border exports to the United Kingdom totaled \$2.7 billion, or 20 percent of all U.S. banking and securities services exports (figure 8-2). Cross-border imports from the United Kingdom totaled \$1.5 billion, or 38 percent of all U.S. banking and securities service imports. Other major export markets included France, Canada, and Japan. Exports to France increased by 12 percent, to \$1.0 billion, while those to Canada increased by 32 percent, to \$792 million, and those to Japan increased by 23 percent to \$755 million. Canada and Japan continued to be key service suppliers accounting for imports valued at \$231 million and \$182 million, respectively. This reflected 4-percent growth in imports from Canada and 5-percent growth in imports from Japan.<sup>13</sup>

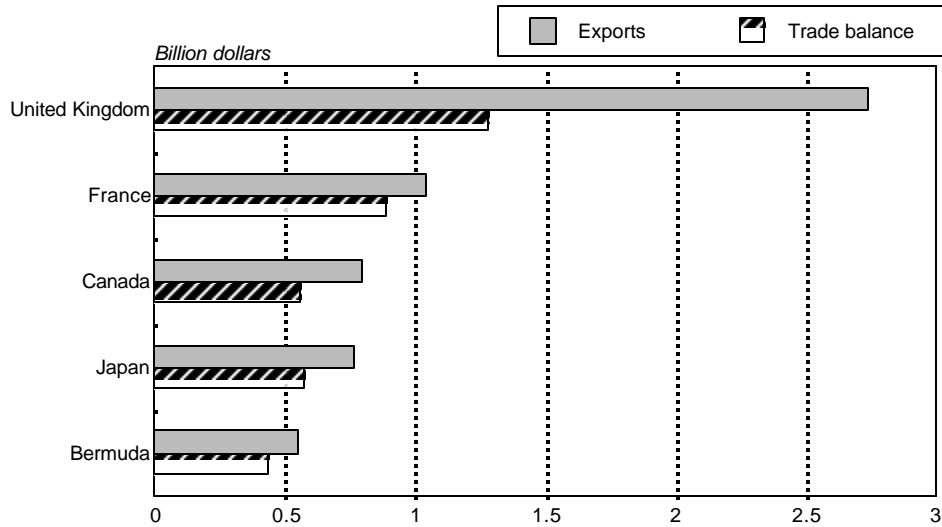
### *Affiliate Transactions, 1992-97*

By establishing a physical presence in foreign markets, commercial banks, securities firms and investment banks are better positioned to develop and nurture consumer relationships. Total affiliate sales data were suppressed in 1997 to avoid disclosure

<sup>12</sup> Ibid., pp. 39, 41.

<sup>13</sup> USDOC, BEA, *Survey of Current Business*, Oct. 1999, p. 82.

**Figure 8-2**  
**Banking and securities services: U.S. cross-border exports and trade balance,**  
**by major trading partners, 1998**



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, p. 83.

of data on individual companies, but limited data on individual countries exists.<sup>14</sup> In 1997, sales by banking and securities affiliates of U.S. firms in Canada and Japan totaled \$2.8 billion and \$2.4 billion, respectively. Australia was also an important market, having accounted for \$1.1 billion of such sales in 1997.<sup>15</sup> However, the United Kingdom is likely the largest U.S. affiliate sales market, having accounted for sales of \$7.1 billion in 1995.<sup>16</sup>

In 1997, U.S. purchases of services from U.S. banking and securities affiliates of foreign firms<sup>17</sup> amounted to \$13.9 billion. Securities, commodity contracts, and other intermediation and related activities accounted for \$11.5 billion in total purchases, while nondepository credit intermediation and related services accounted for \$2.3 billion, and funds, trusts, and other financial vehicles for \$130 million. Japanese-owned affiliates accounted for \$4.6 billion, or one-third, of total U.S. purchases, followed by British affiliates with \$2.6 billion, and Swiss affiliates with \$2.2 billion (figure 8-3). Other important sources of U.S. purchases included Canada and

<sup>14</sup> BEA data on total sales by foreign affiliates of U.S. firms were suppressed in order to avoid disclosing confidential information pertaining to individual firms. Therefore, the data available for U.S. sales are believed to understate U.S. sales during 1997.

<sup>15</sup> USDOC, BEA, *Survey of Current Business*, Oct. 1999, p. 93.

<sup>16</sup> Data reflecting sales by U.K.-based banking and securities affiliates of U.S. firms in 1996 and 1997 were suppressed by BEA in order to avoid disclosure of individual company data.

<sup>17</sup> BEA reported data on 1997 affiliate purchases using the NAICS (North American Industry Classification System), not the SIC (Standard Industrial Classification) system used to report 1997 affiliate sales data and all affiliate transactions data prior to 1997. As a result, it is not feasible to calculate an analytically sound affiliate transactions balance or the growth rate of affiliate purchases in 1997. For more information on the transition from the SIC to the NAICS, see text box 2-1.

Germany, whose affiliates accounted for purchases totaling \$1.2 billion and \$1.1 billion, respectively.<sup>18</sup>

## Summary and Outlook

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Overall trade in banking and securities services continued to grow in 1998, albeit at a slower pace than in 1997. Cross-border exports increased by 19 percent, while cross-border imports increased by 6 percent, resulting in 25-percent growth in the trade surplus on banking and securities services, which totaled \$9.9 billion. With respect to affiliate transactions in 1997, Canada, Japan, and likely the United Kingdom accounted for the largest percentage of sales by banking affiliates of U.S. firms, whereas Japan, the United Kingdom, and Switzerland accounted for the largest percentage of U.S. purchases from U.S. banking and securities affiliates of foreign firms.

The euro, which was introduced on January 4, 1999, will reportedly improve the competitive position of European banking and securities firms in the global market, and thus intensify competitive conditions for U.S. firms abroad. The advent of the euro has stimulated the European financial services market by reducing differences in inflation and interest rates between countries, thereby improving incentives to hold European assets and reducing incentives to hold U.S. dollar assets. Further, as the European Union moves closer to its goal of a single market, demand for European securities is likely to increase, fueled by the need to fund “pay-as-you-go” pension plans, an aging population saving for retirement, and continued privatization and deregulation of key industries.<sup>19</sup>

The development of the euro has also facilitated an increase in cross-border mergers and acquisitions in that region.<sup>20</sup> Through consolidation, European institutions will increase in size and take advantage of economies of scale, creating deeper, more homogeneous capital markets. For example, in 1998, Sweden’s Nordbanken and Finland’s Merita formed Scandinavia’s largest bank, which is currently considering expansion into Denmark and Germany. The Netherlands’ ABN Amro Bank is considering potential acquisitions in Italy and France; Spain’s Banco Santander is reportedly seeking a partner in France; and the Netherlands’ ING Group is interested in potential expansion into Germany.<sup>21</sup>

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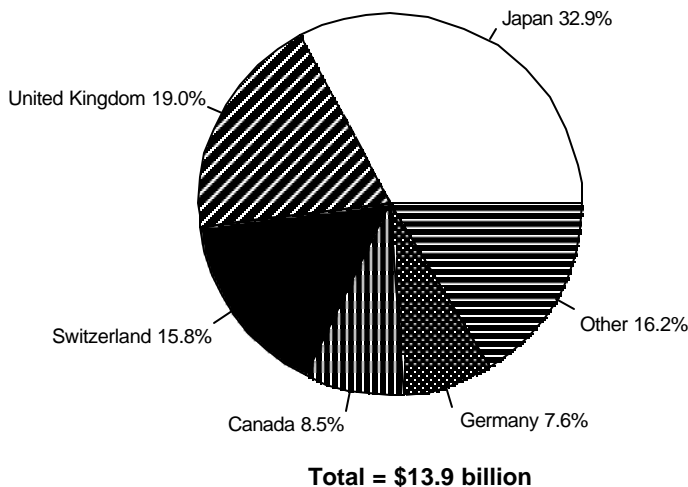
<sup>18</sup> USDOC, BEA, *Survey of Current Business*, Oct. 1999, p. 95.

<sup>19</sup> *Ibid.*, p. 62.

<sup>20</sup> “The Bank Merger Splurge,” *The Economist*, Aug. 28, 1999, found at Internet address <http://www.economist.com/>, retrieved Sept. 24, 1999.

<sup>21</sup> “Jostling for Supremacy,” *Euromoney*, March 1999, found at Internet address <http://proquest.umi.com/>, retrieved Oct. 15, 1999; and “The Bankers’ Grand Waltz,” *Business Week*, Sept. 6, 1999, found at Internet address <http://proquest.umi.com/>, retrieved Oct. 15, 1999.

**Figure 8-3**  
**Banking and securities affiliates: Purchases from majority-owned affiliates of foreign firms, by country of ultimate beneficial owner,<sup>1</sup> 1997**



<sup>1</sup> 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.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business* Oct. 1999, p. 95.

On November 12, 1999, the Financial Services Modernization Act of 1999<sup>22</sup> was signed into law in the United States. The new legislation will reduce Depression-era regulatory barriers by repealing parts of the 1933 Glass-Steagall Act, allowing securities firms, insurance firms, and banks to be combined under one holding company. This type of structure, called universal banking, is permitted in many other parts of the world, and industry representatives report that the ability to offer consumers a wider variety of financial services may enhance the strategic position of U.S. firms both domestically and internationally.<sup>23</sup>

Recent events involving U.S. financial institutions have prompted the Senate Permanent Subcommittee on Investigations to hold hearings on the effects of money laundering, specifically in private banking.<sup>24</sup> Concerns were sparked by the flight of billions of dollars, administered by Western banks, from sensitive economies such as Russia and Mexico. As a result, Congress and the Administration have focused on increasing the effectiveness of existing policies designed to prevent money laundering, including provisions addressing corruption. This places the U.S. banking industry in a delicate position between protecting the privacy of individual customers

<sup>22</sup> Financial Services Modernization Act of 1999, P.L. 106-102, 113 Stat.1338.

<sup>23</sup> Industry representatives, telephone interviews by USITC staff, Sept. 20-27, 1999; and "Clinton Signs Historic U.S. Banking Reform Bill," *Yahoo! News*, found at Internet address <http://dailynews.yahoo.com/>, retrieved Nov. 12, 1999.

<sup>24</sup> Private banking includes banking services, such as lending and investment management, typically used by wealthy customers who prefer extra discretion and care. Thomas P. Fitch, *Dictionary of Banking Terms* (New York: Barron's, 1997), p. 359.

and supporting tougher laws against illicit funds transfer.<sup>25</sup> If enacted, the proposed legislation (S. 1663<sup>26</sup> and H.R. 2896<sup>27</sup>) would require U.S. banks to disclose substantial amounts of customer information to prove that funds deposited at U.S. institutions, domestic and abroad, did not originate from criminal activities.<sup>28</sup> Industry representatives fear these new requirements will prompt their overseas clients to switch to foreign banks, placing their international operations at a competitive disadvantage.<sup>29</sup>

Emerging technology will likely affect the modes of delivering financial services and broad competitive conditions. Currently, over 3,000 banks have Internet sites.<sup>30</sup> Some industry analysts indicate that provision of financial services to U.S. consumers over the Internet will likely expand from approximately \$103 billion in 1999 to more than \$435 billion by 2003.<sup>31</sup> While the majority of online transactions are conducted using personal computers, several financial institutions are currently developing technology that will enable consumers to access account information, transfer funds, pay bills, and trade stocks via wireless devices such as mobile phones and hand held computers.<sup>32</sup> Other banking services provided via the Internet include the sales<sup>33</sup> and servicing of online applications for accounts, loans, and credit cards;<sup>34</sup> online bill payment; online bill presentment; downloadable cash; and smart cards.<sup>35</sup>

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<sup>25</sup> “Hearings Offer View Into Private Banking,” *The New York Times*, Nov. 8, 1999, found at Internet address <http://www.nytimes.com/>, retrieved Nov. 8, 1999; and “Money Laundering Hearing Refocus Privacy Debate,” *ABA Compliance*, Oct. 1999, found at Internet address <http://proquest.umi.com/>, retrieved Nov. 8, 1999.

<sup>26</sup> U.S. Senate, *Foreign Money Laundering Deterrence and Anticorruption Act*, 106th Cong., 1st sess., S. 1663, *Congressional Record*, vol. 145, No. 129, daily ed. (Sept. 29, 1999), S11640.

<sup>27</sup> U.S. House, *Foreign Money Laundering Deterrence and Anticorruption Act*, 106th Cong., 1st sess., H.R. 2896, *Congressional Record*, vol. 145, No. 123, daily ed. (Sept. 21, 1999), H8467.

<sup>28</sup> “U.S. Bankers Fear Laundering Proposals Will Lock Them Out,” *American Banker*, Nov. 23, 1999.

<sup>29</sup> *Ibid.*

<sup>30</sup> Peter Drew, ed. *Global Banking and Financial Policy Review, 1998-1999* (Sussex, UK: Euromoney Publications PLC), p. 30.

<sup>31</sup> Morgan Stanley Dean Witter, *The Internet and Financial Services*, Aug. 1999, p. 1, found at Internet address <http://www.ms.com/>, retrieved Sept. 23, 1999.

<sup>32</sup> “Swedish Bank Starts Offering Services by Cell Phone,” *American Banker*, Oct. 11, 1999.

<sup>33</sup> Many U.S. financial institutions are incorporating links to other businesses on their own Internet sites, enabling their customers to take advantage of “one stop shopping.” See, for example, Wingspanbank.com’s partnerships with InsWeb allowing consumers to search the site for the best insurance products available, ELOAN to access mortgage rates, and DLJdirect to locate private label brokerage services. Morgan Stanley Dean Witter, *The Internet and Financial Services*, p. 11.

<sup>34</sup> This does not necessarily include an online approval, although some U.S. firms are beginning to offer instant online approvals.

<sup>35</sup> Online bill presentment refers to the ability to present bills for payment via the Internet. Downloadable cash refers to the ability to download cash directly onto a smart card via the Internet. Smart cards refer to a bank card containing a computer chip for identification and data storage. Fitch, *Dictionary of Banking Terms*, 1997, p. 427; and Morgan Stanley Dean Witter, *The Internet and Financial Services*, p. 11.

Electronic commerce also has substantially altered the securities industry, expanding the number of online brokerage firms from just one in 1994 to more than 100 in 1998. After E-mail, online stock trading is the fastest growing use of the Internet by consumers, accounting for 37 percent of all retail stock trades. The Internet will reportedly accommodate approximately 60 percent of such trades by 2005.<sup>36</sup> The popularity of new online companies such as E\*trade, which offers convenient online trading at a low price, has motivated traditional investment firms to establish competing sites. For example, Merrill Lynch began to offer Internet trading in December 1999.<sup>37</sup> Deep discount, online brokerage firms hold 55 percent of today's online accounts, followed by "mid-tier" brokerage firms, such as Schwab or Fidelity, at 43 percent, and traditional full service investment firms with 2 percent. However, due to their customers' high net worth, traditional full service firms still represent 18 percent of the online market share.<sup>38</sup>

Online trading also significantly reduces the need for brokers, thereby reducing commissions and transforming client relationships. Competition between firms lowered the average commission of an online trade to \$15.75 in 1999, which has commoditized the cost of a trade. To attract new customers and generate more revenue, some traditional firms are offering more value-added services, such as expert investment advice and information to complement online accounts.<sup>39</sup>

U.S. stock exchanges are also changing as a result of new technologies. The National Association of Securities Dealers (NASD), the regulatory body for the National Association of Securities Dealers Automated Quotation system (Nasdaq), has expanded its efforts to establish "Nasdaq clones" in both Europe and Japan. By setting up electronic trading markets in global cities such as London and Tokyo, Nasdaq could attract more foreign investors to Nasdaq stocks, as well as increase foreign-company listings, thereby increasing both business and revenue for Nasdaq. The overall goal is to create an accessible, 24-hour trading environment for global investors.<sup>40</sup>

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<sup>36</sup> "Online Trading Changes Landscape for Old-Line Brokerage Firms," *New York Times*, Sept. 22, 1999, found at Internet address <http://www.nytimes.com/>, retrieved Sept. 22, 1999; the Organisation of Economic Cooperation and Development (OECD), *The Economic and Social Impacts of Electronic Commerce: Preliminary Finding and Research Agenda*, (Paris: OECD, 1999), p. 44; and George R. Monahan, "www.online\_trading.com," *Securities Industry Trends*, Securities Industry Association publication, May 12, 1999, vol. XXV, No. 4.

<sup>37</sup> "Online Trading Changes Landscape for Old-Line Brokerage Firms."

<sup>38</sup> Monahan, "www.online\_trading.com."

<sup>39</sup> Ibid.

<sup>40</sup> "Evolution of the Exchange: 3 Men Reshaping Markets," *The Washington Post*, Dec. 5, 1999.

# CHAPTER 9

## COMPUTER AND DATA PROCESSING SERVICES

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### Introduction

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Computer and data processing services include computer systems analysis, design, and engineering; custom software and programming services; computer leasing;<sup>1</sup> systems integration services; data entry, processing, and tabulation; and other computer-related services such as computer timesharing, maintenance, and repair.<sup>2</sup> U.S. firms sell computer and data processing services in foreign markets primarily through foreign-based affiliates. However, many computer and data processing services are also provided through cross-border delivery. Advances in electronic transmission technologies continue to simplify long-distance business transactions, allowing U.S. computer and data processing firms to reach an increasing number of cross-border clients. Computer and data processing services most often delivered to foreign clients include systems integration,<sup>3</sup> outsourcing,<sup>4</sup> and custom programming.<sup>5</sup>

### Recent Trends in Cross-Border Trade, 1993-98

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In 1998, U.S. cross-border exports of computer and data processing services decreased by approximately 1 percent to \$2.0 billion, reversing the 20-percent average annual growth rate experienced during 1993-97 (figure 9-1). In contrast, U.S. imports increased by 32 percent to \$365 million, slightly above the 29-percent average annual increase recorded during 1993-97. The decline in exports and the rise in imports reduced the computer and data processing services trade surplus by 7 percent, to \$1.7 billion.

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<sup>1</sup> Data pertaining to computer leasing do not reflect financing fees.

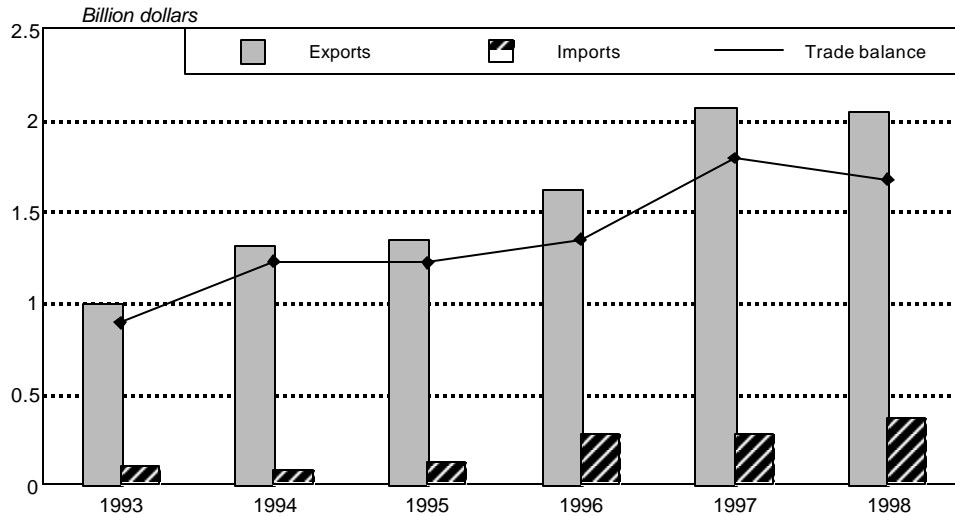
<sup>2</sup> This service category excludes prepackaged software shipped to or from the United States and included in U.S. merchandise trade statistics. U.S. Department of Commerce (USDOC), Bureau of Economic Analysis (BEA), *Instructions to BE-22 Survey*, OMB form No. 0608-0060, July 20, 1995.

<sup>3</sup> 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.

<sup>4</sup> Outsourcing describes the practice of contracting out internal functions, ranging from low-skill services such as data entry to more complex functions such as payroll, invoicing, or managing a company's telecommunication and computer networks.

<sup>5</sup> Custom programmers create or modify software to perform tasks that are unique to client companies.

**Figure 9-1**  
**Computer and data processing services: U.S. cross-border exports, imports, and trade balance, 1993-98**



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, pp. 64-65.

Japan, Canada, and the United Kingdom remained the leading cross-border recipients of U.S. computer and data processing services in 1998 (figure 9-2). Sales to these countries accounted for \$866 million, or 43 percent of total U.S. exports. Although U.S. exports to the Asia Pacific region decreased by 9 percent in 1998, exports to Japan jumped by 13 percent, from \$290 to \$329 million. Canada, India, and the United Kingdom were the leading suppliers of such services to the United States in 1998. U.S. imports of computer and data processing services from India increased significantly in 1998, reflecting a trend in several countries that until recently were relatively minor participants in the global technology market. India's exports to the U.S. totaled \$64 million in 1998, up 700 percent from the previous year.<sup>6</sup> The share of computer-related services delivered to foreign markets through cross-border channels is expected to increase as the Internet and intranets facilitate the transmission of services from remote locations.<sup>7</sup>

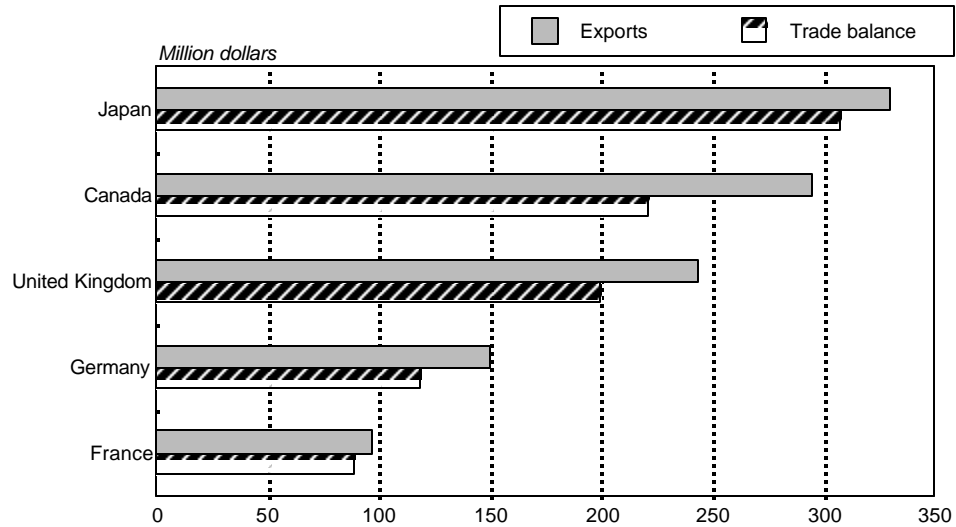
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<sup>6</sup> Significant trade in computer and data processing services also reaches the United States from India via joint ventures and intra-firm transfers. Microsoft, IBM, Oracle, Novell, Hewlett-Packard, and Texas Instruments are among the many U.S. companies with offices in India. IBM employs more than 2,000 people in two joint venture companies, and in 1998, opened a research lab in Delhi. The World Bank, "Champion of Change," found at Internet address <http://www.worldbank.org/ifc/publications/>, retrieved Oct. 14, 1999.

<sup>7</sup> USDOC, BEA, *Survey of Current Business*, Oct. 1999, p. 57.



**Figure 9-2**  
**Computer and data processing services: U.S. cross-border exports and trade balance, by major trading partners, 1998**



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, p. 91.

## Summary and Outlook

Although U.S. exports of computer and data processing services dipped slightly in 1998, the domestic market remained robust, providing U.S. firms with abundant opportunities. The United States is the largest computer and data processing services market in the world, supplying and consuming approximately half of all such services worldwide. U.S. firms such as Andersen Consulting, Automatic Data Processing (ADP), Electronic Data Systems (EDS), GE Information Services, and IBM Global Services are the primary providers of computer and data processing services to the U.S. market. These firms also account for a significant share of the services supplied worldwide, although in certain markets they face intense competition from other multinational computer and data processing service providers such as Cap Gemini (France), Fujitsu (Japan), Groupe Bull (France), and Siemens Nixdorf (Germany).

U.S. computer and data processing firms report that recent weak sales in Asia and Latin America have generally been offset by strong sales in Europe. In addition, the Asian recession has produced some unexpected, potentially long-term, benefits for U.S. firms. Growing numbers of Asian airlines, banks, and other heavy users of computer and data processing services are reducing or eliminating their information technology (IT) departments, instead relying on outside firms to provide their IT services. For example, IBM Global Services has assumed responsibility for the

operation and technical support of Korean Air's major computer systems.<sup>8</sup> In Japan, the Mitsui Marine and Fire Insurance Company recently outsourced its systems operation and management to IBM Global Services in a 10-year contract valued at \$235 million, the largest outsourcing contract in the history of the Japanese insurance industry.<sup>9</sup> However, U.S. firms have not been the sole beneficiaries of this trend. Fujitsu, which experienced a 3-percent reduction in its total sales in 1998, was aided by an 11-percent increase in sales of outsourcing and related services.<sup>10</sup>

Despite the recent downturn, industry analysts expect that the market for IT services in the Asia Pacific region outside Japan will likely reach \$46 billion by 2002, as compared with nearly \$16 billion in 1997.<sup>11</sup> The Chinese market is considered particularly promising, although foreign investment in certain computer-related sectors has been adversely affected by uneven policies. In mid-1999, the Chinese Minister for Information Industry announced that significant sections of the Internet sector were closed to foreign investment, jeopardizing existing foreign investment, stalling additional investment, and complicating the country's efforts to join the World Trade Organization. However, China concluded an accession agreement with the United States in late November 1999 that lifts the current ban on direct investment in China's telecommunications sector, which will directly benefit Internet and computer services sectors.

Europe continues to be the leading export market for U.S. computer and data processing services. Outsourcing was the leading growth sector in 1997, increasing by 19 percent during the year to a total of approximately \$25 billion across Europe. Outsourcing presently accounts for more than 25 percent of the European software and computer services market, second only to IT professional services.<sup>12</sup> During 1999, the top priorities in the European IT market were eradicating year-2000 (Y2K) problems and converting to the euro, the new currency of the European Union (EU). In 1999, Y2K issues and euro compliance<sup>13</sup> reportedly accounted for 17 percent and

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<sup>8</sup> The outsourcing contract is valued at \$120 million over a 10-year period. IBM Global Services, "Korean Air and IBM Announce Strategic Outsourcing Contract," *IBM PressRelease*, Dec. 21, 1998, found at Internet address <http://www.ibm.com/services/pressrel/>, retrieved Oct. 21, 1999.

<sup>9</sup> IBM Global Services, "Mitsui Marine and Fire Insurance selects IBM for \$235 Million Outsourcing," *IBM PressRelease*, Aug. 24, 1999, found at Internet address <http://www.ibm.com/services/pressrel/>, retrieved Sept. 15, 1999.

<sup>10</sup> Fujitsu Limited, *1999 Annual Report*, June 1999, pp. 20, 21.

<sup>11</sup> Terho Uimonen, "Two Sides to the Currency Crisis in Asia," *Computerworld*, Dec 7, 1998; vol. 32, Iss. 49, p. S4.

<sup>12</sup> Andrew Craig, "U.K. Shows Growth in Software, Services," *TechWeb*, Feb. 10, 1998, found at Internet address <http://www.techweb.com/news/>, retrieved Sept. 7, 1999.

<sup>13</sup> By January 1, 2002, businesses operating within the EU must be able to conduct all financial transactions using the euro. Some industry representatives believe that Y2K activity and the euro conversion are creating a "bubble" effect in the European IT services market and that demand for IT services will drop off significantly once the windows for these projects close, resulting in overcapacity and reduced revenues. Industry representatives, telephone interviews by USITC staff, Sept. 9, 1999.

7 percent of European IT budgets, respectively.<sup>14</sup> U.S. IT service providers such as IBM, Microsoft, and Oracle anticipate continued high demand for services associated with the currency conversion. During the transition to the euro, dual (national currency and euro) denomination capabilities will be necessary, adding to the complexity of the conversion.<sup>15</sup>

Internet-related applications are expected to experience continued strong growth in the United States and abroad. One measure of the Internet's growth is America Online's (AOL) sharply rising subscription rates -- membership grew from 12.5 million to 17.6 million during fiscal 1999. Additional users create demand for a wide variety of network and computer-related services, including electronic commerce, network security, and software development. During 1998-99, AOL introduced service in Australia, and prepared for launches in Latin America and Hong Kong. AOL membership outside of the United States reached 3.2 million in early 1999 including 2.8 million members in Europe, where AOL Europe is expanding its strategic relationships in the areas of networks and electronic commerce.<sup>16</sup>

According to industry analysts, in early 1999, 50 percent of U.S. companies with 500 or more employees were using an intranet,<sup>17</sup> and 55 percent of the companies in this segment that currently did not have an intranet planned to deploy one within the year.<sup>18</sup> The most popular intranet applications include information sharing and publishing, electronic mail, document management, electronic forms, and corporate directories. Intranets are also rapidly being implemented throughout Europe. Market research consultants report that the European intranet services market will likely be worth an estimated \$5.2 billion by the end of 2003, up from an early-1999 market value of \$720 million. Also, by the end of 2000, Germany is expected to overtake the United Kingdom as the largest market for intranet services in Europe.<sup>19</sup>

Business-to-business transactions comprise the majority of electronic commerce and this is expected to continue. Industry analysts expect business-to-business activity over the Internet to reach \$1.3 trillion in 2003, when online sales to consumers are

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<sup>14</sup> Dow Jones Newswires, "Information-Technology Budgets In Europe Will Be Flat in 2000," *The Wall Street Journal Interactive*, Aug. 25, 1999, found at Internet address <http://www.wsj.com/>, retrieved Sept. 15, 1999.

<sup>15</sup> European Commission, Information Society Promotion Office, "Migrating to the Euro: System Strategies & Best Practices," Report by the Euro Working Group, Amir Barnea, ed., July 1999, found at Internet address <http://www.ispo.cec.be/>, retrieved Sept. 7, 1999.

<sup>16</sup> America Online, Inc., *1999 American Online Annual Report*, found at Internet address <http://www.corp.aol.com/annual/shareholder/>, retrieved Oct. 21, 1999.

<sup>17</sup> An intranet is a private network built with Internet technologies. A section of an intranet accessible to customers, suppliers, or other outsiders is an extranet. The demand for extranet development services is also rising sharply.

<sup>18</sup> International Data Corporation, "Technology Advances Spark Significant Change in Intranet Use," IDC press release, Apr. 7, 1999, found at Internet address <http://www.idc.com/Press/>, retrieved Oct. 21, 1999.

<sup>19</sup> Jana Sanchez, "Euro Intranet Services to Grow Sevenfold by 2003," *Computerworld*, Online News, Mar. 12, 1999, found at Internet address <http://www.computerworld.com/home/news.nsf/>, retrieved Sept. 16, 1999.

expected to reach \$108 billion.<sup>20</sup> Computer and data processing service providers both develop business-to-business network applications for clients and use such technology to improve the delivery of their own products and services. For example, Automatic Data Processing (ADP) is developing Internet versions of some of its services to give corporations secure, convenient access to their payroll and payroll tax data.<sup>21</sup>

U.S. firms such as Andersen Consulting, Ernst & Young, IBM Global Services, and PricewaterhouseCoopers design, develop, install, and maintain electronic commerce applications for a wide variety of businesses worldwide. Typical applications enable businesses to order products, bill customers, track accounts receivable, trace product shipments, and transfer funds electronically. Such systems allow companies to improve the efficiency of their internal and external business functions through the use of network technologies, or to move their entire business onto the Internet. Andersen Consulting, for example, is developing electronic commerce services that use Internet technologies and sophisticated database management tools. The services will enable businesses to create personalized online relationships with their customers, and then provide goods and services based on an individual's personal preferences.<sup>22</sup>

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<sup>20</sup> Norbert Turek, "E-Commerce Counts On Servers," *Informationweek*, Sept. 13, 1999, found at Internet address <http://www.informationweek.com/>, retrieved Oct. 9, 1999.

<sup>21</sup> Automatic Data Processing, *Annual Report*, June 1999.

<sup>22</sup> Andersen Consulting, "Andersen Consulting and Calico Join Forces to Help Companies Create Personalized Web-Based Buying Experiences," *AC News*, Sept. 20, 1999, found at Internet address <http://www.ac.com:80/news/>, retrieved Oct. 26, 1999.

# CHAPTER 10

## EDUCATION SERVICES

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### Introduction

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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. U.S. cross-border exports reflect the estimated tuition and living expenses of foreign residents enrolled in U.S. colleges and universities.<sup>1</sup> U.S. cross-border imports of education services represent the estimated tuition and living expenses of U.S. residents who study abroad.<sup>2</sup> 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 on cross-border trade.

### Recent Trends in Cross-Border Trade, 1993-98

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In 1998, U.S. exports of education services totaled \$9 billion, while U.S. imports measured \$1.5 billion (figure 10-1). Exports increased by 7 percent in 1998, faster than the 5-percent average annual increase registered during 1993-97. U.S. imports increased by 10 percent in 1998, slower than the 13-percent average annual growth rate recorded during 1993-97. Trade in education services generated a \$7.4 billion surplus in 1998, reflecting 7-percent growth. This was faster than the 4-percent average annual increase achieved during 1993-97.

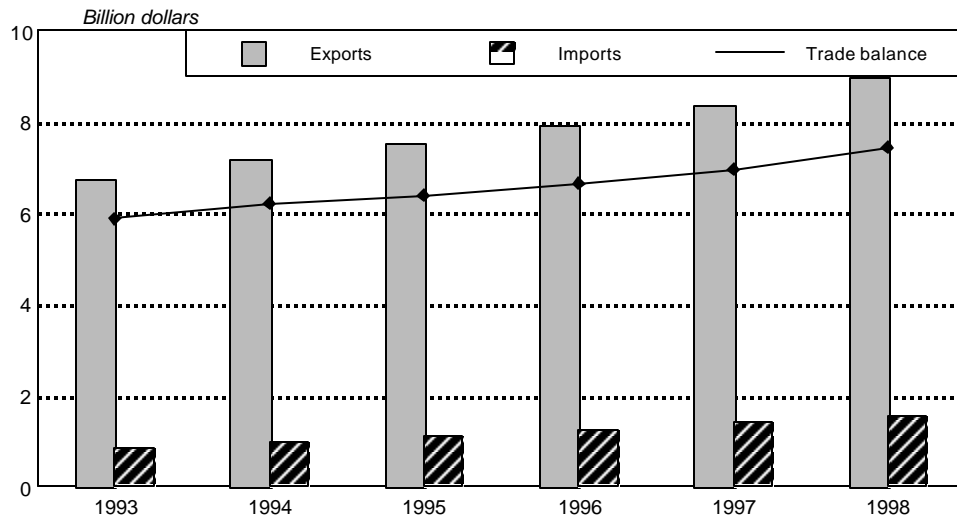
In 1998, the largest U.S. export markets for education services included Japan, China, Korea, India, and Taiwan (figure 10-2). Japan accounted for 10 percent of exports; China, 8 percent; Korea, 7 percent; India, 6 percent; and Taiwan, 5 percent. Exports to each of these markets increased in 1998. Exports to Japan increased by 5 percent; to China, 13 percent; to Korea, 18 percent; to India, 13 percent; and to Taiwan, 3 percent. U.S. imports of education services are principally provided by the United Kingdom, Mexico, Spain, Italy, and France, respectively. Imports from all of these countries increased in 1998. Imports from the United Kingdom increased by 14 percent; Mexico, 8 percent; Spain, 14 percent; Italy, 12 percent; and France, 12 percent.

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<sup>1</sup> Foreign residents do not include U.S. citizens, immigrants, or refugees.

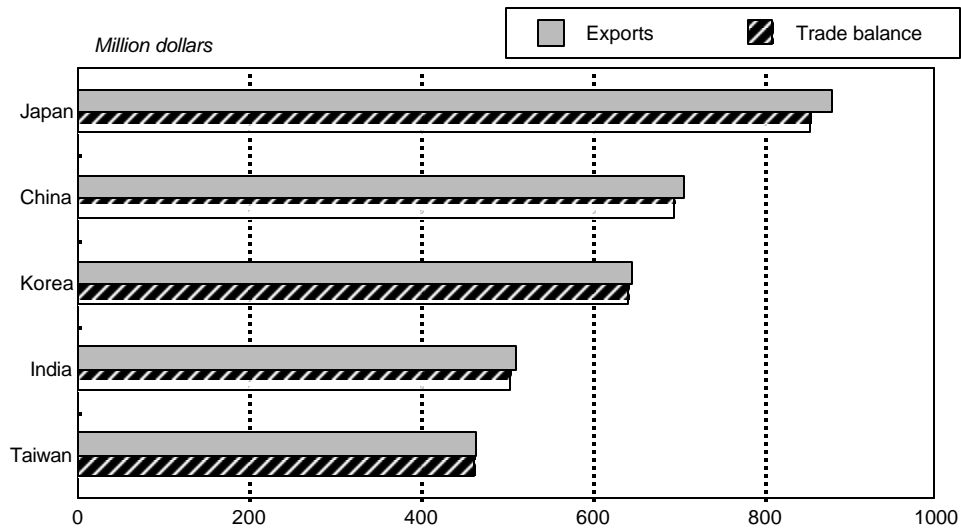
<sup>2</sup> U.S. residents must receive credit from accredited U.S. institutions to be included in trade data; those who do not transfer foreign academic credit to U.S. institutions, or who study abroad on an informal basis, are not included.

**Figure 10-1**  
**Education services: U.S. cross-border exports, imports, and trade balance, 1993-98**



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, pp. 64-65.

**Figure 10-2**  
**Education services: U.S. cross-border exports and trade balance, by major trading partners, 1998**



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, pp. 82-83.

Foreign students studying in the United States numbered 490,933 in the 1998-99 academic year, placing the United States first in the world in terms of foreign student enrollment. Foreign student enrollment increased by 2 percent in 1998-99, more slowly than the 5 percent increase in 1997-98. The number of foreign students from 10 of the 15 leading source countries increased in 1998-99, with particularly strong growth in the number of students from Brazil, with an increase of 15 percent; India, 11 percent; and China, 9 percent. The top five countries of origin in terms of numbers of foreign students –China, Japan, Korea, India, and Taiwan– are also the top five export markets in terms of receipts, although China and Japan trade places as numbers one and two respectively. China and India accounted for 80 percent of the total increase of foreign students studying in the United States during the 1998-99 academic year. In contrast, the number of students from Korea dropped by 38 percent. Community colleges have been the fastest growing segment of the education market for foreign students, with an increase of 32 percent over the last five years. During 1998-99 academic year, community colleges accounted for 17 percent of all foreign students.<sup>3</sup> Reportedly, foreign enrollments in community colleges have been growing due to increased international marketing by several large community colleges, the cost differential between community colleges and traditional universities, and the high demand for training offered by community colleges, such as computer, technology, and English language training.<sup>4</sup>

In 1997, foreign graduate students constituted 43 percent of the total foreign student body in the United States. In some fields, particularly engineering, natural sciences, and business, foreign students accounted for between 20 and 40 percent of all doctorates awarded by U.S. institutions.<sup>5</sup> Such students may have an important impact upon U.S. labor markets. In 1995, 53 percent of foreign postdoctoral students planned to remain in the United States. The percentage was higher among students in the natural science and engineering fields.<sup>6</sup>

The number of U.S. students studying in foreign countries increased by 15 percent in the 1997-98 academic year. This was the largest one year gain in the five years for which data are available. The increase may be related to desires among students to develop international experience as well as the current boom in the U.S. economy. However, the average length of stay of U.S. students abroad has declined, perhaps because the cost of studying abroad has risen and because the increase in the number of U.S. students studying abroad includes students from lower income backgrounds. European markets accounted for 64 percent of the U.S. students who studied abroad in 1997-98. The Latin American region is the second most popular

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<sup>3</sup> Todd M. Davis, ed., *Open Doors: Report on International Educational Exchange* (New York: Institute of International Education, 1999), pp. 13, 39.

<sup>4</sup> Industry representatives, interviews by USITC staff, Washington, DC, Sept. 1999.

<sup>5</sup> “Characteristics of Recipients of Doctorates, 1997” table in *The Chronicle of Higher Education*, Almanac Issue, vol. XLVI, no. 1, Aug. 27, 1999, p. 29.

<sup>6</sup> Todd M. Davis, ed., *Open Doors 1997/98: Report on International Educational Exchange*, (New York: Institute of International Education, 1998), pp. 73-74.

destination, accounting for 16 percent of U.S. students studying abroad.<sup>7</sup>

## Summary and Outlook

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As noted, the United States remains the world's leading exporter of education services. Despite the Asian financial crisis and increasing competition for foreign students by other countries, the number of foreign students seeking an education in the United States continued to increase in 1998. Nevertheless, competition for foreign students seems to be increasing, as countries such as Australia, the United Kingdom, and Canada actively recruit foreign students who might otherwise attend educational institutions in the United States.<sup>8</sup> Australia has been particularly active in recruiting students from Asia, the region which accounts for the highest number of foreign enrollments in the United States. In addition, the recent treaty harmonizing higher education accreditation systems in Europe will likely increase intra-European flows of students, potentially reducing the number of European students in the United States. However, harmonization may not have a significant effect on U.S. exports, since European students are attracted to the United States for its high quality system of education.<sup>9</sup>

Issues that have received considerable attention among providers of educational services include the preservation of quality education in U.S. institutions and the removal of restrictions on the movement of students and faculty, such as unnecessarily onerous or non-transparent visa requirements. Quality issues and accreditation are especially prominent with regard to distance learning through the Internet.<sup>10</sup>

Industry analysts project increasing worldwide demand for higher education, including vocational, university, and graduate-level education, and management and professional training. Increased international demand for higher education stems from two main sources. First, increasing numbers of students, particularly in developing countries, complete the secondary level of education, creating a larger pool of potential tertiary students. Second, there is an increasing demand for "lifelong learning." Lifelong learning includes not only adults re-entering traditional degree programs, but also adults engaging in continual training and upgrading of skills in non-

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<sup>7</sup> Todd M. Davis, telephone interview by USITC staff, Aug. 31, 1999; and Paul Desruisseaux, "15% Rise in American Students Abroad Shows Popularity of Non-European Destinations," *The Chronicle of Higher Education*, Dec. 10, 1999, pp. A60-A61.

<sup>8</sup> Paul Desruisseaux, "Intense Competition for Foreign Students Sparks Concerns About U.S. Standing," *The Chronicle of Higher Education*, Oct. 9, 1998, found at Internet address <http://chronicle.com/>, retrieved Oct. 1, 1999.

<sup>9</sup> Burton Bollag, "European Nations Seek Compatible Degrees: A New Effort Attempts to 'Harmonize' Programs While Preserving Diversity of College Systems," *The Chronicle of Higher Education*, July 9, 1999, pp. A43-A44.

<sup>10</sup> Marjorie Peace Lenn and Bradley D. Millers, eds., *The Foundations of Globalization of Higher Education and the Professions*, (Washington, DC: The Center for Quality Assurance in International Education, 1999); and industry representative, telephone interview by USITC staff, Oct. 6, 1999.



degree programs and training courses. This phenomenon is occurring

globally. Demand for advanced skills is particularly pronounced in the fastest growing sector of the world economy, information technology services.<sup>11</sup>

The current demand for lifelong learning may explain, in part, the growing popularity of testing, training, distance learning programs, and the increasing sales of educational software services.<sup>12</sup> Demand for testing services is growing, not only for admission requirements, but also in the areas of professional accreditation and licensing. Testing services are presently exported to more than 180 countries by U.S. service providers.<sup>13</sup>

U.S. providers of education services are opening educational facilities abroad in response to these trends. For example, in January 1999, Sylvan Learning Systems, Inc. announced plans to open a network of private universities overseas.<sup>14</sup> Temple University now has campuses in Japan and Italy and also offers educational services in London, Athens, and Tel Aviv.<sup>15</sup> The potential international market for distance education is also significant, particularly in remote areas and with regard to business training and continuing education.<sup>16</sup> Several providers of distance education

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<sup>11</sup> Phillip J. O'Connell, "Adults in Training: An International Comparison of Continuing Education and Training," Organisation for Economic Co-operation and Development (OECD), CERI/WD(99)1, 1999; and Arthur Gerstenfeld and Edgardo Gomez Luengo, "Resurging Latin America Presents Global Technology Managers with New Markets and Venture Opportunities," *Research Technology Management*, July/Aug. 1998, found at Internet address <http://proquest.umi.com/>, retrieved Sept. 23, 1999.

<sup>12</sup> The global educational and reference software market totaled \$109 billion in 1996, with U.S. providers capturing 69 percent of the market. CD-ROM sales account for less than one percent of the total market; the rest is delivered via on-line, diskette, and video modes. OECD, "New Developments in Educational Software and Multimedia: Background Paper," CERI/SFT(98)6, 1998, pp. 7-9.

<sup>13</sup> Industry representative, e-mail interview by USITC staff, Oct. 27, 1999.

<sup>14</sup> Kit Lively and Goldie Blumenstyk, "Sylvan Learning Systems to Start A Network of For-Profit Universities Overseas," *The Chronicle of Higher Education*, Jan. 29, 1999, found at Internet address <http://chronicle.com/>, retrieved Oct. 1, 1999; and Goldie Blumenstyk, "Sylvan Learning Systems Moves Into the Higher-Education Market," *The Chronicle of Higher Education*, Mar. 12, 1999, found at Internet address <http://chronicle.com/>, retrieved Oct. 1, 1999.

<sup>15</sup> "Advertiser Profile: Temple University," *The Chronicle of Higher Education*, found at Internet address <http://chronicle.com/>, retrieved Nov. 8, 1999.

<sup>16</sup> A recent survey by Corporate University Xchange found that 80 percent of corporate training takes place in a traditional classroom, while the rest occurs through a variety of other technologies, including, increasingly, the Internet. Laurie Joan Aron, "Online U.," *Across the Board*, Sept. 1999, found at Internet address <http://proquest.umi.com/>, retrieved Sept. 30, 1999. The World Bank launched the "African Virtual University," which delivers courses to 16 African countries via television signals sent by fibre optic or satellite links. David A. Light, "Pioneering distance education in Africa," *Harvard Business Review*, found at Internet address <http://proquest.umi.com/>, retrieved Sept. 30, 1999.

services have recently entered the market, including publishing giant Harcourt General.<sup>17</sup>

There are no comprehensive data regarding restrictions on trade in education services. However, it is clear that significant trade barriers exist, particularly with regard to the foreign provision of education services through affiliates. Trade barriers to educational services reportedly include restrictions on student entry and exit; restrictions on purchase, ownership, and operation of education facilities; accreditation or licensing requirements and recognition standards; and outright prohibitions on foreign private provision of educational services. For example, Greece restricts the granting of degrees to Greek institutions. Mexico limits foreign ownership to 49 percent in the education sector. Japan has highly restrictive accreditation rules.<sup>18</sup> In general, industry representatives cite Asian markets as being the most restrictive in terms of setting up facilities abroad.<sup>19</sup>

The advent of electronic commerce has led to the development of additional education service products, but the data used to gauge such activities is sparse. U.S. companies reportedly are leading providers of educational software, management training, language training, testing services, Internet publishing, and distance education through the Internet.<sup>20</sup> Furthermore, the use of web pages and the Internet

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<sup>17</sup> "Harcourt General Names Massachusetts Commissioner of Education to Lead Its Distance Learning Business," *Business Wire*, Feb. 4, 1998, found at Internet address <http://web4.infotrac.galegroup.com/>, retrieved Oct. 1, 1999. See also, "Online Universities Court a Wary Market," *Training*, Aug. 1999, found at Internet address <http://proquest.umi.com/>, retrieved Sept. 30, 1999; Kathleen Morris, "Wiring the Ivory Tower," *BusinessWeek*, Aug. 9, 1999, found at Internet address <http://proquest.umi.com/>, retrieved Sept. 30, 1999; and Dennis A. Trinkle, "Distance Education: a Means to an End, No More, No Less," *The Chronicle of Higher Education*, Aug. 6, 1999, found at Internet address <http://chronicle.com>, retrieved Oct. 1, 1999 and Nov. 8, 1999. In "Trade in Education Services," May 11, 1999, the Center For Quality Assurance in International Education claims that international exports of affiliates ("physically based campuses") are the fastest growing sector of education services, not distance learning. While the majority of distance education efforts seem to be concentrated at the tertiary levels, there are signs of increasing activity at the secondary level as well. Sarah Carr and Jeffrey R. Young, "As Distance-Learning Boom Spreads, Colleges Help Set Up Virtual High Schools," *The Chronicle of Higher Education*, Oct. 22, 1999, found at Internet address <http://chronicle.com/>, retrieved Nov. 8, 1999.

<sup>18</sup> A report on foreign trade barriers to international education is found in the International Trade Administration of the Department of Commerce's "World-Education/Training FY99-IMI981113 Best Market Reports," found at Internet address <http://www.stat-usa.gov/>. Also, see "Trade in Education Services," The Center for Quality Assurance in International Education (Washington, D.C.: May 11, 1999).

<sup>19</sup> Industry representative, fax interview by USITC staff, Oct. 6, 1999.

<sup>20</sup> For additional information regarding the large gaps in data on educational trade and a suggested research agenda, see John Mallea, "International Trade in Professional and Educational Services: Implications for the Professions and Higher Education," OECD, 1998, pp. 21-24.

to advertise and provide information about educational services is widespread, and is a key component of U.S. educational service providers' international student recruitment strategies.<sup>21</sup>

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<sup>21</sup> Industry representative, fax interview by USITC staff, Oct. 6, 1999.

# CHAPTER 11

## ENERGY SERVICES

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### Introduction

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Energy services consist of a wide variety of activities related to 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.<sup>1</sup> Energy services may also include related design and engineering; transportation; storage; trading, marketing, and brokerage; commodity and price risk management; demand-side and other customer services;<sup>2</sup> as well as waste management and disposal services.<sup>3</sup>

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 usually require a direct presence in foreign markets, such as oil field services; pipeline transportation and distribution services; 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 trade in energy services is reflected in 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 trade, the affiliate transactions do not capture energy-related sales of services by engineering or construction companies, because such transactions cannot be distinguished from non-energy sales. Due to these data limitations, the following data discussion addresses only affiliate transactions by firms engaged directly in petroleum-related and utility businesses.

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<sup>1</sup> 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.

<sup>2</sup> These include programs to reduce or restructure a customer's consumption of energy to improve energy conservation and efficiency. These also include metering and billing services.

<sup>3</sup> 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, 1992-97

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In 1997, sales of energy services by foreign-based affiliates of U.S. firms measured an estimated \$32.4 billion (figure 11-1).<sup>4</sup> U.S. sales increased by 51 percent over the previous year, which was considerably faster than the average annual growth rate of 18 percent recorded during 1992-96. The rapid growth in sales reflects the continuation of a trend that began in 1996, when sales grew by 48 percent. Such strong growth in sales by foreign affiliates of U.S. firms was largely driven by the utilities sectors, which recorded sales growth of 106 percent and 71 percent in 1996 and 1997, respectively. This growth, in turn, reflects a number of major foreign acquisitions by U.S. electric utility companies that pursued new opportunities created by deregulation and privatization programs abroad. With 59 percent of sales, Europe accounted for the largest share of U.S. energy service sales through affiliates. Almost 50 percent of all U.S. affiliate sales of energy services took place in the United Kingdom (figure 11-2). Latin America accounted for an additional 10 percent of sales, while Australia and Japan accounted for 6 percent and 1 percent of sales, respectively.<sup>5</sup>

U.S. purchases of energy services through U.S.-based affiliates of foreign firms measured \$3.2 billion<sup>6</sup> in 1997.<sup>7</sup> Electric utilities and pipeline transportation of crude oil, refined products, and natural gas accounted for the largest proportion of U.S. purchases (31 percent and 29 percent, respectively). Services related to coal mining accounted for 18 percent of U.S. purchases, while oil and gas extraction and support services accounted for 16 percent of such purchases. Natural gas distribution services, which are distinguished from pipeline transport, accounted for 4 percent of purchases. Most U.S. energy service affiliates of foreign firms are owned by European parent companies, which jointly accounted for an estimated 38 percent of U.S. purchases (figure 11-3). Affiliates owned by Canadian parents accounted for an additional 18 percent of U.S. purchases, while Japanese-owned affiliates accounted for 7 percent of such purchases.<sup>8</sup>

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<sup>4</sup> This estimate likely understates the value of sales by foreign affiliates of U.S. firms because data for Canada, Germany, and the Netherlands were suppressed by the U.S. Department of Commerce (USDOC), Bureau of Economic Analysis (BEA) in order to avoid disclosure of individual company data.

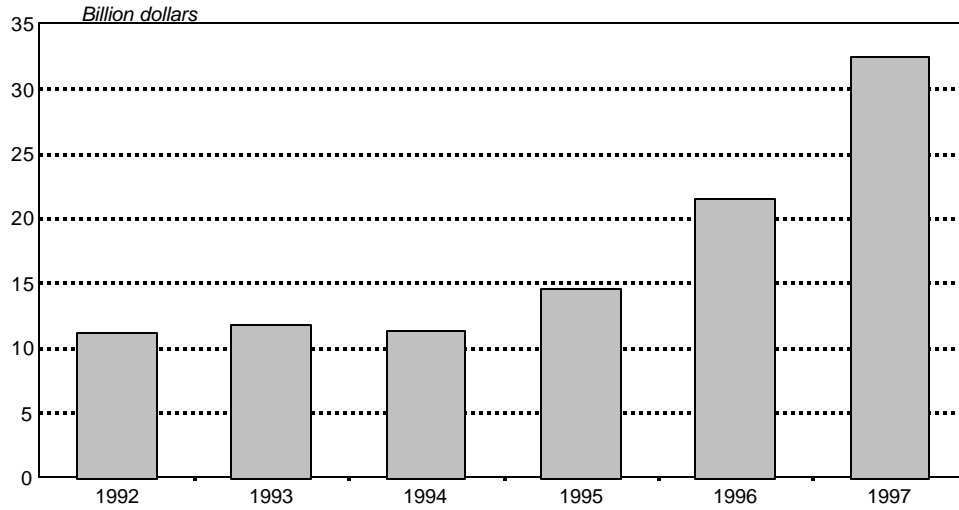
<sup>5</sup> Canada likely accounted for an estimated 5 percent of sales in 1997, however data on 1997 sales by Canada-based utility affiliates were suppressed by BEA in order to avoid disclosure of individual company data.

<sup>6</sup> USITC staff estimate based on data reported in USDOC, BEA, *Survey of Current Business*, Oct. 1999, p. 95; and USDOC, BEA, *Foreign Direct Investment in the United States: Operations of U.S. Affiliates of Foreign Companies*, July 1999.

<sup>7</sup> BEA reported data on 1997 affiliate purchases using the NAICS (North American Industry Classification System), not the SIC (Standard Industrial Classification) system used to report 1997 affiliate sales data and all affiliate transactions data prior to 1997. As a result, it is not feasible to calculate an analytically sound affiliate transactions balance or the growth rate of affiliate purchases in 1997. For more information on the transition from the SIC to the NAICS, see text box 2-1.

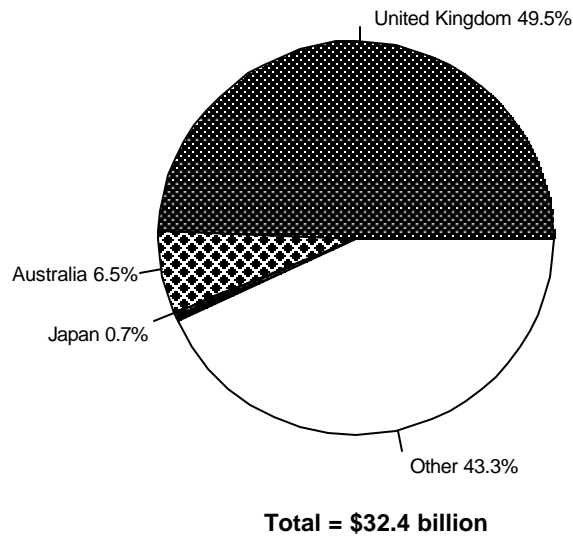
<sup>8</sup> Additional country-specific data on U.S. purchases were suppressed by BEA in order to avoid disclosure of individual company data.

**Figure 11-1**  
**Energy affiliates: Sales of services by majority-owned affiliates of U.S. firms, 1992-97**



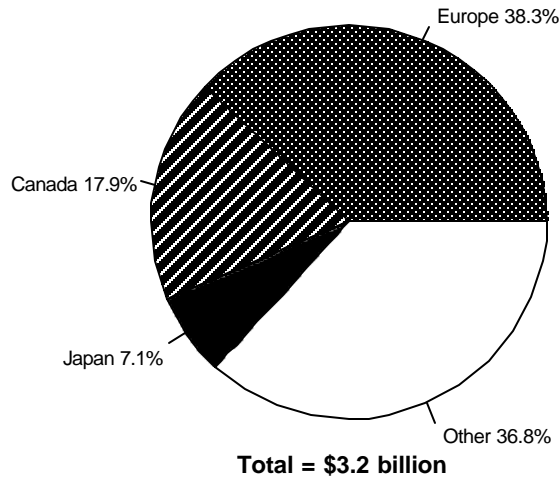
Source: U.S. Department of Commerce (USDOC), Bureau of Economic Analysis (BEA), *Survey of Current Business*, Oct. 1999, p. 93; Oct. 1998, pp. 115-6; Oct. 1997, pp. 137-8; Nov. 1996, pp. 104-5; and Sept. 1994, pp. 135-6; and USDOC, BEA, *U.S. Direct Investment Abroad, 1994 Benchmark Survey, Final Results*, table III.F.20.

**Figure 11-2**  
**Energy affiliates: Sales by majority-owned affiliates of U.S. firms, by principal markets, 1997**



Source: USITC staff estimates.

**Figure 11-3**  
**Energy affiliates: Purchases from majority-owned affiliates of foreign firms, by country of ultimate beneficial owner,<sup>1</sup> 1997<sup>2</sup>**



<sup>1</sup> 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.  
<sup>2</sup> Total may not equal 100 percent due to rounding.

Source: USITC staff estimates.

## Summary and Outlook

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Although it is not possible to draw direct comparisons between U.S. sales and purchases of energy services through foreign affiliates due to different data collection methodologies, the rather large disparity clearly suggests that U.S. energy service firms are far more active internationally than foreign firms are in the United States. This observation is supported by U.S. direct investment data, which indicate that U.S. investment in foreign energy markets far exceeds foreign investment in the U.S. energy market.<sup>9</sup>

With considerable financial, managerial, and technological resources, U.S. energy service providers continue to hold a relatively strong international position. The major challenges and opportunities confronted by U.S. firms tend to be a result of broad economic and political conditions rather than industry-specific phenomena. In 1999, these factors included adverse market conditions in the oil sector and increased opportunities in the electric power and natural gas segments. In the oil sector, weakness in Asian markets and overproduction drove oil prices to a 12-year low in December 1998. Prices remained low through much of 1999 before rebounding in response to coordinated production cutbacks by oil producing countries.<sup>10</sup> While these production cutbacks eventually pushed oil prices over \$30 per barrel in early 2000, the highest level recorded since the Gulf War in 1991,<sup>11</sup> average oil prices in 1999 were still below those recorded in 1998. Low prices and excess production capacity

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<sup>9</sup> USDOC, BEA, *Survey of Current Business*, Sept. 1999, pp. 55-56 and 84-85.

<sup>10</sup> Steve Leisman and Jonathan Friedland, "Oil Nations Plan to Meet: Prices Drop," *The Wall Street Journal*, Oct. 6, 1999, p. A2.

<sup>11</sup> Peter A. McKay and Steve Liesman, "Crude Oil Tops \$30 a Barrel," *The Wall Street Journal*, Feb. 15, 2000, p. C1.



resulted in weak demand for oil field services during 1999, which in turn reduced the earnings of major U.S. oil companies and oil field service providers. In response, companies cut costs by reducing staff levels and sharing services such as research and development.<sup>12</sup> Oil companies have also pursued mergers and acquisitions in order to achieve operating efficiencies and thus reduce costs. For example, British Petroleum completed the integration of its operations with Amoco in 1999, which resulted in the elimination of 8,000 jobs and a projected \$10 billion reduction of combined assets by 2001.<sup>13</sup> The Exxon-Mobil merger, announced in 1998, received final U.S. regulatory approval on November 30, 1999.<sup>14</sup>

In the electric power sector, regulatory reform efforts in the European Union (EU) and the United States, together with privatization programs in emerging markets, have created many new international investment opportunities.<sup>15</sup> The EU Directive creating a common internal electricity market entered into effect on February 19, 1999, when member states were required to open at least 25 percent of their power markets to competition.<sup>16</sup> In practice, an estimated 60 percent of the market is now open to competition.<sup>17</sup> As a consequence of liberalization, the EU accounted for approximately 63 percent of cross-border mergers and acquisitions in the electric power industry during the first three quarters of 1999.<sup>18</sup> Major U.S. investors include AES, which acquired the Drax power station in the United Kingdom for \$3 billion, and Reliant Energy, which acquired Una, one of the Netherlands' four major generating companies, for \$2.4 billion.<sup>19</sup>

Regulatory reform of the U.S. electric power industry continues to proceed on a state-by-state basis. The Federally-regulated interstate, or wholesale market, was opened to competition through the Energy Policy Act of 1992, but Congress has yet to act on any national legislative proposals for the retail segment.<sup>20</sup> The uncertainty created by the absence of a national policy for the retail market combined with the reportedly high costs associated with obtaining the necessary approvals from both U.S. Federal and state regulatory agencies

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<sup>12</sup> Loren Fox, "Fourth Quarter Was a Bruiser for Oil Companies," *The Wall Street Journal*, Jan. 6, 1999, p. B10C; and *International Oil & Gas Finance Review 1999* (Essex, United Kingdom: Euromoney Publications), p. 58.

<sup>13</sup> Bhushan Bahree, "Oil Mergers Often Don't Live Up to the Hype," *The Wall Street Journal*, July 23, 1999, p. A10.

<sup>14</sup> Federal Trade Commission, "Exxon/Mobil Agree to Largest FTC Divestiture Ever," Nov. 30, 1999, found at Internet address <http://www.ftc.gov/>, retrieved Dec. 9, 1999.

<sup>15</sup> For additional information, see United States International Trade Commission (USITC), "Deregulation Fosters Globalization of the Electric Power Industry," *Industry, Trade, and Technology Review* (USITC publication 3134, Sept. 1998); and USITC, "Energy Services: Recent Trends and Future Prospects," *Industry, Trade, and Technology Review* (USITC publication 3206, June 1999).

<sup>16</sup> Directive 96/92/EC of the European Parliament and of the Council of 19 December 1996 concerning common rules for the internal market in electricity, *Official Journal of the European Communities*, No. L 27/20, Jan. 30, 1997.

<sup>17</sup> Reuters, "EU Takes Regulated Approach to Power Liberalization," Jan. 26, 1999, found at Internet address <http://www.energycentral.com/>, retrieved Jan. 28, 1999.

<sup>18</sup> Andrew Taylor, "Europe Retains Leading Role: M&A Activity in the Electricity Sector," *Financial Times*, Sept. 23, 1999.

<sup>19</sup> *Ibid.*

<sup>20</sup> Electric Power Supply Association, "One Step Forward, One Step Back," *Restructuring Matters*, vol. 3, No. 9, Sept. 1999.

appear to have discouraged foreign investment in the U.S. electric power sector.<sup>21</sup> Nevertheless, National Grid of the United Kingdom acquired New England Electric System for \$3.8 billion in 1999, giving the company a 23-percent market share in the northeastern United States; U.K.-based National Power announced plans to invest as much as \$3 billion to develop new power generation plants; and Electricité de France reportedly is considering acquisitions in the United States.<sup>22</sup>

In the natural gas distribution industry, privatization and new project development in emerging markets are driving growth in international investment by U.S. firms. In many regions, natural gas is under-utilized as a fuel source due to the lack of a pipeline and grid infrastructure.<sup>23</sup> Consequently, numerous natural gas infrastructure projects are under development. For example, U.S.-based Amerada Hess entered into a strategic alliance with Premier Oil of the United Kingdom and Petronas, Malaysia's government-owned energy company, to develop and operate pipeline infrastructure between countries in Southeast Asia. In so doing, the three companies hope to develop an integrated gas grid that will more effectively exploit the significant natural gas reserves they control in the region.<sup>24</sup> Similarly, in Nigeria, Mobil is planning to build and operate a 350-megawatt power plant fueled by natural gas, which Mobil will produce and transport from its nearby oil and gas fields.<sup>25</sup> In Brazil, Enron is building a 480-MW power plant that will be fueled by a 385-mile natural gas pipeline originating in Bolivia.<sup>26</sup>

Future prospects for trade in energy services continue to be mixed. Trade in oil field services is unlikely to grow substantially while oil producing countries continue to limit production in an effort to sustain prices. However, production levels are expected to increase during 2000,<sup>27</sup> which may spur renewed demand for field services. In addition, mergers and acquisitions may cause significant shifts in the composition of affiliate transactions. The electric power and natural gas service industries continue to hold the greatest potential for substantial growth, as regulatory reform and privatization programs become increasingly widespread. Demand for these energy sources is projected to grow substantially in emerging markets over the next two decades.<sup>28</sup>

The role of electronic commerce in energy service industries continues to evolve. Energy service providers identify potential international investments, conduct the research necessary to prepare bids, and manage far-flung operations through the Internet. However, electronic

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<sup>21</sup> The Scottish Power acquisition of Pacificorp reportedly cost nearly \$100 million in obtaining the necessary approvals and financing fees and took longer than one year to conclude. Andrew Taylor, "Transatlantic Investment is a Two-Way Street," *Financial Times*, Sept. 23, 1999.

<sup>22</sup> Ibid.

<sup>23</sup> Robert Corzine, "Gas: Race to Dominate Asian Grid," *Financial Times*, Oct. 5, 1999.

<sup>24</sup> Ibid.

<sup>25</sup> Reuters, "Nigerian State Power Firm Ready for Mobil Deal," July 7, 1999, found at Internet address <http://www.energycentral.com/>, retrieved July 8, 1999.

<sup>26</sup> Overseas Private Investment Corporation, "OPIC Board Approves Cuiabá Project with Unprecedented Environmental Safeguards," press release, June 15, 1999; and Enron International, "Our Presence in Brazil," found at Internet address <http://www.ei.enron.com/>, retrieved Oct. 6, 1999.

<sup>27</sup> Leisman and Friedland, "Oil Nations Plan to Meet: Prices Drop," p. A2.

<sup>28</sup> Energy Information Administration, *International Energy Outlook 1999*, Mar. 1999, found at Internet address <http://www.eia.doe.gov/>, retrieved Oct. 7, 1999.

commerce is likely to have the greatest effect in markets where regulatory reform has brought about competition. In these markets, electronic technology can serve as a means of connecting customers with service providers, as a channel for providing services, and even as a virtual trading floor for energy contracts. For example, platforms such as Hewlett-Packard's Vantera enable large corporate consumers to monitor electricity usage across geographically dispersed sites in real time. The system uses the Internet to communicate billing and operational data, thereby enabling more effective monitoring and management of energy costs.<sup>29</sup> In Arizona's newly-deregulated electric power market, individual consumers can register for service, pay bills, and manage their energy use online through Utility.com, an Internet-based energy service provider.<sup>30</sup> Perhaps the most commercially significant application of electronic commerce in the energy sector involves the trading and marketing of energy. The Internet is a medium through which buyers and sellers can interact instantaneously. Services like "Enermetrix.com Exchange" use an Internet-based system to allow energy consumers and suppliers to share information, execute transactions, and generate reports.<sup>31</sup> Such systems may ultimately become the central marketplace for trading electric power and natural gas.

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<sup>29</sup> Business Wire, "HP Vantera Platform Enables Energy Cost Management via the Internet," Jan. 13, 1998, found at Internet address <http://www.newspage.com/>, retrieved Jan. 14, 1998.

<sup>30</sup> Business Wire, "Utility.com Prepares to Launch Online Electricity in Arizona," Oct. 1, 1999, found at Internet address <http://www.energycentral.com/>, retrieved Oct. 4, 1999.

<sup>31</sup> Enermetrix.com, Company Information, found at Internet address <http://www.enermetrix.com/>, retrieved Oct. 6, 1999.

# CHAPTER 12

## ENVIRONMENTAL SERVICES

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### Introduction

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Because of the relatively recent emergence of the environmental services industry, there is no consensus regarding the precise scope of the environmental services sector.<sup>1</sup> For the purposes of this report, environmental services<sup>2</sup> specifically include solid and hazardous waste management, environmental consulting and engineering, remediation,<sup>3</sup> environmental analysis, and wastewater treatment.<sup>4</sup> Architectural, engineering, and consulting firms, construction contractors, laboratories, and specialized waste management firms, along with other professional service providers, supply these services. National governments, local governments, and firms bound by environmental guidelines are the principal consumers of environmental services,<sup>5</sup> with the public sector accounting for the greatest share of environmental services demand in all OECD countries, except the United States and the Netherlands.<sup>6</sup> Environmental goods and services are often provided as part of a single package, in which services frequently play the more important role.<sup>7</sup> 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.

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<sup>1</sup> United Nations Conference on Trade and Development (UNCTAD), “Strengthening Capacities in Developing Countries to Develop their Environmental Services Sector,” May 12, 1998, p. 5.

<sup>2</sup> The scope of the environmental services sector, as discussed herein, is that used by Environmental Business International Inc. (EBI) in the compilation of trade and market data.

<sup>3</sup> 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.

<sup>4</sup> The Bureau of Economic Analysis (BEA) does not classify and report data that reflect cross-border trade in environmental services or transactions by majority-owned affiliates in the environmental services industry. Consequently, this chapter includes data compiled and reported by industry sources, primarily EBI and *Engineering News-Record*, published by the McGraw-Hill Companies.

<sup>5</sup> UNCTAD, “Strengthening Capacities in Developing Countries to Develop Their Environmental Services Sector,” p. 5.

<sup>6</sup> 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.

<sup>7</sup> UNCTAD, “Strengthening Capacities in Developing Countries to Develop their Environmental Services Sector,” p. 11.

## Recent Trends

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U.S. exports of environmental services rose by 1 percent in 1998, from \$3.5 billion in 1997 to approximately \$3.6 billion in 1998 (figure 12-1). This increase was smaller than the 12-percent average annual increase registered during 1994-97. U.S. imports rose by 45 percent to \$2.9 billion in 1998, faster than the average annual increase of 18 percent recorded during 1994-97. The U.S. environmental services trade surplus fell sharply for a second straight year, decreasing by 56 percent to \$700 million in 1998. These changes reflect the continuing consolidation and changing ownership patterns of the U.S. industry, particularly in the solid waste management and wastewater management segments.

U.S. exports of environmental consulting and engineering services rose from \$1.7 billion in 1997 to \$1.8 billion in 1998, accounting for about half of all U.S. environmental service exports (figure 12-2). However, exports of solid waste management services fell for a second consecutive year, dropping from \$1.3 billion in 1997 to \$900 million in 1998. Exports of hazardous waste management services also fell, from \$200 million in 1997 to \$50 million in 1998.

U.S. imports of wastewater treatment services rose from \$1.6 billion in 1997 to \$1.8 billion in 1998, accounting for more than 60 percent of all U.S. environmental service imports. Imports of solid waste management services doubled from \$200 million in 1997 to \$400 million in 1998, and imports of hazardous waste management services increased from virtually nothing in 1997 to \$400 million in 1998.

The United States registered trade surpluses of \$1.5 billion in environmental consulting and engineering services, \$500 million in solid waste management services, and \$400 million in remediation/industrial services in 1998. Wastewater treatment services and hazardous waste management services registered a combined trade deficit of \$1.8 billion in 1998. The most significant shifts occurred in solid waste management services, in which the trade surplus fell by \$600 million from 1997 to 1998, and in hazardous waste management services, which went from a \$200-million surplus in 1997 to a \$300-million deficit in 1998.

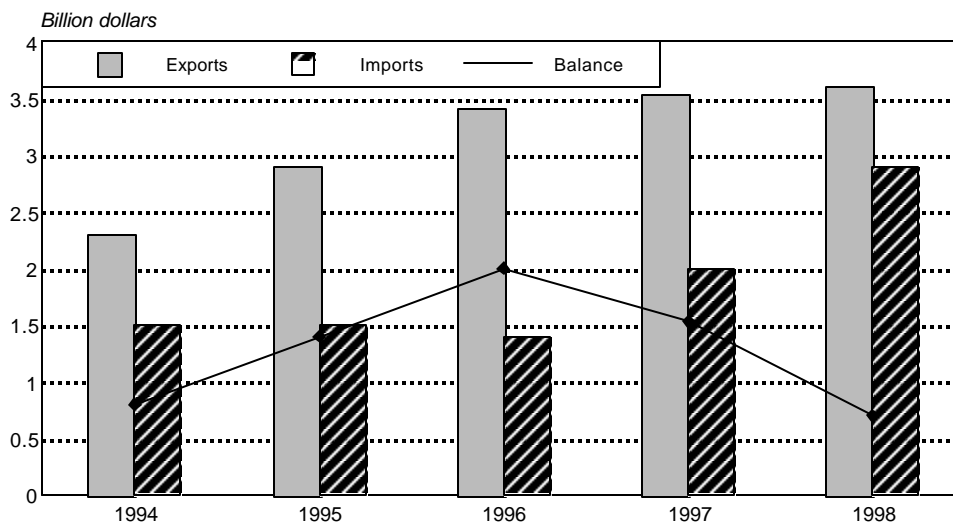
The data used to prepare the discussion above do not provide country-specific detail. However, data based on a different definition of the sector do suggest the relative importance of U.S. trading partners.<sup>8</sup> The largest share of overseas revenue earned by leading U.S.-based environmental firms was reportedly earned in Europe, which accounted for about 50 percent of the total (figure 12-3). Latin America, Asia/Australia, and the Middle East reportedly accounted for 16 percent, 15 percent, and 13 percent of these overseas revenues in 1998, respectively. Canada and Africa accounted for 4 percent and 1 percent of such revenues, respectively.

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<sup>8</sup> The most significant differences in this definition are believed to be the inclusion of revenues from construction services and equipment sales plus the addition of the nuclear waste segment.



**Figure 12-1**  
**Environmental services: U.S. exports, imports, and balance, 1994-98**



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; *EBI Report 1211: Asia Country Briefings*, excerpts presented at Environmental Exports: Outlook 2000, Arlington, VA, Nov. 8-9, 1999.

## Summary and Outlook

During 1998, the U.S. environmental services industry faced another period marked by slow growth, increasing competition, declining profitability, and significant consolidation activity in both domestic and foreign markets. However, figures for the industry as a whole mask significant variation in the diverse segments that make up this industry.

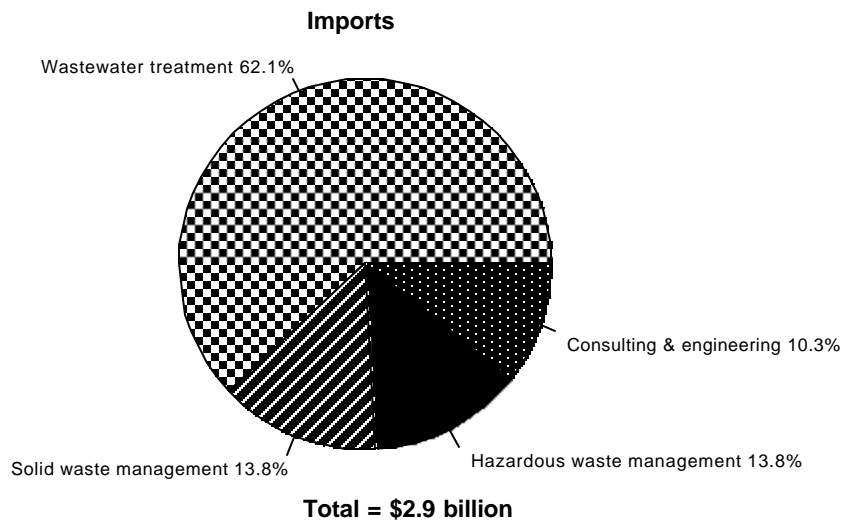
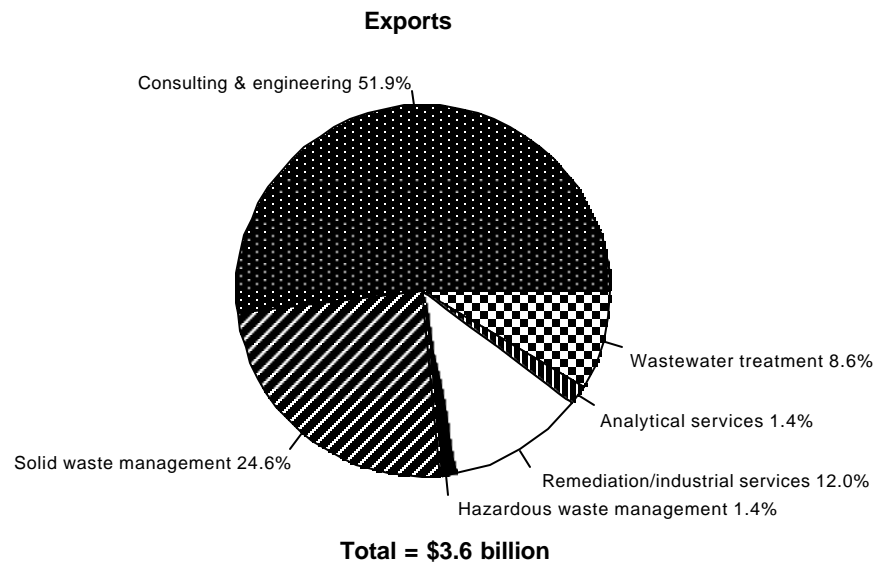
U.S. environmental services firms are competitive in certain segments of the environmental services industry. Many of the segments in which the United States may have an advantage, such as consulting and engineering services, analytical services, hazardous waste management, and remediation are not those in the strongest demand in foreign markets. In the segments with the strongest demand, such as water and wastewater services, the U.S. industry has generally been unable to compete successfully, particularly in foreign markets.<sup>9</sup>

The municipal water and wastewater industry is one of the largest segments of the global environmental services industry and represents a growing market worldwide as governments seek to provide their populations with safe drinking water and sanitary waste disposal.<sup>10</sup> This industry is predominantly publicly-owned, though privatization is increasing, especially in foreign markets. While U.S. consulting and engineering firms have considerable expertise and experience in the design and

<sup>9</sup> U.S. Department of Commerce (USDOC), "Environmental Technologies and Services," *U.S. Industry and Trade Outlook '99*, The McGraw-Hill Companies, 1999, p. 20-3.

<sup>10</sup> The environmental services sector, as defined for this report, does not include municipal and industrial water supply.

**Figure 12-2**  
**Environmental services: U.S. exports and imports, by industry segment, 1998<sup>1</sup>**

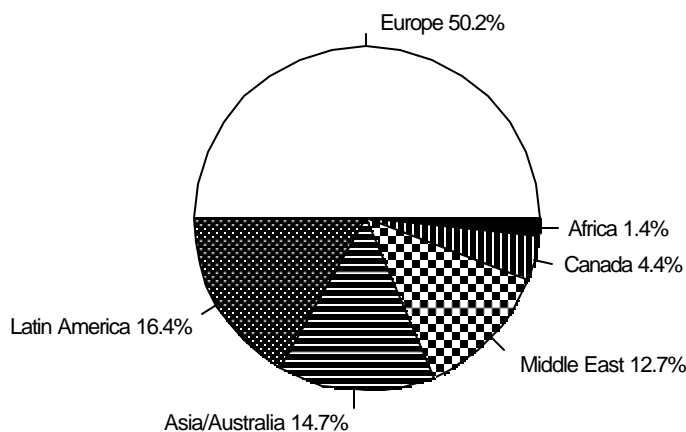


<sup>1</sup> Total may not equal 100 percent due to rounding.

Source: EBI, *EBI Report 1211: Asia Country Briefings*, excerpts presented at Environmental Exports: Outlook 2000, Arlington, VA, Nov. 8-9, 1999.



**Figure 12-3**  
**Environmental industry:<sup>1</sup> Foreign revenue of U.S.-based environmental goods/services firms, by region, 1997<sup>2</sup>**



<sup>1</sup> 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.

<sup>2</sup> Total may not equal 100 percent due to rounding.

Source: Compiled by USITC staff using data reported by "Once Shaky Global Markets Are Looking More Appealing;" *Engineering News-Record*, Wright, Rubin, Powers, Winston, Angelo, Daniels, and Rusta, July 5, 1999, p. 49.

construction of water and wastewater treatment plants, such firms, as well as U.S. water and wastewater service companies, have been unable to compete effectively in the substantial privatizations occurring in the international market as they lack size, customer base, and in many cases, experience specific to the operation of large-scale water and wastewater systems.<sup>11</sup>

The privatized water services segment is dominated by two French transnationals, Vivendi SA, whose water division is General des Eaux, and Suez Lyonnaise des Eaux. These two firms own or control water companies in approximately 120 countries and provide water services to almost 100 million people. The Spanish firm, Aguas de Barcelona, is active in Latin America. British firms Thames Water and Biwater reportedly are acquiring water concessions in Asia and South Africa, and United Utilities has reportedly joined with Bechtel, in North American operations.<sup>12</sup> In March 1999, Vivendi purchased U.S. Filter, making it the largest provider of water services in North America.<sup>13</sup> The foreign acquisitions of U.S. firms, particularly Vivendi's purchase of U.S. Filter, may promote the privatization of the U.S. water and wastewater market.<sup>14</sup>

U.S. competitiveness in the global water and wastewater market may improve through the recent entry of several large pipeline and energy companies, who are in a

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<sup>11</sup> Rebecca Mark, "Enron Raises the Bar in Global Water and Wastewater Markets," *Environmental Business Journal*, Nov./Dec. 1998, vol. 11, No. 11/12, p. 2.

<sup>12</sup> Industry representative, interview by USITC staff, Washington, DC, Aug. 26, 1999.

<sup>13</sup> In part, as a result of this merger, Vivendi's sales of goods and services to the North American market are expected to be \$12 billion in 1999. Gary J. Tulacz, et al., "Good Times Are Shared by All," *Engineering News-Record*, May 31, 1999, p. 9.

<sup>14</sup> Tulacz, et al., "Good Times Are Shared by All," p. 9.

the position to grow by acquiring both newly-privatized and other water service firms. For example, General Electric, together with the World Bank and other investors, reportedly has established a "Global Power Fund" which will be used to assist the privatization of energy and water services around the world.<sup>15</sup> In addition, Enron, a U.S. energy firm, recently established Azurix to develop its water business and acquired Wessex Water PLC of Britain to be part of that operation.<sup>16</sup>

Environmental services providers face many of the same barriers in foreign markets as providers of architectural, engineering, construction, and energy services. Such barriers include weak intellectual property rights protection for project or product designs, discriminatory professional registration and licensing requirements, discriminatory government procurement regulations, and restrictions on investment. Investment barriers may include restrictions on the form of ownership, restrictive concessions for some services, government monopoly provision of some services (i.e., water, wastewater, and solid and hazardous waste treatment and disposal services), and restrictions on the percentage of total assets which can be owned by foreign investors. Government procurement requirements that may act as barriers include the exclusion of foreign service providers from the bidding process, preferences for local contractors, limitations on the scope of services that may be provided by foreign firms, and bonds and deposits that may not be required of local firms.<sup>17</sup>

In addition to providing a new means of advertising a firm's services and qualifications to potential consumers in the U.S. market and abroad, the Internet has added some new capabilities to the tool kits of environmental services firms. For example, the Internet is used for the off-site monitoring of instruments,<sup>18</sup> the operation of computer-controlled equipment at remote locations,<sup>19</sup> and the management of large-scale databases of environmental information and statistics.<sup>20</sup> The Internet also may facilitate the cross-border transfer of environmental services products such as engineering designs and plans, laboratory test results and analyses, environmental training, and computer modeling and analysis.<sup>21</sup>

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<sup>15</sup> Industry representative, interview by USITC staff, Washington, DC, Aug. 26, 1999.

<sup>16</sup> Mark, "Enron Raises the Bar in Global Water and Wastewater Markets," p. 2.

<sup>17</sup> USDOC, Environmental Technologies Trade Advisory Committee (ETTAC), Market Access Subcommittee, *International Market Access Issues Affecting US Environmental Companies: Product Manufacturers and Service Providers*, final draft, May 2000, pp. 19-26.

<sup>18</sup> Industry representative, telephone interview by USITC staff, Sept. 22, 1999.

<sup>19</sup> Examples include the operation of equipment for pump-and-treat plants for site remediation. Andrew Wright, et al., "The 'Other' E-biz Continues to Grow," *Engineering News-Record*, July 5, 1999, p. 9.

<sup>20</sup> Industry representative, telephone interview by USITC staff, Sept. 20, 1999.

<sup>21</sup> USDOC, ETTAC, *International Market Access Issues Affecting US Environmental Companies*, p. 16.

# CHAPTER 13

## HEALTH CARE SERVICES

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### Introduction

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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); medical and dental laboratories; kidney dialysis centers; and specialty outpatient facilities.

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.<sup>1</sup> Affiliate transactions comprise health care services provided to persons in their home countries by foreign-owned affiliates based there. Cross-border transactions account for the greatest proportion of U.S. health care exports,<sup>2</sup> while affiliate transactions account for most U.S. purchases. Cross-border exports 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. residents.

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<sup>1</sup> 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.

<sup>2</sup> Receipts for medical services provided to foreign residents at U.S. hospitals were revised for 1995-98, using an improved methodology and newly available source data. Inpatient estimates were prepared by obtaining information from State regulatory agencies, hospital associations, and hospitals with international medical centers. Outpatient estimates were provided by individual hospitals and are based on approximate data on the number of outpatients, in addition to associated charges per outpatient. Total medical receipts from foreign patients amounted to inpatient charges plus outpatient charges. U.S. Department of Commerce (USDOC), Bureau of Economic Analysis (BEA), *Survey of Current Business*, July 1999, pp. 68-69.

## Recent Trends

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### *Cross-Border Trade, 1993-98*

In 1998, U.S. cross-border exports of health care services totaled \$1.2 billion (figure 13-1). Data on cross-border imports of health care services are not available; such data are not reported by official data collection agencies.<sup>3</sup> U.S. cross-border exports of health care services increased by 8 percent in 1998, slower than the 10-percent average annual growth rate recorded during 1993-97.<sup>4</sup>

Economic conditions and currency values in the home country have an important effect on the ability of foreign patients to travel to the United States for treatment. Economic downturns in Latin American and Asian countries contributed to the decline in the number of foreign patients from these countries seeking medical services in the United States. During the Brazilian currency crisis in early 1998, one Florida-based health care provider reportedly experienced a significant reduction in the number of Brazilian patients treated in its facilities. The same U.S. firm reported that the number of Canadian patients has also recently decreased, likely due to the ongoing depreciation of the Canadian dollar.<sup>5</sup>

### *Affiliate Transactions, 1992-97*

In 1997, sales by foreign-based healthcare affiliates of U.S. firms amounted to \$351 million (figure 13-2). Sales through foreign-based affiliates of U.S. firms decreased by 28 percent in 1997, the second consecutive year of substantial sales declines. This provides a stark contrast to the average annual growth rate of 9 percent recorded during 1992-96. The continued downturn in sales through foreign-based affiliates of U.S. firms may be a reflection of continued retrenchment of U.S. health care firms in the domestic market.<sup>6</sup> European-based affiliates of U.S. firms accounted for sales of \$331 million, or 94 percent of total health care sales, while affiliates based in Latin America accounted for \$20 million, or 6 percent, of total sales (figure 13-3).

Purchases from U.S. affiliates of foreign firms<sup>7</sup> amounted to \$4.7 billion in 1997. U.S.-based affiliates of European firms accounted for \$3.3 billion, or 70 percent, of

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<sup>3</sup> Such data are difficult to capture and presumed to be quite small. BEA representative, telephone interview by USITC staff, Nov. 24, 1998.

<sup>4</sup> USDOC, BEA, *Survey of Current Business*, Oct. 1999, p. 64.

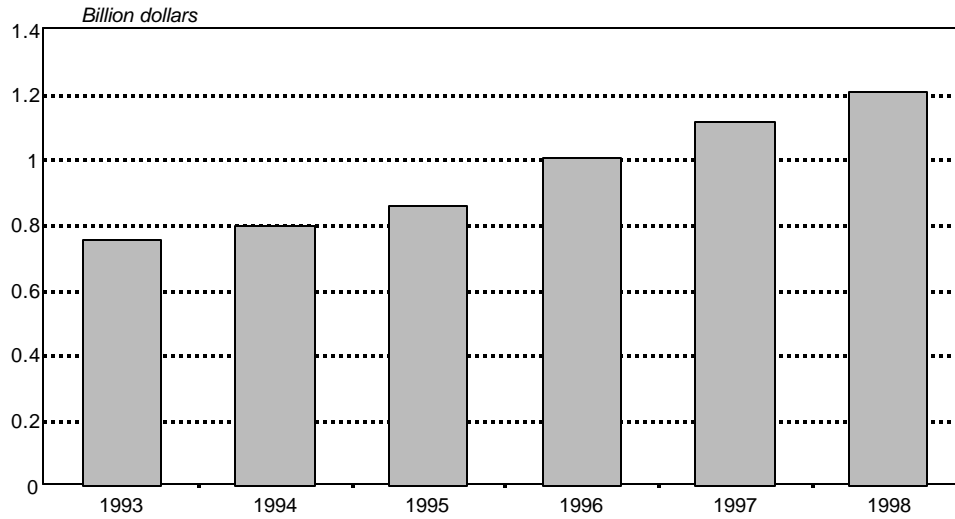
<sup>5</sup> U.S. industry representatives, telephone interviews by USITC staff, Oct. 6, 1999.

<sup>6</sup> U.S. International Trade Commission (USITC), *Recent Trends in U.S. Services Trade: 1999 Annual Report*, May 1999, USITC publication 3198, pp. 12-2 to 12-3.

<sup>7</sup> BEA reported data on 1997 affiliate purchases using the NAICS (North American Industry Classification System), not the SIC (Standard Industrial Classification) system used to report 1997 affiliate sales data and all affiliate transactions data prior to 1997. As a result, it is not feasible to calculate an analytically sound affiliate transactions balance or the growth rate of affiliate purchases in 1997. For more information on the transition from the SIC to the NAICS, see text box 2-1.

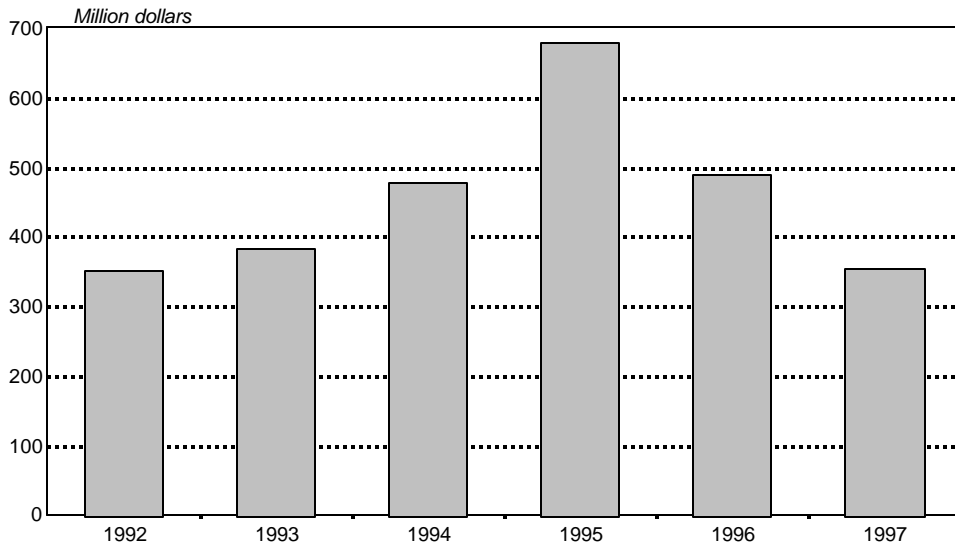
such purchases. One such European firm, German-owned Fresenius AG, expanded

**Figure 13-1**  
**Health care services: U.S. cross-border exports, 1993-98**



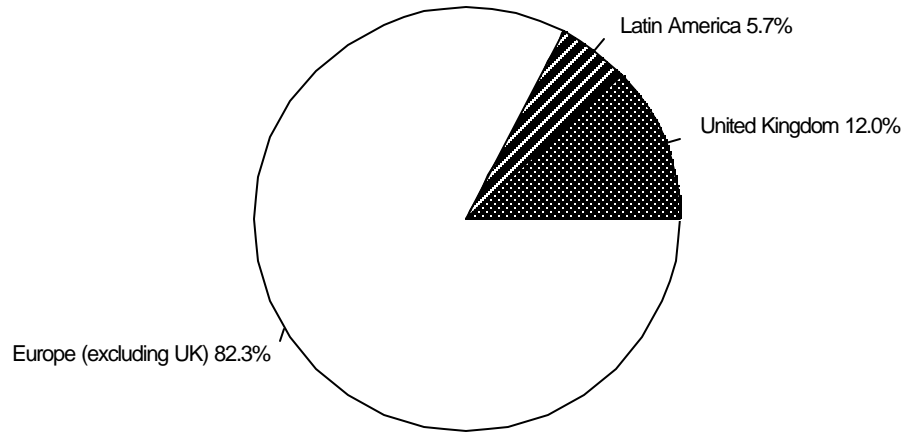
Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, p. 64.

**Figure 13-2**  
**Health care affiliates: Sales of services by majority-owned affiliates of U.S. firms, 1992-97**



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, p. 93; Oct. 1998, p. 115; Oct. 1997, p. 137; Nov. 1996, p. 111; and Sept. 1995, p. 104.

**Figure 13-3**  
**Health care affiliates: Sales by majority-owned affiliates of U.S. firms, by principal markets, 1997**



**Total = \$351 million**

Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, p. 93.

its presence in the U.S. market in 1997 both by acquiring National Medical Care and by forming a partnership with Gull Laboratories, Inc.<sup>8</sup>

## Summary and Outlook

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Despite adverse economic conditions in Latin America and Asia, U.S. cross-border exports in health care services continued to grow in 1998, totaling \$1.2 billion, reflecting an 8-percent increase from 1997. In comparison, sales of health care services by foreign affiliates of U.S. companies decreased by 28 percent, to \$351 million in 1997, whereas purchases from U.S. affiliates of foreign firms totaled \$4.7 billion.

Since 1990, an average of \$1.7 trillion, or 8 percent of the world's annual income, has been spent on health care.<sup>9</sup> In 1997, the United States spent approximately 14 percent of its gross domestic product on health care, followed by Canada, at 10 percent, and Germany, at 9 percent.<sup>10</sup> Although some health care providers have attempted to decrease consumer expenditures by reducing overnight hospital stays

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<sup>8</sup> Fresenius AG, press release, 1997, found at Internet address <http://www.fresenius-ag.com/>, retrieved Nov. 17, 1999.

<sup>9</sup> AT Kearney, "The Driving Force Behind Changes in the Global Healthcare Industry," found at Internet address <http://www.atkearney.com>, retrieved Sept. 17, 1999.

<sup>10</sup> PricewaterhouseCoopers, "Health Care Statistics," found at Internet address <http://www.pwchealth.com/>, retrieved Oct. 5, 1999.

and relying more on outpatient procedures, U.S. health care spending per capita<sup>11</sup> continues to climb, in part, due to increased costs of state-of-the-art health care technologies, facilities, and services.<sup>12</sup> Yet, with respect to trade, it is because of constant advancements in technology and quality of care that U.S. health care providers continue to play a large role in the global health care services market. Opportunities for U.S. companies are growing in overseas markets, as foreign governments seek ways to improve their own health care systems.

During the last ten years, the global health care system has undergone significant changes. Rising costs and overall public dissatisfaction have led countries to reevaluate the state of their health care systems. Countries with public health care systems are beginning to embrace the concept of managed private care as an alternative means of providing citizens with cost-effective, quality health care services. Privatization of public health care systems and health insurance is well underway in Europe, Asia, Latin America, and Africa, creating new opportunities for U.S. health care companies. As a result, an increasing number of U.S. health experts are acting as consultants on the establishment and operation of private health care projects in foreign markets. For example, one program between Centro Internacional de Medicina (CIMA)<sup>13</sup> and Baylor University Medical Center of Dallas, trains CIMA doctors and administrators to focus on the improvement and better organization of health care and administrative practices.<sup>14</sup>

U.S. health care service and insurance providers are continuing to form alliances with foreign providers and health insurance companies to establish or enhance their presence in foreign markets. Alliances with local hospitals, for example, may allow U.S. health services providers to offer U.S. consumers quality health care while traveling abroad. Blue Cross has developed a worldwide network of 130 foreign hospitals, allowing its customers to receive medical services in over 40 countries. Opportunities may also develop for U.S. health insurance firms to provide broader coverage in overseas markets to foreign citizens who have little or no access to international coverage under their domestic public health care systems. In essence, foreign citizens would supplement their existing health insurance by purchasing additional coverage through U.S. health insurance providers. Some U.S. hospitals are also pursuing alliances with foreign health care firms that could increase cross-

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<sup>11</sup> Health care expenditures per capita stood at \$3,925 in 1997, up 46 percent from \$2,690 in 1990. U.S. Department of Health and Human Services, *Health, United States, 1999* (Washington, DC: GPO, 1999), p. 284.

<sup>12</sup> Gerald F. Anderson, "Multinational Comparisons of Health Care," Oct. 1998, found at Internet address <http://www.cmwf.org/>, retrieved Nov. 15, 1999.

<sup>13</sup> International Hospital Corporation (IHC), a Dallas-based company, recently developed CIMA, a private health care system in Latin America, which includes two private hospitals in Hermosillo and Chihuahua, Mexico and construction of others in Puebla, Mexico and San Jose, Costa Rica.

<sup>14</sup> Sally Gelston, "Just What the Doctor Ordered," *IFC Impact*, Spring 1999, vol. 3, No. 2, pp. 9-13.



border trade.<sup>15</sup> For instance, U.S. hospitals may establish agreements with foreign insurers to provide specialized medical services to foreign citizens who are unable to obtain these services in their home country.

U.S. hospitals increasingly provide tailored health care services in order to attract U.S. and foreign patients. Some U.S. hospitals are offering luxury hospital suites that include amenities such as gourmet meals and high-end beauty products.<sup>16</sup> In addition, many U.S. hospitals are catering to foreign patients by providing multilingual staff, arranging hotel accommodations for family members, furnishing transportation to and from airports, and accommodating cultural, religious, and dietary needs.<sup>17</sup>

The use of information technology will likely benefit the U.S. health care industry by reducing costs, errors, and fraud. Electronic processing and storing of pertinent information such as patients' records, physicians' notes, insurance records, and test results will significantly reduce time and costs associated with record-keeping. By maintaining an electronic system, all information will be readily accessible to health care providers, providing a system of checks and balances that may reduce errors, such as incorrectly prescribed medicines, and help avert insurance fraud. Currently, the industry spends 2 percent of its revenue on information technology (IT), and it is estimated that the IT budgets of U.S. health care providers will command between 6 and 7 percent of annual revenues within five years.<sup>18</sup>

Consumers use the Internet as a source of information on physicians, treatments, new technology, health insurance, care facilities, and other topics related to health care.<sup>19</sup> In turn, the health care industry uses the Internet to increase sales, attract new customers, build name recognition, reach new markets that cross geographic borders, and provide quick, efficient service to its customers.<sup>20</sup> The Internet will also shorten the time needed to make a diagnosis, as physicians are able to offer and receive second opinions by scanning and transmitting patient information via email.<sup>21</sup> The

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<sup>15</sup> U.S. industry representatives, telephone interviews by USITC staff, Oct. 6-7, 1999; and "Providing Local Care on an International Scale," *Managed Healthcare*, June 1999, found at Internet address <http://www.proquest.umi.com/>, retrieved Nov. 8, 1999.

<sup>16</sup> "America's Most Luxurious Hospitals," *The Wall Street Journal*, Aug. 27, 1999.

<sup>17</sup> Orlando Regional Healthcare System, "International Services," found at Internet address <http://www.orhs.org/>, retrieved Oct. 6, 1999; and U.S. industry representatives, telephone interviews by USITC staff, Oct. 6-7, 1999.

<sup>18</sup> PricewaterhouseCoopers, "Health Care Statistics."

<sup>19</sup> The baby boomer generation (35-54) are the most likely to engage in online searches for health information at 41 percent, followed by those aged 55 and older and 18-34 year olds at 30 percent and 29 percent, respectively. J.D. Power and Associates, "Internet Health Initiative," found at Internet address <http://www.intel.com/>, retrieved Oct. 4, 1999.

<sup>20</sup> Madeleine Bickert, "1999: The Impact of Ecommerce on Legacy Health-Care Companies," *Cyber Dialogue*, found at Internet address <http://www.cyberdialogue.com/>, retrieved Oct. 6, 1999.

<sup>21</sup> U.S. industry representatives, telephone interviews by USITC staff, Oct. 6, 1999.

use of telemedicine is increasing in the United States and globally.<sup>22</sup> Commonly used telemedicine services include teleradiology and telepathology, both of which use electronic transmissions to enable radiologists, pathologists, and other physicians to view images simultaneously for the purposes of interpretation and consultation.<sup>23</sup>

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<sup>22</sup> Telemedicine is defined as the transfer of medical information from one site to another via electronic communications for the purpose of improving patient care. American Telemedicine Association, found at Internet address <http://www.atmeda.org/>, retrieved Oct. 7, 1999.

<sup>23</sup> Definitions found at Internet addresses <http://www.imagesoncall.com/> and <http://www.telepathology.com/>, retrieved Oct. 22, 1999.

# CHAPTER 14

## INSURANCE SERVICES

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### Introduction

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The insurance industry underwrites financial risk for life and non-life (property/casualty) products, and provides many specialty items. The latter include reinsurance (further transferring of risk between insurance companies), marine and transportation insurance (for hulls, cargoes, off-shore oil rigs), and brokerage services (specialists who package policies from several insurance underwriters to cover a given risk). In addition to risk transfer, insurance is also an important individual savings device in most countries.<sup>1</sup> 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, affiliate transactions are considerably larger than cross-border trade.

### Recent Trends

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#### *Cross-Border Trade, 1993-98*

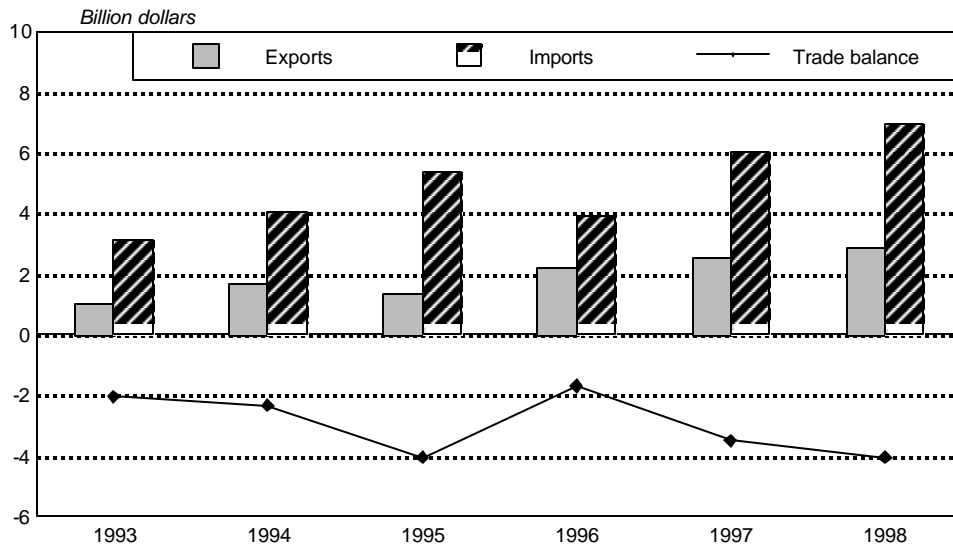
In 1998, U.S. cross-border exports of insurance services<sup>2</sup> totaled \$2.8 billion, and imports totaled \$6.9 billion, yielding a trade deficit of \$4.1 billion (figure 14-1). U.S. exports increased by 14 percent in 1998, slower than the average annual rate of 25 percent registered during 1993-97. This was a consequence of higher than average claims payments, which resulted from a string of natural disasters including Hurricanes Georges and Mitch, and ice storms in Canada responsible for at least \$1.4 billion in damage. Imports grew by 15 percent in 1998, slightly slower than the 1993-97 average annual growth rate of 18 percent, although this average obscures a

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<sup>1</sup> 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 Swiss Reinsurance Company (Swiss Re), *Sigma*, No. 4, 1997, table I, p. 19.

<sup>2</sup> 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.

**Figure 14-1**  
**Insurance services: U.S. cross-border exports, imports, and trade balance, 1993-98**



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, pp. 64-65.

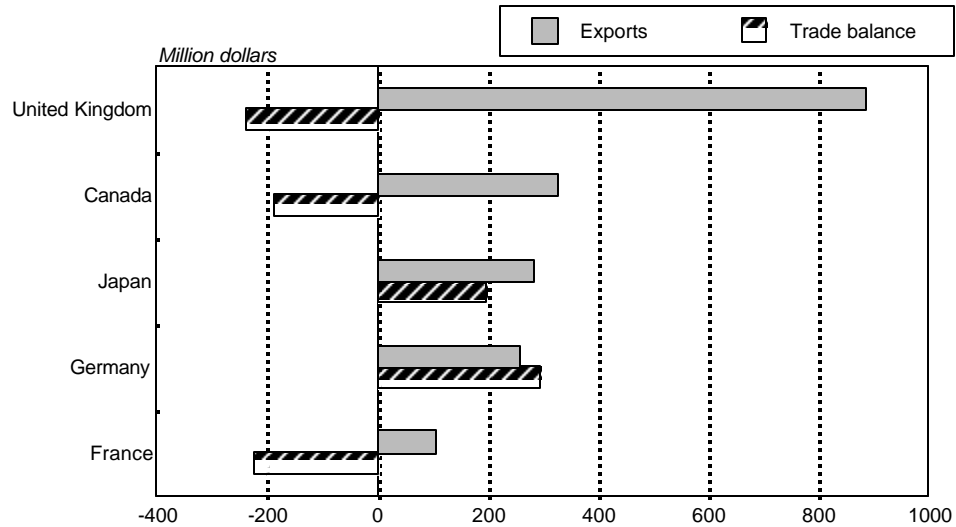
28 percent drop in imports in 1996. Sluggish import growth resulted from an increase in U.S. residents' claims in the wake of an uncommon string of hurricanes, tornadoes, and violent storms. The trade deficit in insurance services has persisted throughout 1993-98. This deficit increased by 16 percent in 1998, slightly faster than the average annual growth rate of 14 percent registered during 1993-97. The fluctuation in the trade deficit mirrors the trend in imports, with both decreasing in 1996 before rising again in 1997 and 1998.

Measured in terms of net receipts, the largest export markets for U.S. insurance firms in 1998 were the United Kingdom (31 percent), Canada (11 percent), Japan (10 percent), Germany (9 percent), and France (4 percent) (figure 14-2). Market shares shift somewhat when viewed solely in terms of premiums paid.<sup>3</sup> The British and Japanese shares of U.S. receipts drop to 21 percent and 7 percent, respectively, while the Canadian share rises to 15 percent. Bermuda accounted for 6 percent of U.S. insurance premium receipts, which ranks it fourth, ahead of France, in these terms.

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<sup>3</sup> 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.

**Figure 14-2**  
**Insurance services: U.S. cross-border exports and trade balance, by major trading partners, 1998**



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, p. 91.

With respect to net imports, the largest U.S. trading partner by far is Bermuda, with 44 percent of net U.S. insurance payments in 1998.<sup>4</sup> Other significant recipients of net U.S. insurance payments include the United Kingdom (16 percent), followed by Canada (7 percent), France (5 percent), and Switzerland (4 percent). Net insurance payments to Switzerland totaled \$289 million, the first year since 1992 that premiums paid to Swiss insurers exceeded claims received. The net payment by U.S. residents to German insurers in 1998 was negative \$40 million,<sup>5</sup> meaning claims received by U.S. residents exceeded premiums paid by this account. In terms of premiums paid, Bermuda remains the largest U.S. trading partner, with 31 percent of net payments. Germany ranks ahead of both Switzerland and France in terms of total premiums paid by U.S. residents, accounting for 8 percent of such premiums.

## *Affiliate Transactions, 1992-97*

As noted previously, the vast majority of insurance trade takes place through affiliates operating in foreign markets. In 1997, U.S.-owned affiliates' sales in

<sup>4</sup> Beginning in the 1970's, reinsurance companies began locating captive insurance companies in Bermuda to take advantage of favorable tax treatment in that country. Since that time, Bermuda has become a major insurance center, due to both the favorable tax climate and the presence of a large number of firms providing services to the insurance industry.

<sup>5</sup> Negative net imports occur when claims paid to U.S. policyholders exceed premiums collected from these persons for a given year.

foreign markets reached \$47.2 billion, up 15 percent from 1996 (figure 14-3).<sup>6</sup> The 1997 increase in sales was slightly faster than the average annual growth rate of 13 percent recorded during 1992-96, continuing the steady upward trend observed during the period. The major markets for insurance sales by U.S.-owned affiliates are Japan and the United Kingdom, with 19 percent and 18 percent, respectively, of such sales (figure 14-4). Other important markets are Germany, with 11 percent of U.S. affiliate sales, and Canada, which accounts for 9 percent. Meanwhile, U.S.-based affiliates of foreign insurance firms generated almost \$59 billion in sales in the United States during 1997.<sup>7</sup> Of this total, 51 percent was accounted for by property/casualty insurance, and 44 percent by life insurance. The remainder, 5 percent, consisted of fees paid to insurance agents and brokerage firms. Insurance sales by U.S. affiliates of foreign companies are highly concentrated, with firms from six foreign countries responsible for 96 percent of insurance sales by foreigners in the United States (figure 14-5). These countries are the United Kingdom, with 26 percent; Canada and Switzerland, both with 17 percent; Germany and the Netherlands, both with 13 percent; and France, with 11 percent of sales by U.S. affiliates of foreign firms.

## Summary and Outlook

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In 1998, cross-border exports increased by 14 percent over 1997, while imports increased by 15 percent, resulting in a total cross-border trade deficit of \$4.1 billion. Sales of insurance services by foreign affiliates of U.S. parent companies also increased by 15 percent in 1997, to \$47.2 billion, while purchases of insurance from U.S. affiliates of foreign companies totaled \$59.0 billion.

In 1997, global insurance premiums totaled \$2.1 trillion, 58 percent of which were accounted for by life insurance premiums. Global life insurance premiums increased by 8 percent over the 1996 level, reflecting the increased use of life insurance as a savings vehicle in many countries.<sup>8</sup> By contrast, total premiums for property/casualty insurance increased by only 0.2 percent. Although developed countries continue to account for almost three-fourths of global insurance premiums, both the life and non-life sectors grew rapidly in emerging markets, particularly Brazil, Argentina, Mexico, Korea, Taiwan, and China.<sup>9</sup>

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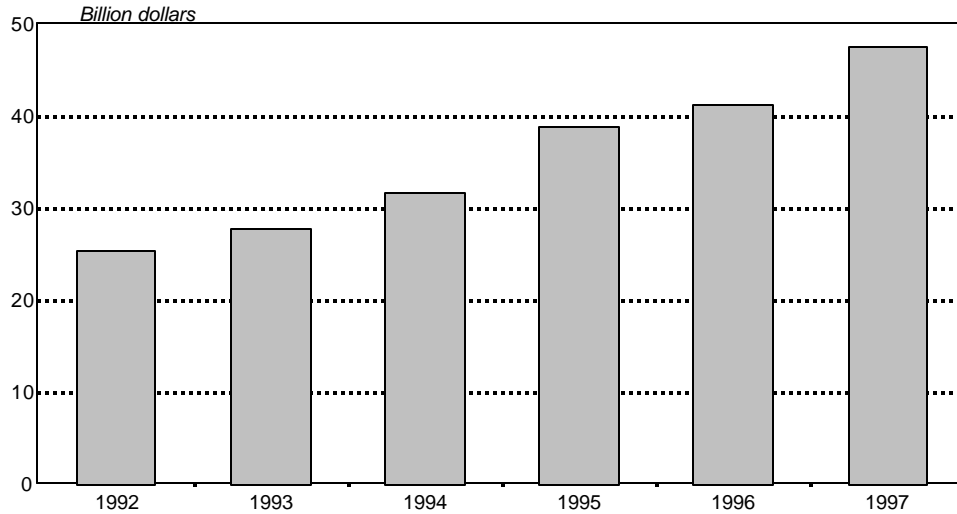
<sup>6</sup> Affiliate data reflect premiums paid only. Affiliate trade data are not comparable with cross-border insurance trade data because the latter are net of claims paid.

<sup>7</sup> Bureau of Economic Analysis (BEA) reported data on 1997 affiliate purchases using the NAICS (North American Industry Classification System), not the SIC (Standard Industrial Classification) system used to report 1997 affiliate sales data and all affiliate transactions data prior to 1997. As a result, it is not feasible to calculate an analytically sound affiliate transactions balance or the growth rate of affiliate purchases in 1997. For more information on the transition from the SIC to the NAICS, see text box 2-1.

<sup>8</sup> Swiss Re, "Global Insurance Markets in 1997: Growth in the Life Business at a Nine-Year High, While Non-Life Hits a Ten-Year Low," *Sigma*, No. 3, 1999, p. 6.

<sup>9</sup> *Ibid.*, pp. 6-7.

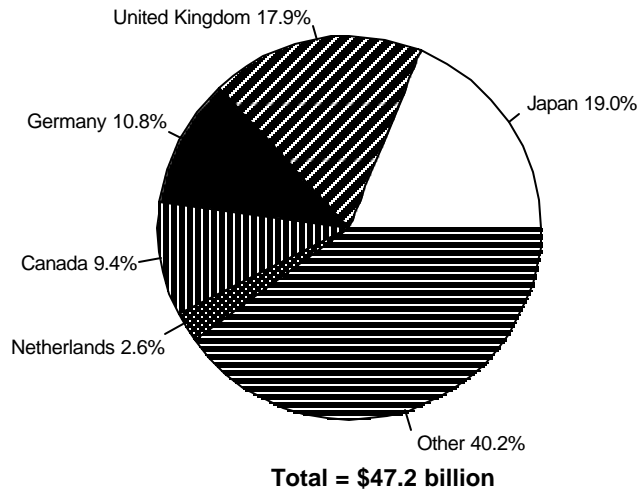
**Figure 14-3**  
**Insurance affiliates: Sales of services by majority-owned affiliates<sup>1</sup> of U.S. firms, 1992-97**



<sup>1</sup> Data reflect premiums only for primary insurance and reinsurance. Affiliate trade data are not comparable with cross-border insurance trade data because cross-border data are net of claims paid.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, p. 93.

**Figure 14-4**  
**Insurance affiliates: Sales by majority-owned affiliates<sup>1</sup> of U.S. firms, by principal markets, 1997<sup>2</sup>**

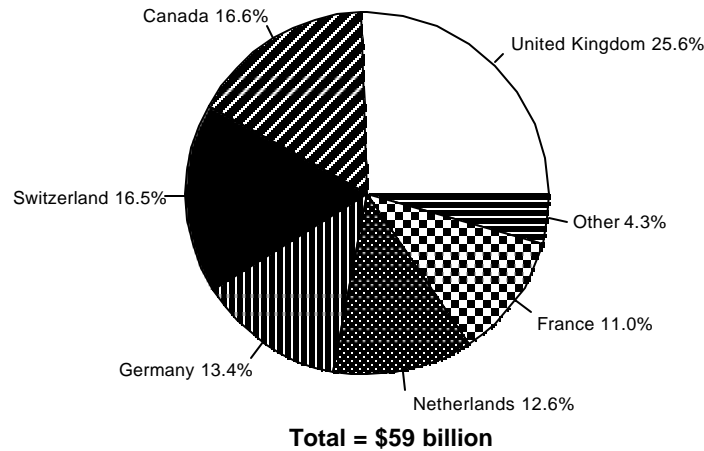


<sup>1</sup> Data reflect premiums only for primary insurance and reinsurance. Affiliate trade data are not comparable with cross-border insurance trade because cross-border data are net of claims paid.

<sup>2</sup> Total may not equal 100 percent due to rounding.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, p. 93.

**Figure 14-5**  
**Insurance affiliates: Purchases from majority-owned affiliates<sup>1</sup> of foreign firms,**  
**by country of ultimate beneficial owner,<sup>2</sup> 1997**



<sup>1</sup> Data reflect premiums only for primary insurance and reinsurance. Affiliate trade data are not comparable with cross-border insurance trade because cross-border data are net of claims paid.

<sup>2</sup> 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.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, p. 95.

Consolidation is continuing in the insurance, banking, and securities industries. Increasingly, both in the United States and globally, banks are selling insurance products, and both banks and insurance companies are selling mutual funds.<sup>10</sup> Sales of insurance products by U.S. banks reached \$8.6 billion in 1998, a 35-percent increase over 1997.<sup>11</sup> Bankers and insurers are also forming business alliances, in which banks sell annuities and other insurance products through their branches, and insurance companies underwrite these policies.<sup>12</sup> Insurance companies had filed a total of 36 applications for thrift charters<sup>13</sup> as of July 1999, in an effort to enter the banking business.<sup>14</sup> The Financial Services Modernization Act of 1999,<sup>15</sup> signed into law on November 12, 1999, removed most of the barriers to consolidation in

<sup>10</sup> See, for example, "Banks Expand Array of Products, Assn. Finds," *National Underwriter*, July 19, 1999, p. 15; "Mellon Enters Term Life Sales With Product from Jackson," *American Banker*, Aug. 17, 1999, found at Internet address <http://www.americanbanker.com/>, retrieved Oct. 4, 1999; and "Insurers Can Penetrate Retail Mutual Fund Market," *National Underwriter*, Aug. 9, 1999, p. 7.

<sup>11</sup> "U.S. Banks Increase Insurance Sales," *World Insurance Report*, Oct. 15, 1999, p. 6.

<sup>12</sup> See "Bank Insurance Market Competition Grows," *National Underwriter*, July 19, 1999.

<sup>13</sup> Thrift institutions are depository financial institutions which were originally set up to promote personal savings and home ownership. Today they offer many of the services offered by commercial banks, but are regulated separately. Savings and loan associations and credit unions are considered thrift institutions.

<sup>14</sup> "Regulation of Financial Services Debated," *National Underwriter*, July 19, 1999, p. 20.

<sup>15</sup> Financial Services Modernization Act of 1999, P.L. 106-102, 113 stat. 1338, passed Nov. 12, 1999.



financial services, and is expected to reshape the U.S. financial sector through a wave of mergers and acquisitions.

In August 1999, the International Commission working to resolve Holocaust-era insurance claims announced an agreement with five of Europe's largest insurance companies.<sup>16</sup> The companies agreed to pay about 10 times the face value of the policies, and to sponsor a media campaign designed to notify the heirs of Holocaust victims covered by these policies.<sup>17</sup> In June 1999, the California Insurance Commissioner scheduled administrative hearings to investigate the U.S. affiliates of four European insurers which declined to participate in the Commission's negotiations. If the hearings find that the parent companies are liable for refusing to pay claims resulting from Holocaust-era policies, the affiliates could lose their California operating licenses.<sup>18</sup>

U.S. insurers continue to expand their presence in Asian markets. In December 1999, the Indian Parliament passed a long-awaited bill liberalizing its insurance market, which allows foreign investors to own a 26-percent equity stake in joint venture insurance companies, and establishes an insurance regulatory agency.<sup>19</sup> Thirty-five non-Indian companies, including 12 U.S. companies, have already established plans for joint ventures with Indian firms in anticipation of market liberalization,<sup>20</sup> although the bill was passed with restrictions that may dissuade some of them from seeking licenses.<sup>21</sup> The Government has no plans to sell shares in the two state-owned companies that currently hold monopoly positions in the Indian insurance market.<sup>22</sup> The first licenses are expected to be awarded by the end of 2000.

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<sup>16</sup> The companies involved in the agreement with the International Commission are Winterthur Swiss Insurance Company (Switzerland), Zurich Financial Services Group (Switzerland), Assicurazioni Generali (Italy), Axa (France), and Allianz (Germany).

<sup>17</sup> See "Holocaust Insurance Issue Settled," *The Washington Post*, Aug. 9, 1999, found at Internet address <http://www.washingtonpost.com/>, retrieved Aug. 9, 1999; and "Holocaust Panel Head Ends Negotiations," *National Underwriter*, Aug. 9, 1999, p. 29.

<sup>18</sup> "Calif. Acts Against Four Firms Over Holocaust Claims," *National Underwriter*, June 28, 1999, p. 1. The four firms are Gerling Konzern (Germany), Basler Lebens-Versicherungs-Gesellschaft (Switzerland), Swiss Reinsurance (Switzerland), and Munchener Ruckversicherungs-Gesellschaft (Germany).

<sup>19</sup> "India: Insurance Liberalisation Bill Finally Passed," *World Insurance Report*, No. 627, Dec. 10, 1999, p. 6.

<sup>20</sup> Industry representative, telephone interview by USITC staff, Jan. 3, 2000.

<sup>21</sup> U.S. Dept. of State telegram, "The Insurance Law: A Modest Step Forward," message reference No. 009082, prepared by U.S. Embassy, New Delhi, Dec. 7, 1999.

<sup>22</sup> "India: Insurance Liberalisation Bill Finally Passed," p. 6.

China has also been gradually opening its insurance industry to foreign companies. Five new licenses have been granted to non-Chinese insurers since April 1999,<sup>23</sup> and the Chinese Government has announced that four more cities, in addition to Shanghai and Guangzhou, will soon be opened to such insurance operations.<sup>24</sup> China and the United States concluded a trade agreement in November 1999, regarding Chinese entry into the World Trade Organization.<sup>25</sup> If this agreement goes into effect, U.S. insurance companies will have greatly expanded access to the Chinese market. In May 1999, the Chinese Government offered its first insurance brokers exam, in an effort to develop a cadre of experienced Chinese brokers before the sector is opened to foreign competition, which is expected to occur during 2000.<sup>26</sup> As of July 1999, foreign companies in Vietnam were permitted to market and sell insurance products directly to the public. There are currently eight non-Vietnamese insurers operating in the country, six through joint ventures. No U.S. insurance companies are currently operating in Vietnam, but one or more U.S. insurers are expected to receive operating licenses soon. Approximately 40 foreign insurers and brokers have applied for Vietnamese insurance licenses and are awaiting approval.<sup>27</sup> In August 1999, Singapore's Deputy Prime Minister Lee Hsien Loong announced that, for the first time in 10 years, the country would allow additional foreign insurers to establish a presence in the country, as part of Singapore's effort to become a world class financial center. At the end of 1998, the 107 direct insurers then operating in Singapore registered total assets of approximately \$17 billion.<sup>28</sup>

In Brazil, the privatization of the government-owned monopoly reinsurance company, previously planned for October 1999, is now scheduled to take place during the first half of 2000.<sup>29</sup> The company is expected to be sold to a non-

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<sup>23</sup> The Chubb Group of Insurance Companies (US) will open a wholly-owned branch to underwrite property/casualty insurance. Four companies will open joint ventures to write life insurance: John Hancock Mutual Life Insurance Co. (US), Prudential Assurance Company Ltd. (UK), Sun Life Assurance Co. (Canada), and Axa (France). See "Foreign Insurance Firms Get Green Light," *China Daily*, Apr. 6, 1999, found at Internet address <http://today.newscast.com/>, retrieved Apr. 7, 1999; and "China OKs AXA's Bid for New Life Insurer," *National Underwriter*, June 7, 1999, p. 28.

<sup>24</sup> The cities are Shenzhen, Chongqing, Dalian, and Tianjin. As of September 1999, no further details regarding the opening were available. "China Opens Further to Foreigners," *Reactions*, Aug. 1999, p. 8.

<sup>25</sup> U.S. Trade Representative, "U.S., China Sign Historic Trade Agreement," press release No. 99-95, found at Internet address <http://www.ustr.gov/>, retrieved Dec. 8, 1999.

<sup>26</sup> U.S. Dept. of State telegram, "Shanghai's Licensed Foreign Insurers on the CIRC," message reference No. 01644, prepared by U.S. Consulate, Shanghai, June 10, 1999.

<sup>27</sup> U.S. Department of Commerce (USDOC), International Trade Administration (ITA), "Vietnam: Insurance Services," Industry Sector Analysis, Aug. 1, 1999, found at Internet address <http://www.stat-usa.gov/>, retrieved Sept. 15, 1999.

<sup>28</sup> U.S. Dept. of State telegram, "Singapore Economic/Financial News: August 14-20," message reference No. 002562, prepared by U.S. Embassy, Singapore, Aug. 23, 1999; and "Singapore Pledges to Remove Insurance Entry Barriers," *Journal of Commerce*, Aug. 19, 1999, found at Internet address <http://www.joc.com/>, retrieved Sept. 17, 1999.

<sup>29</sup> USDOC, ITA, "Brazil: Economic and Financial Update," International Marketing Insight, Sept. 13, 1999, found at Internet address <http://www.stat-usa.gov/imi.nsf/>, retrieved Sept. 15,

(continued...)

Brazilian buyer.<sup>30</sup> Saudi Arabia approved a new rule in August 1999, mandating that private-sector firms provide health insurance for their expatriate employees. The rule is expected to increase the value of the expatriate health insurance market in Saudi Arabia from \$186.7 million in 1999 to \$1.6 billion, an increase that will primarily benefit the 80 non-Saudi insurance companies operating in the country.<sup>31</sup>

In Russia, former President Yeltsin vetoed a bill in July 1999 that would have severely restricted foreign investment in the Russian insurance industry.<sup>32</sup> A similar bill was passed by the Duma in November 1999, but this one is expected to receive the President's signature. Russia and the European Union (EU) have signed a separate agreement which permits EU insurance companies to establish 100-percent foreign-owned affiliates in Russia.<sup>33</sup> It is currently unclear whether a most-favored-nation agreement with Russia will entitle U.S. insurance companies to benefit from the market access concessions contained in the E.U.-Russia insurance agreement. As of January 1999, 62 foreign insurance companies were collecting approximately 2 percent of total Russian insurance premiums.<sup>34</sup>

The U.S. insurance industry is making extensive use of the Internet. Most insurance companies offer information, distribute policy applications and quotes, provide customer service, and offer assistance with claims on the Internet.<sup>35</sup> "Insurance malls," Internet marketing sites that offer information and provide policy quotes from more than one insurer, are also becoming popular. The malls match customer needs to available insurance policy options, and return a list of companies offering the desired insurance.<sup>36</sup> Customers are then able to compare policy conditions, coverage, and prices before purchasing a policy.<sup>37</sup> One new Internet insurance portal permits consumers to specify the type of insurance they need and the price they are willing to pay; transmits customer data from motor vehicle departments, rating agencies, and other sources to the site for use by insurance agents; and allows agents to respond with competitive offers to match the desired insurance coverage. By December 1999, the site was expected to offer all forms of insurance, including commercial

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<sup>29</sup> (...continued)

1999.

<sup>30</sup> "The Sleeping Giant Awakes," *Latin Insurance*, supplement to *Reactions*, vol. 2, No. 3 (Autumn 1999), pp. 13-14.

<sup>31</sup> USDOC, ITA, "Saudi Arabia: Health Insurance Firms," *International Marketing Insight*, Aug. 16, 1999, found at Internet address <http://www.stat-usa.gov/imi.nsf/>, retrieved Sept. 15, 1999.

<sup>32</sup> The bill would have restricted foreign capital to 49 percent of the total statutory capital of any Russian insurance company, or 15 percent of the total capital of the Russian insurance industry as a whole.

<sup>33</sup> USDOC, ITA, "Russia: Seminar on Insurance Industry," *International Marketing Insight*, Aug. 10, 1999, found at Internet address <http://www.stat-usa.gov/imi.nsf/>, retrieved Sept. 15, 1999.

<sup>34</sup> USDOC, ITA, "Russia: Insurance," *Industry Sector Analysis*, Aug. 1, 1999, found at Internet address <http://www.stat-usa.gov/isa.nsf/>, retrieved Sept. 15, 1999.

<sup>35</sup> National Association of Insurance Commissioners (NAIC), *The Marketing of Insurance Over the Internet*, (Kansas City, MO: NAIC, 1998) pp. 7-8.

<sup>36</sup> These insurance malls currently offer retail insurance, but not commercial insurance.

<sup>37</sup> NAIC, *The Marketing of Insurance Over the Internet*, pp. 8-9.

insurance.<sup>38</sup> In the reinsurance sector, Swiss Re has developed an Internet-based system that streamlines the process of submitting, pricing, and managing cession statements<sup>39</sup> for certain types of reinsurance contracts.<sup>40</sup> Several other large reinsurance companies have also developed Internet-based applications that permit primary insurers to place bids for reinsurance over the Internet.<sup>41</sup>

The validity of electronic signatures is one of the chief issues facing insurers and regulators. Because insurance policies are legal contracts that require signatures, the widespread sale of insurance policies on the Internet depends on the development of legally binding electronic signatures. The ease of altering electronic documents, particularly the text of insurance policies, also concerns insurers. In response, electronic signature software is being developed that would “lock” the text of an insurance policy once the document is signed. As of 1998, at least 18 states had laws in effect that authorize or regulate the use of electronic signatures,<sup>42</sup> and a bill to regulate such signatures is currently under consideration in Congress. Another important concern of insurance regulators is the potential for Internet fraud. For example, it would be possible for a person to set up an Internet site claiming to be a licensed insurance company, collect a number of premium payments, then close down the site and disappear. Reportedly, this type of activity would be very difficult to track and prosecute.<sup>43</sup> Regulators are also using the Internet to distribute information to consumers and to search for illegal marketing practices on-line.

Retail insurers have embraced electronic commerce to a greater extent than the large, commercial insurers which typically work through brokers. This is due to the complexity of large deals, which must be tailored to individual company needs.<sup>44</sup> The impact of electronic commerce on the insurance business will likely be profound, once the use of electronic signatures becomes widespread, making it feasible to sell large numbers of insurance policies on-line. Currently, however, the impact of the Internet on trade in insurance services remains uncertain.

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<sup>38</sup> “First Policy-Buying Internet Portal Launched,” *Insurance Accounting*, Sept. 13, 1999, p. 1.

<sup>39</sup> A cession statement defines the amount of risk that a primary insurance company has transferred to a reinsurance company.

<sup>40</sup> “Swiss Re Nabs Sun’s Java Cup at IASA Show,” *Insurance & Technology*, July 1999, p. 14, found at Internet address <http://proquest.umi.com/>, retrieved Sept. 16, 1999.

<sup>41</sup> Industry representative, telephone interview by USITC staff, Sept. 21, 1999.

<sup>42</sup> NAIC, *The Marketing of Insurance Over the Internet*, Appendix D.

<sup>43</sup> NAIC, *The Marketing of Insurance Over the Internet*, pp. 16-17.

<sup>44</sup> Industry representatives, telephone interviews by USITC staff, Sept. 16 and Sept. 24, 1999.

# CHAPTER 15

## INTANGIBLE INTELLECTUAL PROPERTY RIGHTS

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### Introduction

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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 intellectual 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.<sup>1</sup> Additionally, royalties and license fees are collected for the rights to distribute, use, and reproduce computer software,<sup>2</sup> to sell products under a particular brand name or signature, and for management services.<sup>3</sup>

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 intracorporate

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<sup>1</sup> 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.

<sup>2</sup> In the 1998 *Survey of Current Business*, the USDOC, BEA modified its methodology to include computer software royalties and license fees among other royalties and license fees. Intellectual property trade in computer software comprises transactions that confer (1) rights to distribute software and (2) rights to use or reproduce computer software that has been electronically transmitted or made from a master copy. Intellectual property trade in computer software does not include fees for custom software and programming services. 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.

<sup>3</sup> Management services essentially include administrative, professional, and managerial 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.

transactions between parent companies in one country and their affiliates<sup>4</sup> in another. In 1998, intracorporate trade accounted for approximately 73 percent of cross-border trade in intangible intellectual property rights. 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, 1993-98**

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In 1998, the United States exported intangible intellectual property valued at \$36.8 billion and imported intellectual property valued at \$11.3 billion, resulting in a \$25.5 billion surplus (figure 15-1). This surplus, which represented a 5-percent increase over the previous year, is slightly less than a third of the total services surplus. Intangible intellectual property rights respectively accounted for 15 percent and 7 percent of U.S. exports and imports of all services. Exports increased by 9 percent in 1998, slower than the 12-percent average annual growth rate registered during 1993-97. In contrast, U.S. imports increased by 20 percent in 1998, faster than the 17-percent average annual growth rate recorded during 1993-97.

In 1998, U.S. exports of intangible intellectual property consisted of U.S. parents' receipts from their foreign-based affiliates (\$24.7 billion), U.S.-based firms' receipts from unaffiliated firms (\$10 billion), and U.S.-based affiliates' receipts from their foreign parents (\$2 billion) (figure 15-2).<sup>5</sup> In 1998, receipts from affiliated and unaffiliated firms increased by 7 percent and 15 percent, respectively. The overall increase in receipts from affiliated firms was attributable to a 6.9-percent increase in receipts of U.S. parent companies from their foreign affiliates, and a 13.6-percent increase in receipts of U.S.-based affiliates from their foreign parents. The increase in receipts from unaffiliated firms was largely a result of increased exports of industrial processes and software licenses, the latter of which is one of the fastest growing segments of trade in intangible intellectual property.<sup>6</sup>

U.S. imports of intangible intellectual property rights in 1998 consisted of U.S. affiliates' payments to their foreign parents (\$7.2 billion), U.S.-based firms' payments to unaffiliated firms (\$2.9 billion), and U.S. parents' payments to their foreign affiliates (\$1.2 billion). During the year, U.S. imports from both affiliated and unaffiliated firms increased by 20 percent.

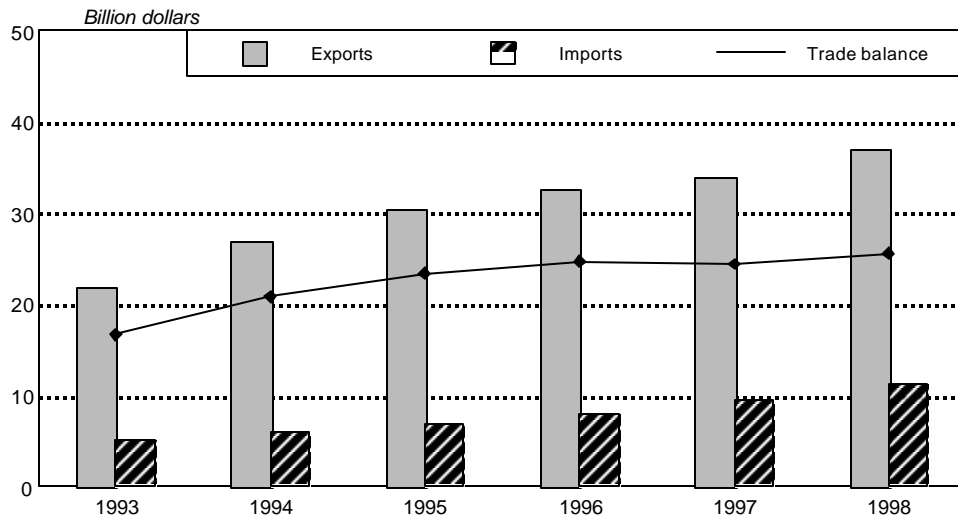
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<sup>4</sup> Herein, foreign-based affiliates of U.S. firms are defined as those at least 10 percent owned directly or indirectly by U.S. parent firms. Similarly, U.S.-based affiliates of foreign-owned firms are defined as those at least 10 percent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

<sup>5</sup> Figures do not sum to \$36.8 billion due to rounding.

<sup>6</sup> Software licensing agreements remain the primary means through which computer-related services are delivered to foreign markets through cross-border channels.

**Figure 15-1**  
**Royalties and license fees services: U.S. cross-border exports, imports, and trade balance, 1993-98**



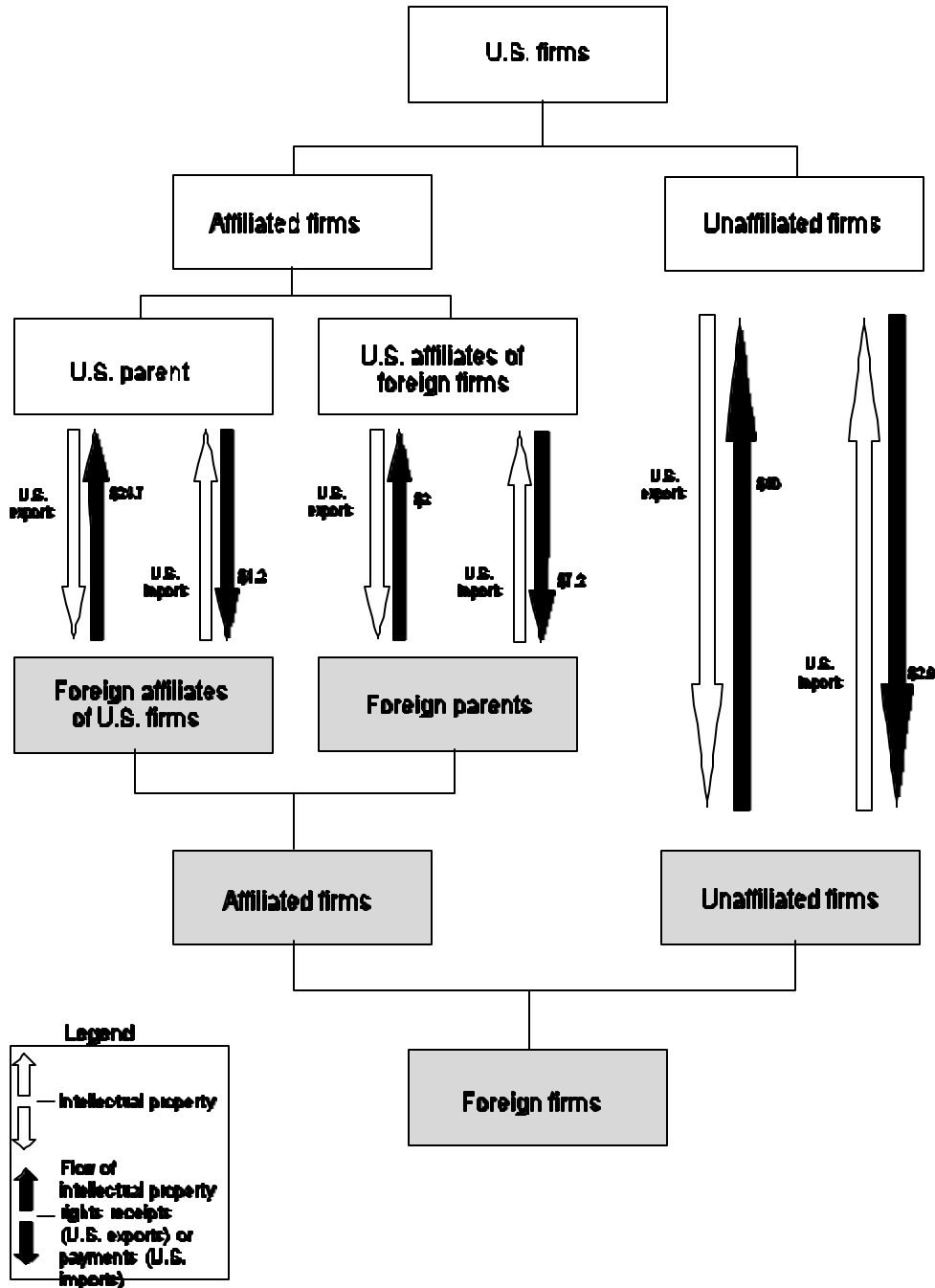
Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, pp. 64-65.

On balance in 1998, the United States recorded surpluses amounting to \$18.4 billion in trade among affiliated firms and \$7.1 billion in trade among unaffiliated firms. While the surplus in intracorporate trade remained virtually unchanged from that recorded in 1997, the surplus resulting from trade among unaffiliated firms increased by 13 percent.

In 1998, the major U.S. export markets for intangible intellectual property were, in descending order, Japan, the United Kingdom, Germany, the Netherlands, and France (figure 15-3). Exports of \$6.3 billion to Japan were slightly less than exports to that country in 1997. This decrease is likely a result of the downturn in the Japanese economy. The United Kingdom, Germany, the Netherlands, and France accounted for U.S. exports of \$3.7 billion, \$3.3 billion, \$3 billion, and \$2.2 billion, respectively.

The major foreign suppliers of intangible intellectual property to the U.S. market in 1998 were Japan, the United Kingdom, Germany, France, and Switzerland. Japan displaced the United Kingdom as the largest supplier of intangible intellectual property, as imports from Japan grew by 10 percent to \$2.3 billion in 1998. Similarly, imports from Germany increased by 54 percent to \$1.4 billion, imports from France grew by 48 percent to \$938 million, and imports from Switzerland grew by 5 percent to \$835 million. In contrast, imports from the United Kingdom decreased by 3 percent in 1998.

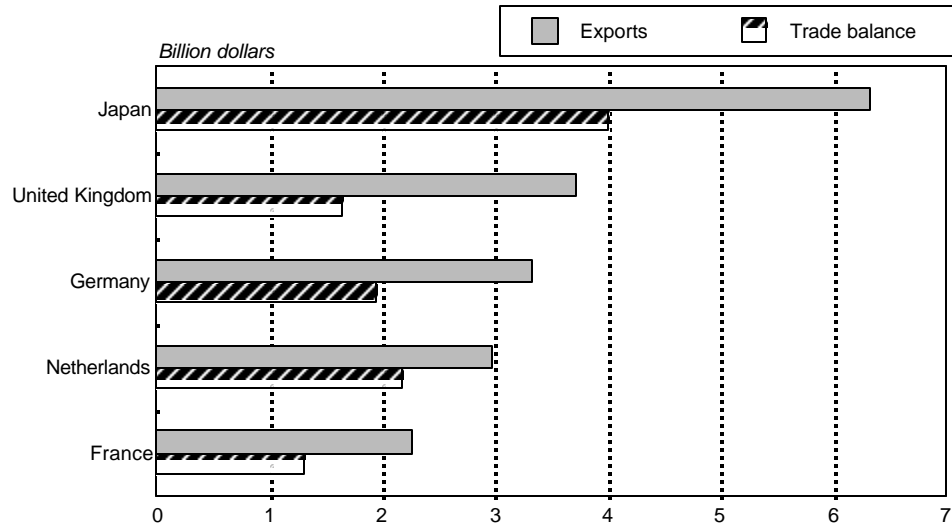
Figure 15-2  
 U.S. cross-border trade in intangible intellectual property rights, 1998  
 (Billion dollars)



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, pp. 62-63.



**Figure 15-3**  
**Royalties and licenses fees services: U.S. cross-border exports and trade balance, by major trading partners, 1998**



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, p. 91.

## Summary and Outlook

In 1998, the U.S. cross-border trade surplus in intangible intellectual property rights increased by 5 percent. This increase is in contrast to the 1-percent decline recorded in 1997. The increase in 1998 is attributable to an increase in exports of royalties and license fees to both affiliated and unaffiliated foreigners.

The consistent U.S. surplus on trade in intangible intellectual property is largely a result of U.S. parent firms' sales of patented industrial processes, copyrighted materials, and other intellectual property to their foreign-based affiliates, particularly in the machinery-manufacturing, chemicals-manufacturing, and wholesaling industries.<sup>7</sup> Exports of intellectual property to unaffiliated firms is smaller than intracorporate trade, but its continued growth reflects the success with which U.S. firms sell industrial processes and other intellectual property abroad.<sup>8</sup>

<sup>7</sup> U.S. International Trade Commission (USITC), "U.S. Trade in Intangible Intellectual Property: Royalties and Licence Fees," *Industry, Trade, and Technology Review*, USITC publication 3039, Apr. 1997, p. 24.

<sup>8</sup> *Ibid.*

Future trade growth in intangible intellectual property partially depends upon scientific and technological innovations.<sup>9</sup> The United States continues to rank as the world leader in innovation, as measured by the number of patents awarded to U.S. firms in the United States and abroad.<sup>10</sup> However, some European and Asian countries are catching or have surpassed the United States in terms of other indicators of science and technology innovation. For example, Korea, Sweden, Finland, and Ireland have reportedly increased research and development investment during the 1990s,<sup>11</sup> and Sweden, Finland, and Japan currently lead the United States in terms of research and development expenditure as a percentage of GDP.<sup>12</sup> Additionally, the United States ranks below many OECD countries in terms of the proportion of college graduates in science and engineering,<sup>13</sup> and continues to lag behind Japan with respect to the percentage of researchers in the labor force.<sup>14</sup> Such trends suggest that U.S. firms may face more intense foreign competition in the future.

The proliferation of the Internet, which increases distribution channels and expands the global reach of companies that trade intellectual property rights, will likely enhance the competitive position of U.S. firms. The most profound effects will likely be on the U.S. software industry,<sup>15</sup> as the ability to download software directly from U.S. producers or via Internet portal sites<sup>16</sup> without incurring shipping costs would reduce the expense of, and thereby promote, U.S. exports.<sup>17</sup> U.S. software companies, which enjoy a strong competitive position, would be able to transport their products more freely across borders, and perhaps increase revenues by expanding into previously untapped markets.

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<sup>9</sup> 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. Innovation in these areas will likely improve the competitive position of U.S. firms in the related industries and increase U.S. exports of intellectual property.

<sup>10</sup> Patent-based statistics are the most widely used indicators of innovative activity because patents are closely linked to invention, patent data are readily available, and the patents contain specific information about technologies. Organisation for Economic Co-operation and Development (OECD), *Science, Technology, and Industry Scoreboard, Benchmarking Knowledge-Based Economies 1999* (Paris: OECD, 1999), p. 90.

<sup>11</sup> Organisation for Economic Co-operation and Development (OECD), *Science, Technology, and Industry Scoreboard 1999*, p. 28.

<sup>12</sup> *Ibid.*, p. 29.

<sup>13</sup> *Ibid.*, p. 27.

<sup>14</sup> *Ibid.*, p. 29.

<sup>15</sup> The OECD has estimated that the Internet will reduce distribution costs for software companies by as much as 99 percent. Additionally, the OECD expects online software transactions to account for 33 percent of all Internet transactions by the year 2005. OECD, *The Economic and Social Impact of Electronic Commerce, Preliminary Findings and Research Agenda* (Paris: OECD, 1999), pp. 14, 44.

<sup>16</sup> For example, Sun Microsystems recently announced plans to provide software over a network that can be accessed by individuals or companies at set rates. Industry representatives have indicated that the lack of sufficient bandwidth may delay the roll out of such initiatives, especially in foreign countries. Industry representative, telephone interview by USITC staff, Sept. 19, 1999.

<sup>17</sup> OECD, *The Economic and Social Impact of Electronic Commerce*, p. 64.

However, representatives from the audiovisual and software industries have expressed concern over the ease with which digital transmissions can be pirated, and have undertaken a global effort to combat the electronic theft of intellectual property.<sup>18</sup> These industries are exploring new technologies, such as digital water-marking and encryption technologies, that may help curb piracy. These technologies, together with the implementation of enforceable copyright laws, may lessen piracy, promoting U.S. exports of intangible intellectual property.<sup>19</sup>

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<sup>18</sup> For example, the software and audiovisual industries have emphasized the importance of strong copyright laws, and have called on countries to ratify and implement the World Intellectual Property Organization's Copyright Treaty, which seeks to protect computer programs, databases, and sound recordings.

<sup>19</sup> Industry representative, telephone interview by USITC staff, Sept. 17, 1999.

# CHAPTER 16

## LEGAL SERVICES

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### Introduction

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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.

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. 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 host country courts or giving advice on host country law, unless that advice is based on the counsel of a member of the local bar. This arrangement is common in most major legal markets throughout the world, although some jurisdictions, notably Japan and France, impose comparatively more burdensome restrictions on foreign providers of legal services.

### Recent Trends in Cross-Border Trade, 1993-98

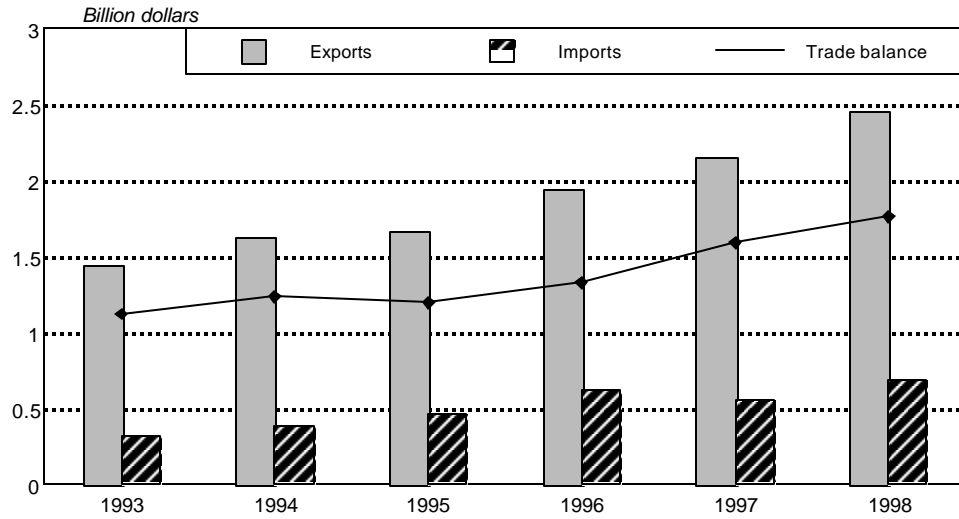
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Legal services is one of the fastest growing segments of business, professional, and technical services. In 1998, U.S. cross-border exports of legal services totaled approximately \$2.5 billion (figure 16-1), a gain of 14 percent over the previous year. This increase surpassed the 11-percent average annual increase achieved during 1993-97. U.S. cross-border imports of legal services jumped 23 percent to \$688 million in 1998, outpacing the 15-percent average annual growth rate achieved during 1993-97. Although the growth rate for imports exceeded that for exports in 1998, the U.S. cross-border trade surplus in this sector widened by 11 percent, from approximately \$1.6 billion to \$1.8 billion.

The United Kingdom and Japan remained the leading destinations of U.S. legal service exports in 1998, accounting for 22 and 17 percent, respectively, of all U.S. exports of legal services (figure 16-2). They were also two of the fastest growing U.S. export markets in 1998. U.S. exports to the United Kingdom rose by 17 percent

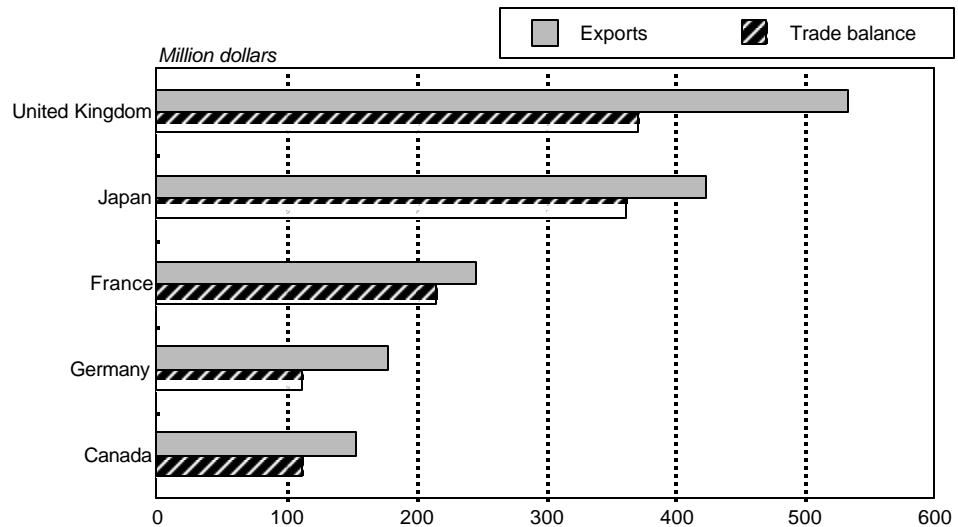
while exports to Japan increased by 14 percent. Other cross-border export

**Figure 16-1**  
**Legal services: U.S. cross-border exports, imports, and trade balance, 1993-98**



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, pp. 64-65.

**Figure 16-2**  
**Legal services: U.S. cross-border exports and trade balance, by major trading partners, 1998**



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, p. 91.

markets that experienced strong growth included Korea, up 18 percent, and France, up 15 percent. U.S. imports of legal services from Europe rose sharply in 1998, gaining 30 percent over 1997. U.S. imports from the United Kingdom, the leading European legal service provider to the United States, increased by 24 percent, while imports from France and Germany increased by 58 and 45 percent, respectively. Together, these three trading partners accounted for 37 percent of U.S. imports of legal services. The United States recorded a surplus on legal services trade with each of these trading partners.

## Summary and Outlook

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In 1998, the U.S. legal services industry enjoyed strong markets at home and abroad. U.S. firms that focused on foreign markets saw exports increase by 14 percent, while firms that focused on the domestic market reportedly experienced very favorable results as well.<sup>1</sup> While U.S.-based law firms such as Baker & McKenzie and Coudert Brothers continued to expand their international networks, many other U.S. firms demonstrated reluctance to incur the expense and risk of establishing foreign offices given the high demand for their services in the U.S. market. U.S. firms face limited domestic competition from foreign law firms in many of the most lucrative practice areas such as securities, mergers and acquisitions, and corporate finance.

British law firms are the U.S. legal industry's only significant competition in the most profitable and technically demanding fields within the global legal market. Currently, British law firms maintain a limited presence in the United States, although a number of British firms are reportedly eager to expand their U.S. presence. British law firms reportedly believe that in the long-term, their home market will not provide sustained, strong demand for legal services. Many, therefore, are moving into Continental Europe, the United States, and other foreign markets to increase revenue. For example, Freshfields, a top-five British law firm, expanded its New York office and opened an office in Washington, DC in 1998. The firm has more than 100 U.S. lawyers that specialize in areas such as securities, project finance, and public international law.<sup>2</sup> Likewise, five of Europe's premier law firms, including another top-five British firm Linklaters, formed Linklaters & Alliance in 1998, becoming Europe's largest multi-jurisdictional legal practice. Linklaters & Alliance has 32 offices employing a total of 1,900 lawyers in 18 countries.<sup>3</sup>

Major U.S. accounting and consulting firms are expanding their legal services divisions in Europe. U.S. accounting firms Arthur Andersen and PricewaterhouseCoopers, for example, each have more than 1,500 lawyers working

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<sup>1</sup> Industry representatives, telephone interviews by USITC staff, Oct. 1999.

<sup>2</sup> Freshfields, "Freshfields in the U.S.," *Freshfields News*, found at Internet address <http://www.freshfields.com/>, retrieved Sept. 23, 1999.

<sup>3</sup> Linklaters, "Linklaters & Alliance Expands Into Italy," *Linklaters Latest News*, July 16, 1999, found at Internet address <http://www.linklaters.com/>, retrieved Sept. 23, 1999.

overseas.<sup>4</sup> In the United States, the provision of legal services within multi-disciplinary practices (MDP) is the focus of an ongoing debate that, once settled, may significantly alter the structure of the U.S. legal industry. Court-imposed ethics rules have expressly barred fee-sharing and mixed professional partnerships in the United States since 1969. However, MDPs are common in Europe, where international accounting firms routinely provide legal services, including litigation services. Support for MDPs in the United States has been growing since a proposal to allow fee-sharing was presented by a special American Bar Association (ABA) commission in August 1999, although the proposal was rejected pending further study.<sup>5</sup> While some legal professionals argue that the current rules serve a vital function, others contend that the restrictions are outdated and impede business growth in today's increasingly consolidated global marketplace. PricewaterhouseCoopers hopes to triple its legal staff over the next five years, although it claims that such expansion can be achieved only if bans on MDPs are abolished, especially in the United States.<sup>6</sup>

The Internet and electronic commerce are transforming the legal industry in a number of ways. Most notably, information technology (IT) has brought about new legal issues that must be addressed. For instance, intellectual property (IP) trademark infringement and copyright abuses are proliferating on the Internet, spurring demand for lawyers specializing in trademarks, copyrights, and other intangibles. The merger of Washington D.C.-based Howrey & Simon and Houston IP firm Arnold, White & Durkee, which created the world's largest IP legal practice, was reportedly prompted by the growth in technology-related litigation in the United States and Europe. The new firm plans to add offices in London, Brussels, and Geneva.<sup>7</sup>

Firms specializing in electronic commerce and other IT-related areas advise clients on matters such as electronic payment systems, the creation and enforcement of electronic contracts, electronic authentication, and data protection and security. Legal service providers are also distributing their services on the Internet. A number of law firms have created legal forms that can be downloaded from Internet web sites, filled out, and submitted to the appropriate party. In addition, web sites such as the *Martindale-Hubbell Lawyer Locator* provide information on law firms and attorneys.

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<sup>4</sup> Paul M. Barrett, "Increased Drive to Go Global Spurs Law-Firm Merger Talk," *The Wall Street Journal*, Mar. 18, 1999.

<sup>5</sup> American Bar Association, "ABA House of Delegates Calls for Additional Study of Multi-disciplinary Practice," news release, Aug. 10, 1999.

<sup>6</sup> PricewaterhouseCoopers, news release, found at Internet address <http://www.pwcglobal.com/>, retrieved Sept. 8, 1999.

<sup>7</sup> "Merging U.S. Law Firms Form Global IP Giant," News Update, *The Lawyer*, Sept. 13, 1999.



# CHAPTER 17

## MARITIME SERVICES

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### Introduction

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For the purpose of this discussion, maritime transportation services include freight transportation and port services. Trade in freight transportation and port services stems from merchandise trade. For instance, exports of freight transportation services take place when U.S. ocean carriers<sup>1</sup> transport U.S. merchandise exports to foreign destinations, or when U.S. ocean carriers convey cargo between two foreign ports.<sup>2</sup> Imports of freight transportation services, on the other hand, occur when foreign ocean carriers transport merchandise imports to the United States.<sup>3</sup> U.S. exports of port services encompass the value of goods and services procured by foreign ocean carriers while in U.S. sea ports, whereas imports of port services comprise the value of goods and services procured by U.S. carriers while in sea ports of foreign countries.

Cross-border delivery is the prevailing mode of trade in maritime transportation services, though sales by affiliates may play a large role in freight transportation in countries where regulatory barriers prohibit cross-border delivery. For this reason, the following discussion will focus on cross-border trade in maritime transportation services.

### Recent Trends in Cross-Border Trade, 1993-98

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The U.S. trade deficit in maritime transport services increased by 158 percent from \$1.9 billion in 1997 to \$4.8 billion in 1998 (figure 17-1). The sharp increase in the

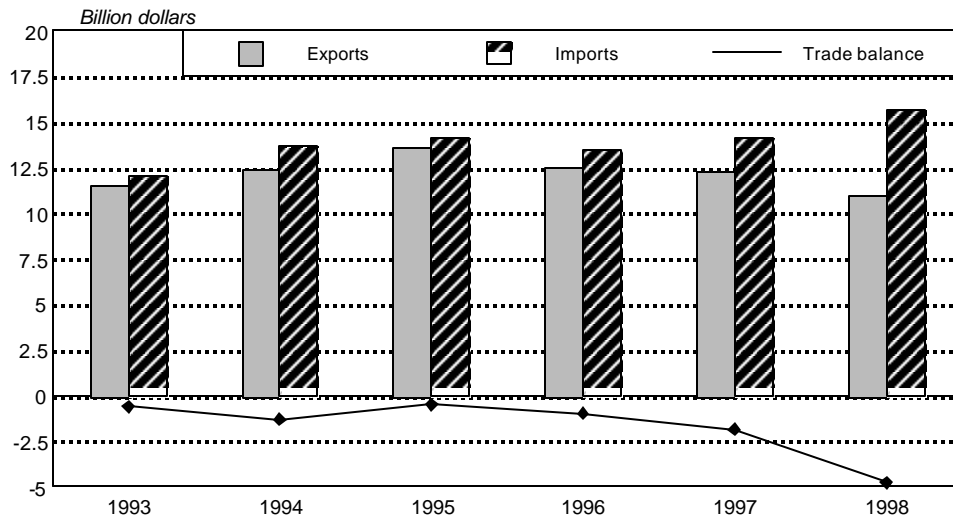
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<sup>1</sup> According to the U.S. Department of Commerce (USDOC), Bureau of Economic Analysis (BEA) a U.S. ocean carrier is a ship which is operated by crew members whose country of residence is the United States, but which may not necessarily be U.S.-owned or fly the U.S. flag.

<sup>2</sup> 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, bears all subsequent transportation costs. Therefore, receipts of U.S. carriers for the transport of U.S. imports are excluded from U.S. transportation exports because, by this convention, they represent transactions between U.S. parties. By the same token, payments to foreign carriers for transporting U.S. exports are not included in U.S. imports because they represent transactions between foreign residents and foreign airline, vessel, and truck operators. USDOC, BEA, *Survey of Current Business*, Oct. 1998, p. 78.

<sup>3</sup> 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. imports. BEA official, telephone interview by USITC staff, Nov. 16, 1998.

**Figure 17-1**  
**Maritime services: U.S. cross-border exports, imports, and trade balance, 1993-98**



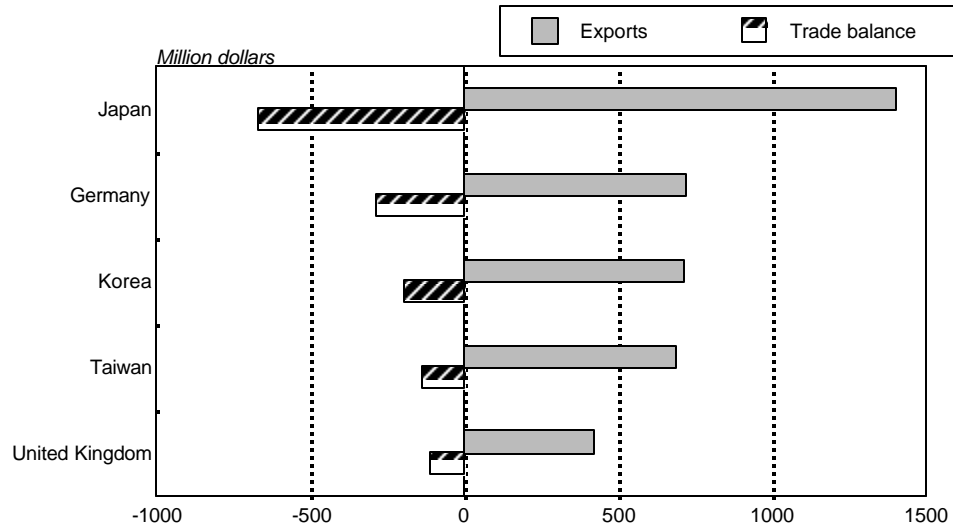
Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, pp. 68-71; Oct. 1998, p. 90; and Oct. 1997, p. 112.

deficit in 1998 was nearly five times larger than the 32-percent average annual growth rate recorded during 1993-97. U.S. exports of maritime transport services decreased by 11 percent to \$10.9 billion in 1998, whereas they grew at an average annual rate of 2 percent during 1993-97. At the same time, U.S. imports increased by 11 percent to \$15.7 billion, compared to an average annual growth rate of 4 percent during 1993-97. More specifically, the rise in the U.S. trade deficit was largely attributable to a 17-percent decrease in U.S. exports of ocean freight services and a 15-percent increase in U.S. imports of such services. In addition, the U.S. maritime transport account was adversely affected by a decline in U.S. exports of ocean port services, which stemmed from a decrease in fuel prices.<sup>4</sup> U.S. exports of ocean port services decreased by 8 percent, from \$7.7 billion in 1997 to \$7.1 billion in 1998.

The top five export markets for maritime transport services in 1998 were the same as those in the previous year. These included Japan, accounting for 13 percent of all exports; Germany and Korea, 7 percent each; Taiwan, 6 percent; and the United Kingdom, 4 percent (figure 17-2). The relative importance of these markets, however, changed somewhat in 1998, as Germany and Taiwan exchanged places. U.S. exports to Germany increased by 16 percent in 1998, while U.S. exports to Taiwan decreased by 42 percent. Trade in maritime transport services with Japan, Korea, and Taiwan was adversely affected by the Asian financial crisis, which led to

<sup>4</sup> Although lower fuel prices also contributed to a decline in U.S. imports of ocean port services, this decline was numerically less significant than the fall in U.S. port service exports. U.S. exports of ocean port services decreased by \$585 million in 1998, whereas U.S. imports fell by \$162 million. USDOC, BEA, *Survey of Current Business*, Oct. 1999, pp. 52 and 55.

**Figure 17-2**  
**Maritime services: U.S. cross-border exports and trade balance, by major trading partners, 1998**



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, p. 71.

a fall in the value of these countries' currencies relative to the dollar<sup>5</sup> and a resultant decline in shipments of U.S. goods to these markets. The U.S. deficit in maritime transport trade with Japan increased fourteen-fold, from \$49 million in 1997 to \$671 million in 1998. The U.S. bilateral deficit on the maritime services account with Korea increased to more than ten times its 1997 level, growing from \$19 million to \$195 million in 1998. Similarly, the U.S. trade deficit on maritime transport with Taiwan rose by 76 percent to \$134 million.

## Summary and Outlook

The U.S. trade deficit in maritime transport services increased sharply, from \$1.9 billion in 1997 to \$4.8 billion in 1998. This was the largest deficit recorded during the period 1993-98. Growth in the maritime transport services deficit in 1998 primarily reflected a 34-percent increase in the deficit in ocean freight services, which rose from \$7.3 billion in 1997 to \$9.8 billion in 1998.

Excess shipping capacity and a consequent decline in freight rates in major trade lanes continue to encourage consolidation between U.S. and foreign shipping lines. For instance, in July 1999, Danish shipping line Maersk acquired the international

<sup>5</sup> During 1997-98, the average exchange rates for the Japanese yen, the Korean won, and the Taiwan dollar fell by roughly 10 percent, 50 percent, and 20 percent, respectively, against the U.S. dollar. These percentages were calculated using Federal Reserve data, found at <http://www.bog.frb.fed.us/releases/HIO/hist/>, retrieved Mar. 2, 2000.

container shipping business of U.S.-owned Sea-Land Service, Inc.<sup>6</sup> This was the third acquisition of a U.S. shipping line by a foreign entity since 1997.<sup>7</sup> Under the terms of the acquisition, Maersk will operate 19 Sea-Land vessels that are used solely for international transport, although these vessels will remain under the U.S. flag.<sup>8</sup> Sea-Land will continue to own 16 vessels that are used only for domestic transport services.<sup>9</sup> More recently, U.S. shipping line Crowley American Transport has considered joining its South American operations with those of German shipping line Hamburg-Sud. The alliance would likely reduce the two carriers' costs by allowing them to better control the capacity that they deploy in U.S.-South America shipping lanes.<sup>10</sup>

Shippers'<sup>11</sup> desire to reduce domestic transport costs in the United States has motivated national debate on reforming the Jones Act.<sup>12</sup> The Jones Act requires that the transport of oceanborne cargo between U.S. ports be provided on vessels that are built in the United States, and that are owned and operated by U.S. citizens.<sup>13</sup> Those in favor of reforming the Jones Act<sup>14</sup> currently propose allowing some U.S. shipping

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<sup>6</sup> "A.P. Moller-Maersk Line to Acquire Sea-Land's International Shipping Business," press release, July 22, 1999, found at Internet address <http://www.sealand.com/>, retrieved Oct. 5, 1999.

<sup>7</sup> In 1997, U.S. shipping lines Lykes Lines and APL Ltd. were purchased by Canadian Pacific Ltd and Singapore's Neptune Orient Lines, respectively. "Maersk-SeaLand," *Journal of Commerce*, July 26, 1999, found at Internet address <http://www.joc.com/>, retrieved on Sept. 23, 1999.

<sup>8</sup> Under the terms of the acquisition, ownership of these vessels will be transferred to a U.S. bank, while operation of the vessels will reside with a U.S. ship line management company. The U.S. bank will lease such vessels to the U.S. management firm which, in turn, will time charter the ships to Maersk. Time charter involves the leasing of both equipment and crew. Both APL and Lykes have engaged in similar arrangements, thus permitting their acquiring companies, Neptune Orient Lines and Canadian Pacific, to deploy ships in international shipping lanes that are owned and operated by U.S. citizens and fly the U.S. flag. Industry representative, telephone interview by USITC staff, Feb. 3, 2000.

<sup>9</sup> Industry representative, telephone interview by USITC staff, Oct. 5, 1999.

<sup>10</sup> Terry Brennan, "Hamburg-Sud and Crowley in Alliance Talks," *Journal of Commerce*, Aug. 2, 1999, found at Internet address <http://www.joc.com/>, retrieved Sept. 23, 1999.

<sup>11</sup> A shipper refers to a party that procures maritime transportation services.

<sup>12</sup> 'The Jones Act' is the shorthand name given to section 27 of the 1920 Merchant Marine Act (46 U.S.C. 883). Tim Sansbury and Rip Watson, "Shippers Group to Open Talks With Lines, Labor on Jones Act Changes," *Journal of Commerce*, June 28, 1999, found at Internet address <http://www.joc.com/>, retrieved Sept. 23, 1999.

<sup>13</sup> U.S. citizens must hold at least 75-percent ownership in Jones Act vessels. Kenneth R. DeJarnette, "Maritime Transportation Issues and the 105th Congress," *CRS Report for Congress*, Sept. 17, 1997, p. 1.

<sup>14</sup> Supporters of Jones Act Reform include the Jones Act Reform Coalition (JARC), a congressional group formed in 1994, and the National Industrial Transportation League (NIT), an organization representing U.S. shippers. DeJarnette, "Maritime Transportation Issues and the 105th Congress," p. 1; and "NIT League to Plunge into Jones Act Debate," *Journal of Commerce*, June 29, 1999, found at Internet address <http://www.joc.com/>, retrieved Sept. 23, 1999.

lines to deploy foreign-built ships for the domestic transport of cargo.<sup>15</sup> Reportedly, shipbuilding costs in the United States are relatively high and contribute, in part, to the high freight rates charged by U.S. shipping lines.<sup>16</sup> In addition, reform of U.S. build requirements found in the Jones Act may encourage U.S. shipping lines to expand their domestic fleets by allowing them to build ships more cheaply overseas.<sup>17</sup> Similarly, legislation was introduced in August 1999 to permit foreign cruise lines to transport passengers between U.S. sea ports. Reportedly, the legislation would also provide incentives for foreign cruise operators to build cruise ships in the United States, operate them under the U.S. flag, and employ U.S. crews.<sup>18</sup>

Restrictions on the operation of foreign shipping lines in both Japan and China continue to have an adverse impact on U.S. ocean carriers. The U.S. Federal Maritime Commission (FMC) recently renewed its investigation into Japan's restrictive port practices.<sup>19</sup> Previously, the FMC identified two Japanese practices, in particular, which impede the operations of U.S. and other non-Japanese shipping lines. First, non-Japanese shipping lines must receive prior approval from the Japan Harbor Transportation Association (JHTA), a private Japanese stevedoring company, before implementing any changes in the nature of their operations in Japanese ports. Such changes may include alterations in vessel assignments, docking schedules, or the location where cargo is warehoused. Second, U.S. and other non-Japanese shipping lines must receive licenses from Japan's Ministry of Transport in order to establish wholly-owned subsidiaries for cargo handling.<sup>20</sup> Although the United States and Japan concluded a bilateral agreement on October 24, 1997, in which Japan committed to reform its port practices,<sup>21</sup> U.S. shipping lines indicate that such

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<sup>15</sup> For example, a bill introduced by U.S. Senator Sam Brownback (R-Kansas) would permit U.S. shipping lines that transport both liquid and dry bulk cargo to deploy vessels that are built outside of the United States. "Senate Bill Aims to Reform Jones Act," *Journal of Commerce*, May 18, 1999, found at Internet address <http://www.joc.com/>, retrieved Sept. 23, 1999.

<sup>16</sup> For further information, see U.S. International Trade Commission, *The Economic Effects of Significant U.S. Import Restraints*, May 1999, USITC publication 3201.

<sup>17</sup> Ken Cottrill, "Waiving the Flag," *Traffic World*, Aug. 2, 1999, p. 32.

<sup>18</sup> The legislation was introduced by U.S. Senator John McCain (R-Arizona) and would amend the Passenger Service Act of 1886 (Section 8 of Ch. 421, June 19, 1886, 24 Stat. 79 at 81). The Passenger Service Act requires that ocean passengers within the United States be transported on ships that are built in the United States, and that are owned and operated by U.S. citizens. Tim Sansbury, "McCain Offers Bill to Reform Cruise-Ship Law," *Journal of Commerce*, Aug. 9, 1999, found at Internet address <http://www.joc.com/>, retrieved Sept. 23, 1999; and Stephen J. Thompson, "The Passenger Service Act, Domestic Ocean Passenger Service, and the 106th Congress," *CRS Report for Congress*, Jan. 15, 1999, p. 1.

<sup>19</sup> The Federal Maritime Commission initiated its investigation on Japan's port practices in 1995. "FMC Revives Japanese Ports Probe," *American Shipper*, July 1999, p. 10.

<sup>20</sup> Japan Economic Institute, "U.S.-Japan Maritime Relations: The View From the Federal Maritime Commission," Report No. 40A, Oct. 23, 1998, pp. 1-2.

<sup>21</sup> Federal Maritime Commission (FMC), "37th Annual Report for Fiscal Year 1998," p. 93.

reform has been either slow or non-existent.<sup>22</sup> The FMC has also identified restrictions which hamper the operation of U.S. and other foreign shipping lines in China. For example, the Chinese Government currently limits the ability of U.S. shipping lines to establish subsidiaries in China and places onerous pre-clearance requirements on U.S. ships that use Chinese ports.<sup>23</sup> In September 1999, the United States resumed maritime talks with China in an effort to remove operational restrictions on U.S. shipping lines.<sup>24</sup>

Both U.S. and foreign shipping lines have begun to conduct an increasing proportion of their business on the Internet, either through their own Internet sites or through contracts with third-party online technology firms. For instance, U.S. shipping firm American President Lines (APL) allows customers to track cargo shipments electronically on its Internet site.<sup>25</sup> Similarly, Hong Kong firm Overseas Orient Container Line Ltd. (OOCL) offers electronic bills of lading and vessel schedule information on its Internet site.<sup>26</sup> With the passage of the U.S. Ocean Shipping Reform Act of 1998,<sup>27</sup> more shipping firms are turning to third-party providers of tariff database management services. For example, both APL and OOCL employ database management firm E-Transport, which provides freight rate information to the carriers' customers on the Internet. Furthermore, several nonvessel-operating-common-carriers<sup>28</sup> employ firms that provide online auction services for cargo space, enabling shippers to secure more competitive freight rates.<sup>29</sup> Technological developments are also in place which will allow the online negotiation of individual service contracts between carriers and shippers. Online contract negotiation may become the most common use of electronic commerce within the maritime service

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<sup>22</sup> Japan Economic Institute, "U.S.-Japan Maritime Relations: The View From the Federal Maritime Commission," Report No. 40A, Oct. 23, 1998, p. 4.

<sup>23</sup> "FMC Revives Japanese Ports Probe," *American Shipper*, July 1999, p. 10; and Tim Sansbury, "U.S.-China Talks Sought to Avoid Shipping Restrictions," *Journal of Commerce*, July 19, 1999, found at Internet address <http://www.joc.com/>, retrieved Sept. 23, 1999.

<sup>24</sup> Tim Sansbury, "Maritime Trade Talks With China," *Journal of Commerce*, Sept. 15, 1999, found at Internet address <http://www.joc.com/>, retrieved Sept. 23, 1999.

<sup>25</sup> Ken Cottrill, "Keeping Options Open," *Traffic World*, Sept. 13, 1999, p. 42.

<sup>26</sup> A bill of lading is a document which outlines the contract terms under which a shipping line transports goods for a shipper. Cottrill, "Keeping Options Open," *Traffic World*, Sept. 13, 1999, p. 42; and P.T. Bangsberg, "OOCL Taps US Firm to Handle Tariff Data," *Journal of Commerce*, May 6, 1999, found at Internet address <http://www.joc.com/>, retrieved Sept. 23, 1999.

<sup>27</sup> The 1998 Ocean Shipping Reform Act (P.L. 105-258) eliminated the requirement for shipping lines to file freight rate information with the Federal Maritime Commission; rates need only be made available to the public through the Internet or through carriers' own automated systems. Federal Maritime Commission (FMC), "37th Annual Report for Fiscal Year 1998," p. 8.

<sup>28</sup> A nonvessel-operating-common-carrier (NVOCC) purchases cargo space at wholesale rates from shipping lines and resells such space at retail prices to shippers. Japan Economic Institute, "U.S.-Japan Maritime Relations: The View From the Federal Maritime Commission," appendix, p. 5.

<sup>29</sup> Helen Atkinson, "Carriers Cautious About Online Auctions," *Journal of Commerce*, Oct. 7, 1999, found at Internet address <http://www.joc.com/>, retrieved Oct. 7, 1999.

industry.<sup>30</sup> As the Internet facilitates more efficient transactions between shipping lines and shippers, it could result in the transportation of more cargo by ocean carriers.

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<sup>30</sup> Cottrill, "Keeping Options Open," p. 43.

# CHAPTER 18

## RETAIL SERVICES

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### Introduction

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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 provided by retailers, whether incidental or nonincidental to retailing. Nonincidental services could include installation or repair services, credit services, or warranty services, as well as promotion and advertising services. In the case of computer retailers, nonincidental services may also include systems integration and support services.

### Recent Trends in Affiliate Transactions, 1992-97

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Data reflecting total sales registered by foreign-based retailing affiliates of U.S. firms were suppressed by BEA in order to avoid disclosure of individual company data. Only data for the United Kingdom, Latin America, and Australia were reported. However, based on assessments of retail trade data from previous years, it is presumed likely that these locations were significant markets for U.S. affiliate sales of retail services in 1997.<sup>1</sup> Australia-based retailing affiliates of U.S. firms accounted for \$173 million in sales, followed by Latin America-based affiliates with \$154 million in sales, and UK-based affiliates with \$140 million in sales.<sup>2</sup> Sales of services through retail affiliates in the United Kingdom increased by 17 percent during 1996-1997, while sales in Latin America jumped by 75 percent.<sup>3</sup> The growth of sales by retailing affiliates in these locations reflects the strong demand for U.S. retailing services in both mature and developing markets.

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<sup>1</sup> See, for instance, USITC, *Recent Trends in U.S. Services Trade: 1999 Annual Report*, May 1999, USITC publication 3198, pp. 16-1 to 16-4.

<sup>2</sup> U.S. Department of Commerce (USDOC), Bureau of Economic Analysis (BEA), *Survey of Current Business*, Oct. 1999, p. 93.

<sup>3</sup> *Ibid.*, and USDOC, BEA, *Survey of Current Business*, Oct. 1998, p. 115.



U.S. purchases of services from U.S.-based retail affiliates of foreign firms totaled \$503 million in 1997.<sup>4</sup> On a bilateral basis, U.S.-based retailing affiliates of UK firms sold services worth \$78 million, or 16 percent of total U.S. purchases of services from retailing affiliates of foreign firms. Affiliates of Canadian firms sold services worth \$73 million, or 15 percent of the total, and affiliates of Japanese firms accounted for sales of \$69 million, or 14 percent of the total.<sup>5</sup>

## Summary and Outlook

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The United States has one of the most vibrant and competitive retail industries in the world. U.S. consumers can access goods and services through a wide variety of retail channels, from traditional “brick-and-mortar” retailers, such as “category killers,”<sup>6</sup> factory outlets, and specialty stores, to nonstore retailers, such as catalogue companies and Internet-based retailers. In addition, U.S. retailers have kept prices low by developing efficiencies in key areas such as sourcing, inventory management, logistics, and merchandising. U.S. retailers are enjoying unprecedented domestic economic expansion, led by brisk consumer spending. Services such as credit card financing, installation and repair, and computer systems integration further boost sales. However, retailers are facing challenges and opportunities that will shape the industry’s strategic position in the future. Primary among these are globalization, consolidation, and electronic commerce.

A mature domestic market has motivated U.S. retailers to enter or further participate in foreign markets, thereby further globalizing this industry. Some retailers, such as Home Depot, have recently focused on expansion in developing markets. Home Depot currently plans to establish an affiliate in Argentina in 2000 to complement its two Chilean affiliates, which opened in 1998.<sup>7</sup> Prior to its focus in developing markets, the retailer had established 40 stores in Canada and 1 in Puerto Rico.<sup>8</sup> Wal-

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<sup>4</sup> BEA reported data on 1997 affiliate purchases using the NAICS (North American Industry Classification System), not the SIC (Standard Industrial Classification) system used to report 1997 affiliate sales data and all affiliate transactions data prior to 1997. As a result, it is not feasible to calculate an analytically sound affiliate transactions balance or the growth rate of affiliate purchases in 1997. For more information on the transition from the SIC to the NAICS, see text box 2-1.

<sup>5</sup> USDOC, BEA, *Survey of Current Business*, Oct. 1999, p. 95.

<sup>6</sup> “Category killers” offer a huge, low-price selection of merchandise in one particular category, i.e., Office Depot (office supplies), PetSmart (pet supplies), and Toys R Us (toys). International Council of Shopping Centers, “Shopping Center Definitions,” found at Internet address <http://www.icsc.org/srch/lib/shopcentdefs.html>, retrieved Nov. 1, 1999.

<sup>7</sup> James R. Hagerty and Almar Latour, “Home Depot Adds Moberg of Ikea Group to Head Its International Expansion,” *The Wall Street Journal*, Mar. 23, 1999, p. B9; and Julie Creswell and Nelson D. Schwartz, “10 Stocks to Grow With,” *Fortune*, Aug. 16, 1999, found at Internet address <http://proquest.umi.com/>, retrieved Sept. 29, 1999.

<sup>8</sup> “Home Center Industry Tailors Itself to Consumers,” *Chain Store Age*, Aug. 1999, found at Internet address <http://proquest.umi.com/>, retrieved Sept. 29, 1999; and Richard Halverson, “The Golden Eye of DIY,” *Discount Store News*, Dec. 14, 1998, found at Internet address

(continued...)

Mart, on the other hand, continued its push into Europe by purchasing Asda, a British supermarket chain, in June 1999,<sup>9</sup> following similar acquisitions in Germany in 1998.

The ability to establish a commercial presence or acquire majority ownership of an existing retailer in foreign markets is often impeded by restrictions on foreign direct investment. U.S. retailers cite foreign equity limits and investment screening as the principal impediments to growth in foreign markets.<sup>10</sup> For example, China imposes geographic, equity, and form of establishment restrictions on foreign retailers. In Malaysia, foreign direct investment is subject to government approval and foreign equity limits.<sup>11</sup> Japan's Large-scale Retail Store Law (LSRL) is reportedly designed in part to protect indigenous local merchants from large-scale retail competition.<sup>12</sup> In addition, foreign retailers are prohibited from investing in certain foreign markets, such as the Philippines.<sup>13</sup>

Consolidation is another notable trend in retailing. In the midst of low-cost competition and stagnant markets, grocery and department store retailers are consolidating to reduce expenses and increase sales.<sup>14</sup> Ahold, a Dutch grocery concern, continued its buying spree in the Eastern United States by acquiring Pathmark, a Carteret, NJ-based supermarket chain.<sup>15</sup> Wal-Mart's recent forays into Germany and the United Kingdom led to the defensive merger of French retailers Carrefour and Promedes.<sup>16</sup> Likewise, Wal-Mart's ability to apply its distribution

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<sup>8</sup> (...continued)

<http://proquest.umi.com/>, retrieved Sept. 29, 1999.

<sup>9</sup> Ernest Beck, "The Wal-Mart is Coming! And Shopping for the British May Never be the Same," *The Wall Street Journal*, June 16, 1999, p. A23; and "Upfront: Wal-Mart Moves to Buy British Supermarket Chain," *Stores*, July 1999, p. 14.

<sup>10</sup> Industry representative, telephone interview by USITC staff, Sept. 16, 1999.

<sup>11</sup> Organisation for Economic Co-operation and Development (OECD), Working Party of the Trade Committee, "Retail Trade Services," TD/TC/WP(99)41, Aug. 17, 1999, p. 39.

<sup>12</sup> Although the LSRL will be replaced by the new Large-Scale Retail Store Location Law (LSRSL) by 2000, foreign and domestic large retailers anticipate that they will continue to experience difficulty establishing retail facilities under the new, locally-administered rules. The new LSRSL regulates stores based on environmental considerations such as traffic, noise, parking and garbage removal. The old LSRL required stores of a certain size to obtain permission from the Ministry of International Trade and Industry for store openings, business hours, and expansion. U.S. Department of State telegram, "1999 Investment Climate Statement for Japan," message reference No. 005897, prepared by U.S. Embassy, Tokyo, July 18, 1999; and OECD, "Retail Trade Services," pp. 28-30.

<sup>13</sup> USDOC, International Trade Administration (ITA), "Philippines - Retailing - ISA971001," STAT-USA database, found at Internet address <http://www.stat-usa.gov/>, retrieved Dec. 8, 1998.

<sup>14</sup> Frederick A. Crawford, "Focus: Retail Consolidation," *Retail News: Trends and Developments in the Retail Industry*, Summer 1998, p. 2.

<sup>15</sup> PriceWaterhouseCoopers "Today's Global Challenges," *Retail & Consumer Worlds Executive News Summary*, Apr. 1999, Issue 29, p. 2.

<sup>16</sup> Beck, "The Wal-Mart is Coming! And Shopping for the British May Never be the Same," p. A23; and "Upfront: Wal-Mart Moves to Buy British Supermarket Chain," p. 14.

efficiencies to its supercenter<sup>17</sup> format has resulted in profit margins that rival its discount stores, prompting defensive mergers among competing U.S. grocery chains.<sup>18</sup>

The Internet is also reshaping the retailing industry, and is doing so in two primary ways. First, the Internet acts as an alternative shopping outlet for consumers, creating a new market for retailers. Second, the Internet integrates each component of the supply chain, streamlining the distribution process. Retailers use the Internet to facilitate sourcing, increase supplier and product availability, improve accuracy, and reduce costs.<sup>19</sup>

Internet retailing<sup>20</sup> currently accounts for less than 1 percent of total retail sales.<sup>21</sup> However, forecasters predict that by 2002, Internet retail sales will reach between \$40 billion and \$80 billion.<sup>22</sup> Consequently, some industry analysts see a pronounced shift toward nonstore retailing during the next 10-15 years at the expense of brick-and-mortar stores.<sup>23</sup> Certain goods such as books, music, video, and software, lend themselves to distribution via the Internet, and have a higher share of total online consumer sales.<sup>24</sup> These goods may affect brick-and-mortar sales of retailers, particularly those that sell digitally transmittable goods. Some brick-and-mortar music retailers are already experiencing competition from Internet retailers such as CDNow and Amazon.com, as well as new formats such as MP3, that allow consumers to download music directly.<sup>25</sup>

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<sup>17</sup> Wal-Mart supercenters combine a full-line grocery store with Wal-Mart's discount general merchandise. Wal-Mart Stores, Inc., Form10-K, Apr. 19, 1999, found at Internet address <http://www.sec.gov/>, retrieved Sept. 29, 1999.

<sup>18</sup> David P. Schulz, "Top 100 Retailers: The Nation's Biggest Retail Companies," *Stores*, July 1999, p. S6.

<sup>19</sup> Susan Reda, "Borderless Selection: Global Sourcing on the Internet," *Stores*, June 1999, p. 20.

<sup>20</sup> For more information see, U.S. International Trade Commission "Nonstore Retailing: Alternative Retailers Attracting Customers," *Industry, Trade, and Technology Review*, USITC publication 3153, Dec. 1998.

<sup>21</sup> USDOC, Economics and Statistics Administration (ESA), "The Emerging Digital Economy II," found at Internet address <http://www.ecommerce.gov/ede>, retrieved Sept. 16, 1999. The Census Bureau estimated that online retail sales were \$5.3 billion, or 0.64 percent, of total retail sales of \$821.2 billion recorded during the fourth quarter 1999. This is the first official U.S. Government estimate of online retail sales. USDOC, "Retail E-Commerce Sales for the Fourth Quarter 1999 Reach \$5.3 Billion," *Census Bureau Reports*, USDOC News, Mar. 2, 2000, found at Internet address <http://www.census.gov/mrts/www/current.html>, retrieved Mar. 2, 2000.

<sup>22</sup> USDOC, ESA, "The Emerging Digital Economy II."

<sup>23</sup> David P. Schulz, "Growth of Direct-to-Consumer Channels Reshapes Retail Distribution," *Stores*, Mar. 1999, p. 48.

<sup>24</sup> OECD, "Retail Trade Services," p. 14.

<sup>25</sup> David P. Schulz, "Top 100 Specialty Stores," *Stores*, Aug. 1999, p. S8.

# CHAPTER 19

## TELECOMMUNICATION SERVICES

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### Introduction

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Telecommunication services trade encompasses both basic<sup>1</sup> and value-added<sup>2</sup> 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. Cross-border trade data are essentially a product of the “accounting rate system,” fashioned by European carriers in the latter half of the nineteenth century. Under this system, telecommunication carriers bilaterally negotiate fees, called accounting rates, for carrying international traffic, measured in calling minutes. Each carrier’s portion of the accounting rate is referred to as the settlement rate, which in almost all cases is equal to one-half of the negotiated accounting rate. As bilateral imbalances in international calling traffic occur, the carrier whose outbound calling minutes exceed its inbound calling minutes makes a net settlement payment to its foreign counterpart. The net settlement payment is essentially calculated by multiplying the settlement rate by the number of imbalanced calling minutes.<sup>3</sup> Net settlement payments register as imports on the balance of payments, whereas net settlement receipts register as exports.

### Recent Trends

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#### *Cross-Border Trade, 1993-98*

In 1998, exports of telecommunication services totaled \$3.7 billion, while U.S. imports measured \$8.1 billion, resulting in a \$4.4 billion deficit in telecommunication services trade (figure 19-1). Exports decreased by 7 percent in 1998, in contrast to the 9-percent average annual increase registered during 1993-97. Similarly, U.S. imports declined by 3 percent, in contrast to the 7-percent average annual increase recorded

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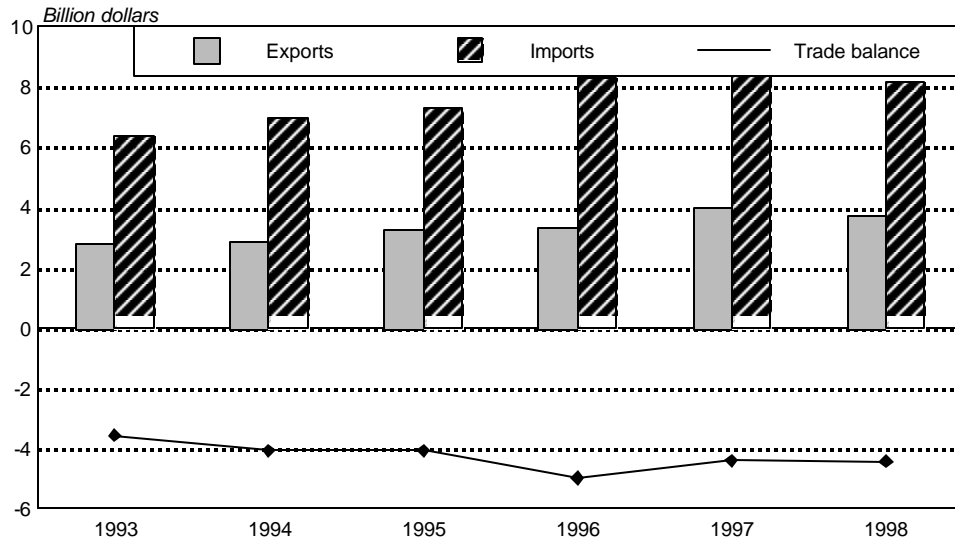
<sup>1</sup> Basic services entail the transmission of voice and data without change in form or content.

<sup>2</sup> Value-added services include services such as electronic mail, electronic data interchange, electronic funds transfer, enhanced facsimile, and on-line database access.

<sup>3</sup> Settlement payments may also reflect surcharges that some countries impose on collect and country-direct calls.

during 1993-97. Although the deficit in telecommunication

**Figure 19-1**  
**Telecommunication services: U.S. cross-border exports, imports, and trade balance, 1993-98**



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, pp. 64-65.

services trade increased by 1 percent in 1998, this increase is lower than the 5-percent average annual growth rate registered during 1993-97.<sup>4</sup>

The United States consistently recorded a trade deficit in cross-border telecommunication services during 1993-98, primarily because most calls between the United States and foreign countries originate in the United States, and U.S. carriers terminate more international collect calls, which obligate U.S. carriers to remit payments 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; and the average length of calls, which tends to be longer for calls originating in the United States.

The simultaneous declines in import and export figures stem from significant reductions in settlement rates, which the Federal Communications Commission (FCC) moved to lower with its 1997 Benchmark Order.<sup>5</sup> The order established a five-year timeframe during which settlement rates would be reduced to \$0.15 per minute for upper income countries, \$0.19 per minute for middle income countries, and \$0.23 per minute for lower income countries.<sup>6</sup> During the first year of the staged reductions, which commenced January 1, 1998, the average settlement rate declined by 18

<sup>4</sup> U.S. Department of Commerce (USDOC), Bureau of Economic Analysis (BEA), *Survey of Current Business*, Oct. 1999, pp. 64-65.

<sup>5</sup> FCC, *Benchmark Order*, 12 FCC Rcd 19,806 (1997).

<sup>6</sup> *Ibid.*

percent, from \$0.43 per minute to \$0.35 per minute.<sup>7</sup> Imports likely decreased more slowly than exports because of the continued popularity of services such as call-back<sup>8</sup> and country direct services,<sup>9</sup> which appear as outbound U.S. calls for accounting purposes.

Mexico, Canada, the United Kingdom, Japan, and Brazil are the top five export markets for U.S. telecommunication services (figure 19-2). Although U.S. exports of telecommunication services to Mexico declined by 2 percent to \$441 million in 1998, Mexico remained the United States' largest export market. Canada and the United Kingdom exchanged places on the top-five list, as exports to Canada fell by only 2 percent to \$293 million, while exports to the United Kingdom decreased by 26 percent to \$262 million. Japan maintained the number 4 position on the top-five list, with \$216 million. Additionally, Brazil replaced China on the top-five list, as exports to Brazil increased by 14 percent to \$127 million. Representing 14 percent of all telecommunication services imports, Mexico continues to be the top recipient of U.S. settlement payments, measuring \$1.1 billion in 1998. Canada, China, Japan, and India received payments of \$333 million, \$325 million, \$319 million, and \$311 million, respectively.<sup>10</sup>

## *Affiliate Transactions, 1992-97*

In 1997, sales of services by foreign-based telecommunication affiliates of U.S. firms generated revenues of \$8.8 billion (figure 19-3). This represents a 39-percent increase over 1996, significantly higher than the 13-percent average annual rate of growth registered during 1992-96. The jump in affiliate sales is attributable to the continuing privatization and liberalization of foreign telecommunication markets, which enables U.S. firms to establish affiliates in new markets.<sup>11</sup> The United Kingdom continues to be the largest foreign market for affiliate sales, accounting for 29 percent of all sales by U.S.-owned telecommunication affiliates (figure 19-4). Sales to the United Kingdom increased by 46 percent, from \$1.8 billion in 1996 to \$2.6 billion in 1997. Data on total sales of services by U.S.-based telecommunication affiliates of foreign parents<sup>12</sup> were suppressed by BEA in order to

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<sup>7</sup> FCC, *Report on International Telecommunications Markets, 1997-1998*, Dec. 7, 1998.

<sup>8</sup> Call-back services enable a customer outside the United States to call an assigned U.S. telephone number and thereby receive a computer-driven, return call with a U.S. dial tone from a U.S. call-back firm. The customer may then place a call to the desired destination at a rate substantially less than that charged for calling directly.

<sup>9</sup> Country direct services provide a customer in a foreign location with access to a U.S. carrier for the purpose of placing calls to the United States or foreign destinations.

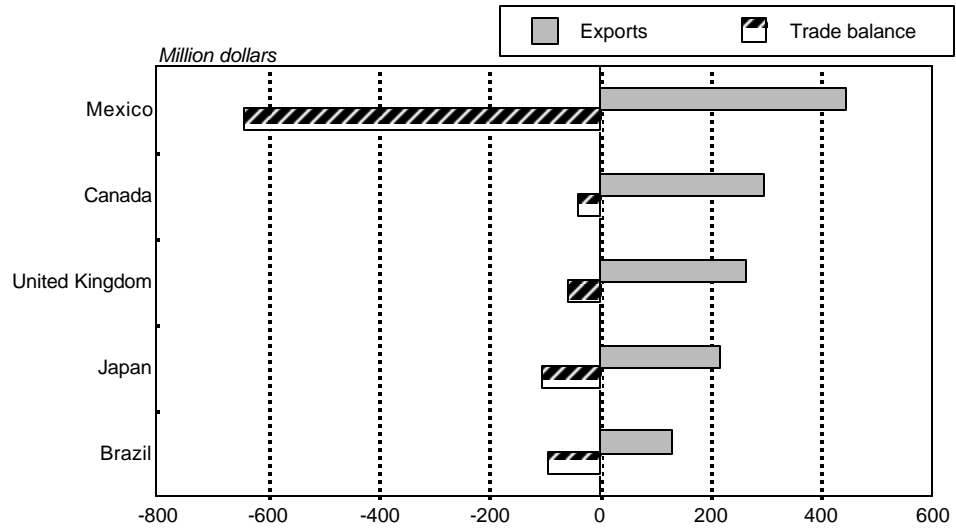
<sup>10</sup> USDOC, BEA, *Survey of Current Business*, Oct. 1999, pp. 82-83.

<sup>11</sup> Pekka Tarjanne, "Preparing for the Next Revolution in Telecommunications: Implementing the WTO Agreements", *Telecommunications Policy*, vol. 23, No. 1 (1999).

<sup>12</sup> BEA reported data on 1997 affiliate purchases using the NAICS (North American Industry Classification System), not the SIC (Standard Industrial Classification) system used to report 1997 affiliate sales data and all affiliate transactions data prior to 1997. As a result, it is not feasible to calculate an analytically sound affiliate transactions balance or the growth rate of affiliate purchases in 1997. For more information on the transition from the SIC to the

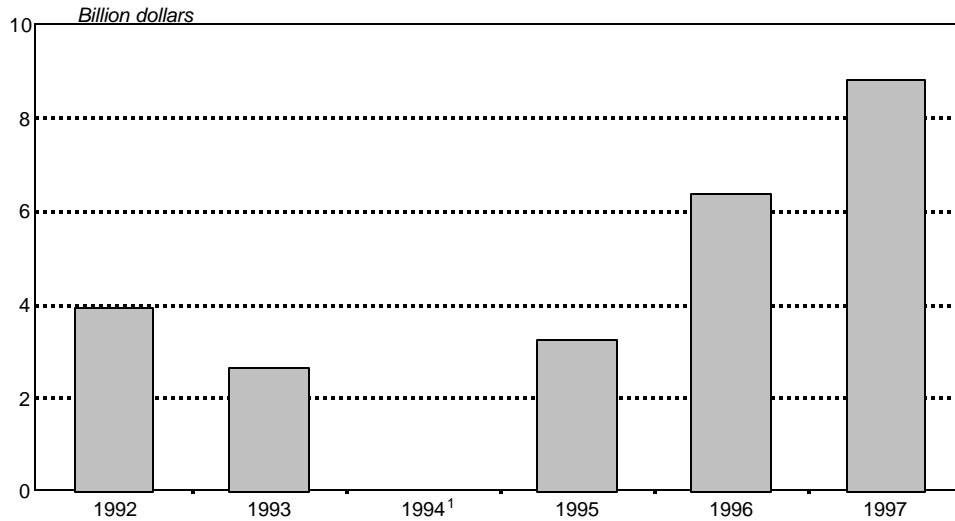
(continued...)

**Figure 19-2**  
**Telecommunication services: U.S. cross-border exports and trade balance, by major trading partners, 1998**



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, p. 91.

**Figure 19-3**  
**Telecommunication affiliates: Sales of services by majority-owned affiliates of U.S. firms, 1992-97**



<sup>1</sup> Not available.

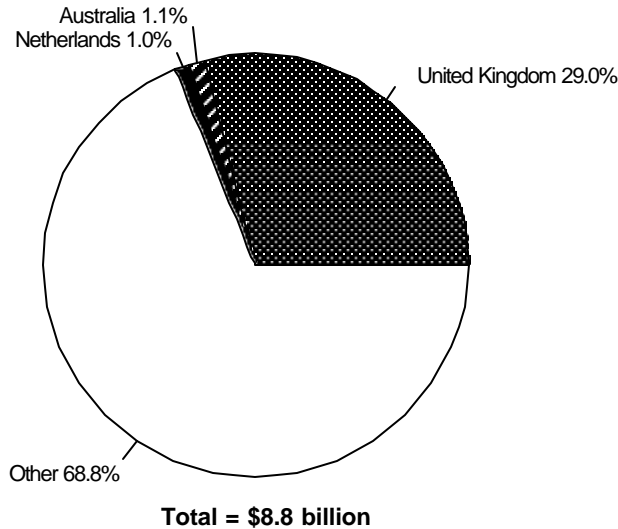
Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, p. 93.

<sup>12</sup> (...continued)

NAICS, see text box 2-1.



**Figure 19-4**  
**Telecommunication affiliates: Sales by majority-owned affiliates of U.S. firms, by principal markets, 1997<sup>1</sup>**



<sup>1</sup> Total may not equal 100 percent due to rounding.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, p. 93.

avoid disclosure of individual company data. However, available data indicate that sales by U.S. affiliates of British parents measured \$1 billion, representing 84 percent of the EU total, and that sales by U.S. affiliates of Canadian companies measured \$378 million.<sup>13</sup>

## Summary and Outlook

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In 1998, U.S. exports of telecommunication services declined by 7 percent while imports fell by 3 percent, largely as a result of a continuing decline in calling fees. Overall, international calling volume continued to rise due to lower accounting rates, lower calling fees, and greater market access. Affiliate sales grew significantly in 1997, as U.S. companies continued to benefit from liberalization initiatives in foreign markets.

Rapid technological advancements, changing customer demand, and the continuing liberalization of foreign markets will likely continue to drive growth in the U.S. telecommunication services industry.<sup>14</sup> Telecommunication companies' utilization of

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<sup>13</sup> USDOC, BEA, *Survey of Current Business*, Oct. 1999, pp. 93-95.

<sup>14</sup> Industry representative, telephone interview by USITC staff, Oct. 1, 1999.

advanced technology, such as fiber optic cables<sup>15</sup> and Internet Protocol (IP),<sup>16</sup> has resulted in the development of high-speed networks capable of transmitting voice, video, and data simultaneously.<sup>17</sup> As these networks develop, the digitization<sup>18</sup> of information will likely encourage the convergence of traditional voice telephony with computing and media services,<sup>19</sup> and allow telecommunication carriers to bundle such services together for their customers.<sup>20</sup> In an effort to capitalize on the growing market for integrated services, AT&T spent \$110 billion during 1998 and 1999 to acquire cable companies TCI and MediaOne.<sup>21</sup> According to AT&T, these acquisitions will allow it to offer voice telephony and Internet services via cable, potentially providing their customers with a single bill for telephone, cable television, and Internet services.<sup>22</sup> Similarly, on October 19, 1999, SBC Communications announced its plan to invest \$6 billion to construct fiber-optic networks in the U.S. regions it serves.<sup>23</sup> SBC, together with its strategic partner Williams Communications, Inc., intends to provide end-to-end voice, data, and video services over its networks. Early efforts to provide integrated services in the United States may better enable U.S. firms to provide these services abroad.

In addition to bundled services, business customers are creating demand for transborder service suppliers.<sup>24</sup> With such services, a U.S. multinational company would deal with one telecommunication service provider for all of its needs. This has prompted a series of international alliances, such as AT&T's global joint venture with British Telecom, in which the two companies will invest in an IP-based network spanning more than 100 cities worldwide. The planned venture will likely reduce telecommunication costs and expand services for its multinational customers, which include CitiGroup, Merrill Lynch, and American Express.<sup>25</sup>

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<sup>15</sup> Fiber optic cables are glass cables that use beams of light to carry information. Fiber optic cables are able to transmit more information over greater distances than copper cable. Harry Newton, *Newton's Telecom Dictionary* (New York: Telecom Books, Feb. 1999) pp. 319-320.

<sup>16</sup> Internet Protocol (IP) is network communication language that controls the routing of data over the Internet.

<sup>17</sup> The Economist Intelligent Unit (EIU), *Vision 2010: New Strategies for Communications Enterprises*, report published in cooperation with Andersen Consulting, 1999, p. 4.

<sup>18</sup> Digitization is the process by which data is transformed into bits represented by "1s" and "0s" for electronic transmission.

<sup>19</sup> Tarjanne, "Preparing for the Next Revolution in Telecommunications."

<sup>20</sup> Reportedly, consumers will likely prefer the convenience of bundled services, as it will allow consumers to pay one bill each month for local, long distance, and cellular telephone service; Internet access; and cable television. EIU, *Vision 2010*, p. 7.

<sup>21</sup> Dave Lindorff, "The Next Wave," *The Investment Dealers' Digest*, New York, Oct. 4, 1999, found at Internet address <http://proquest.umi.com/>, retrieved Nov. 8, 1999.

<sup>22</sup> Ibid.

<sup>23</sup> SBC Communications, "SBC launches \$6 billion initiative," press release, Oct. 18, 1999, found at Internet address [http://www.sbc.com/project\\_pronto/home.html](http://www.sbc.com/project_pronto/home.html), retrieved Nov. 4, 1999.

<sup>24</sup> Ibid.

<sup>25</sup> Monica Simms, "AT&T Takes on the New World Order," *Wall Street & Technology*, Oct. 1999, found at Internet address <http://proquest.umi.com/>, retrieved Nov. 8, 1999.

The WTO's Agreement on Basic Telecommunications,<sup>26</sup> the European Union's (EU) unilateral decision to open its telecommunication markets to competition, and Japan's decision to fully liberalize its telecommunication market demonstrate the spread of competition throughout the world.<sup>27</sup> Since liberalizing, the European telecommunication market has become increasingly competitive, forcing European carriers to invest in new markets both within and outside their country's borders in order to ensure their profitability and survival. In August 1999, SwissCom announced its intention to purchase 50 percent of Germany's Debitel, a telecommunication reseller with 3.8 million customers throughout Western Europe. SwissCom has already formed joint ventures in Italy, Austria, France, and Germany, and expects the proportion of revenues generated outside its home market to increase significantly as a result.<sup>28</sup> More recently, German conglomerate Mannesmann AG and British wireless telecommunications firm Vodafone AirTouch PLC agreed to merge in a deal valued at \$180 billion. The combined company would become the largest wireless operator in the world, with wireless operations in 25 countries.<sup>29</sup>

Deregulation and liberalization of the world's telecommunication markets will likely benefit U.S. service providers that possess the financial and technological resources necessary to invest in new markets. The growing demand for broadband services in the \$200-billion European market has motivated U.S. companies to increase their investments in the region. MCI WorldCom, Inc., for example, is spending \$1 billion a year to lay fiber-optic cable in Europe.<sup>30</sup> Additionally, Microsoft Corp. reportedly wants to invest in Germany's cable television market,<sup>31</sup> and Denver-based Qwest Communications has combined with Dutch communications company KPN to provide Internet links across Europe.<sup>32</sup> In Central and South America, U.S. regional

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<sup>26</sup> The WTO's Agreement on Basic Telecommunications became effective on February 5, 1998. As a result, the United States and 71 of its trading partners agreed to bind market liberalizing commitments, thereby providing foreign service providers 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. Together those participating in the agreement represent 91 percent of global telecommunication service revenue.

<sup>27</sup> On January 1, 1998, the European Union opened its telecommunication markets to competition, and in 1997, the Japanese Diet passed legislation that would liberalize its telecommunication market. The EU's WTO commitments mirror what was accomplished through the implementation of the EU's Telecommunications Policy, and Japan was one of the first governments to ratify the WTO treaty protocol.

<sup>28</sup> Candi Harper, "Swisscom Moves on 'Heart of Europe' Strategy," *Telecommunications*, Aug. 1999, found at Internet address <http://www.proquest.umi.com/>, retrieved Nov. 9, 1999.

<sup>29</sup> "Vodafone, Mannesmann Reach Agreement on \$180 Billion Friendly Deal," *Dow Jones Business News*, Feb. 3, 2000.

<sup>30</sup> Stephen Baker, Jack Ewing, and Kerry Capell, "The Race to Wire Europe," *Business Week*, June 7, 1999, found at Internet address <http://www.proquest.umi.com/>, retrieved Nov. 9, 1999.

<sup>31</sup> *Ibid.*

<sup>32</sup> "KPN and Qwest to Form Europe's Biggest Traffic Network," *International Financial Law Review*, Jan. 1999, found at Internet address <http://www.proquest.umi.com/>, retrieved

(continued...)

telephone provider BellSouth is investing in local telecommunication providers. By co-branding its services with local providers, BellSouth aims to develop strong relationships with those companies, while benefitting from their local knowledge and abilities.<sup>33</sup>

Reportedly, the growth of electronic commerce will encourage the convergence of voice and data services, as U.S. telecommunication companies respond to increasing demand for data services by investing in IP technologies.<sup>34</sup> For example, Sprint recently announced plans to spend \$400 million on upgrading its network to transmit packet switched data via the Internet.<sup>35</sup> Some observers warn, however, that bandwidth limitations may delay the rapid rollout of IP-based services. In the near term, it is expected that IP will have a greater impact on communication services that are less time sensitive, such as fax, voice mail, and paging.<sup>36</sup> Further, the transition to IP-based networks may contribute to the global reduction in settlement rates, encouraging carriers to adopt a flat rate system.<sup>37</sup>

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<sup>32</sup> (...continued)

Nov. 9, 1999.

<sup>33</sup> Liane Labarbe, "Love and War in Latin America," *Telephony*, Oct. 4, 1999, found at Internet address <http://www.proquest.umi.com/>, retrieved Nov. 9, 1999.

<sup>34</sup> Industry representative, telephone interview by USITC staff, Oct. 12, 1999.

<sup>35</sup> EIU, *Vision 2010*, p. 5.

<sup>36</sup> Ibid.

<sup>37</sup> Ibid.

# CHAPTER 20

## TRAVEL AND TOURISM SERVICES

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### Introduction

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Trade in travel and tourism services encompasses expenditures made by travelers while in another country, such as for lodging and meals. Foreign visitors' expenditures in the United States are recorded in the U.S. balance of payments as exports, while U.S. residents' expenditures abroad are recorded as 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 air transport services. Travel and tourism services are traded mainly through cross-border channels, although transactions also transpire through affiliates.

### Recent Trends

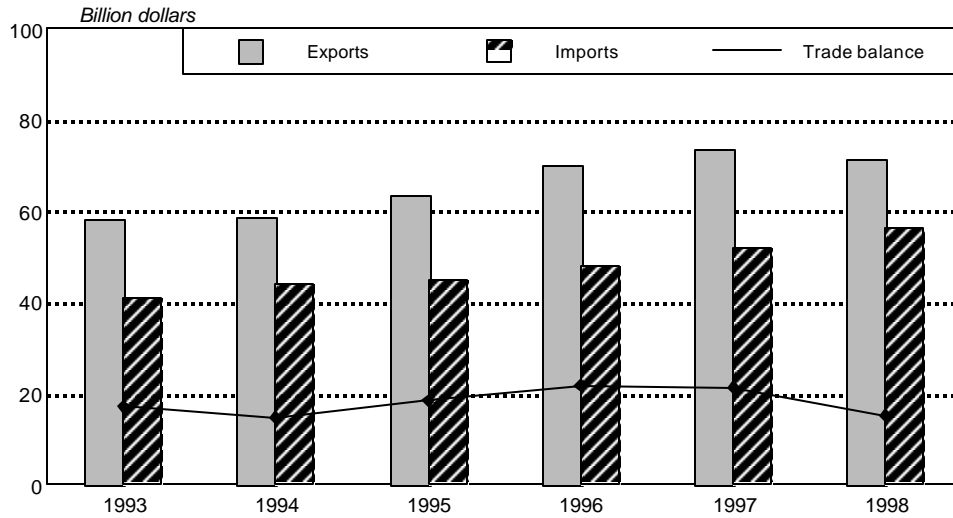
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#### *Cross-Border Trade, 1993-98*

In 1998, the United States earned \$71.3 billion from cross-border travel and tourism exports (figure 20-1), representing 29 percent of total U.S. service exports. Cross-border exports of travel and tourism services declined by 3 percent in 1998, a reversal from the 6 percent average annual growth rate recorded during 1993-97. Conversely, cross-border imports grew by 8 percent to \$56.1 billion in 1998, slightly faster than the 6-percent average annual increase registered in 1993-97. The resulting U.S. surplus declined by 29 percent to \$15.1 billion in 1998, in sharp contrast to the 6-percent average annual growth rate recorded during 1993-97.

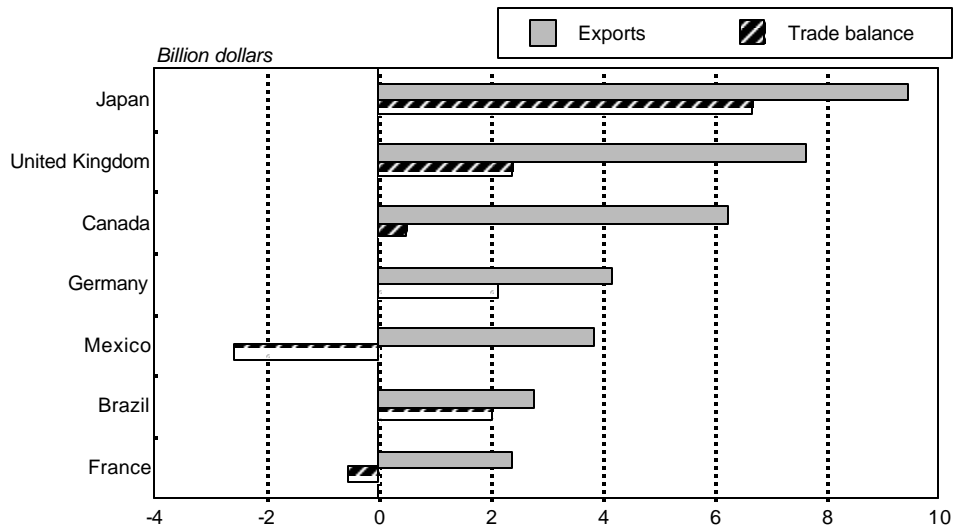
Visitors from Japan, the United Kingdom, Canada, Germany, Mexico, Brazil, and France, ranked in descending order by expenditures in the United States, accounted for slightly more than one-half of U.S. cross-border travel and tourism exports in 1998 (figure 20-2). The United States recorded a travel and tourism surplus with all of these countries except Mexico and France. Japan accounted for \$6.7 billion, or 44 percent, of the U.S. surplus in such services. However, the U.S. travel and tourism trade surplus with Japan fell by 17 percent, reversing the 5-percent average annual growth rate registered during 1993-97. This decline is likely a result of Japan's recession and the U.S. dollar's strength against the yen. Arrival data indicate that the

**Figure 20-1**  
**Travel and tourism services: U.S. cross-border exports, imports, and trade balance, 1993-98**



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, pp. 64-65.

**Figure 20-2**  
**Travel and tourism services: U.S. cross-border exports and trade balance, by major trading partners, 1998**



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, p. 71.

number of visitors from Japan decreased by approximately 9 percent in 1998.<sup>1</sup> The U.S. travel and tourism surplus with Canada decreased dramatically, by 75 percent in 1998.<sup>2</sup> The number of Canadian travelers to the United States in 1998 was at the lowest level in the past decade, a consequence of the less favorable exchange rate between the Canadian and U.S. dollars.<sup>3</sup> U.S. travel and tourism trade with the United Kingdom expanded in 1998, with both exports and imports climbing upward, and the surplus increasing by 2 percent. The number of visitors from the United Kingdom, in contrast to the number of Japanese and Canadian visitors, increased by 7 percent.<sup>4</sup> In 1998, the United States recorded a \$2.6-billion deficit with Mexico, slightly less than the \$3-billion deficit recorded in 1997. The last U.S. travel and tourism surplus with Mexico was recorded in 1992. Reduction of the deficit resulted from an 11-percent increase in U.S. exports, to \$3.8 billion, and a 1-percent decrease in imports, to \$6.4 billion. Overall, the number of U.S. visitors traveling abroad exceeded the number of arrivals in 1998. Mexico, Canada, the United Kingdom, France, Japan, and Italy, ranked in descending order, were the top six recipients of U.S. travel expenditures.<sup>5</sup>

## *Affiliate Transactions, 1992-97*

Travel and tourism services are also sold through 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 \$3.3 billion in 1997, up 16 percent from 1996 (figure 20-3).<sup>6</sup> This increase was higher than the 8-percent average annual growth rate registered during 1992-96. The relatively high growth rate recorded in 1997 may reflect, in part, a series of acquisitions of foreign lodging companies by U.S. companies. Data for 1997 indicate that the U.S. affiliate sales were highest in Canada, the United Kingdom, Australia, France, and Germany, respectively (figure 20-4). Purchases of travel and tourism services by U.S. persons from U.S.-based affiliates of foreign firms totaled \$13.5 billion in 1997. Japan and

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<sup>1</sup> U.S. Department of Commerce (USDOC), International Trade Administration (ITA), "Forecast for International Travel," Oct. 1999, chart 2, found at Internet address <http://tinet.ita.doc.gov/>, retrieved Oct. 29, 1999.

<sup>2</sup> USDOC, ITA, "Canadian Travel to the U.S. and Forecast, Presentation - 1998," found at Internet address <http://tinet.ita.doc.gov/>, retrieved Sept. 9, 1999.

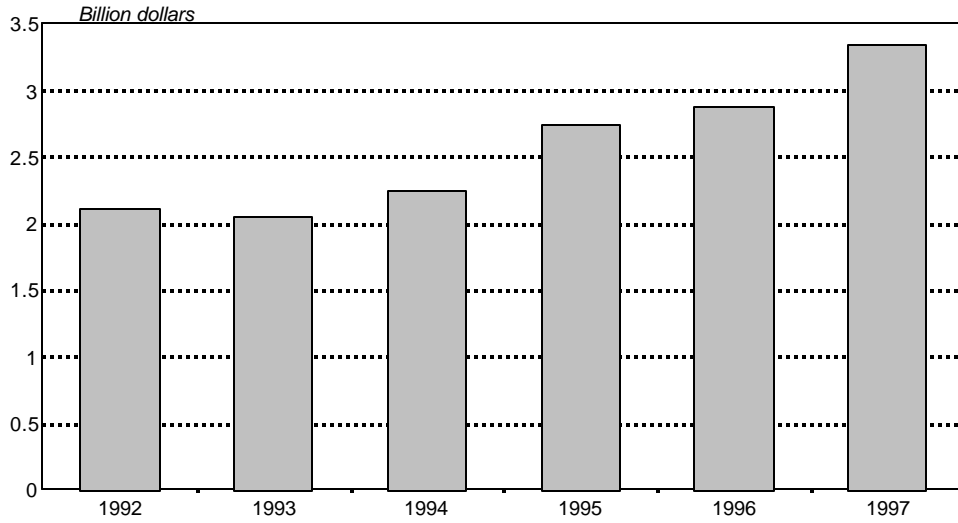
<sup>3</sup> *Ibid.*, charts 12 & 14.

<sup>4</sup> USDOC, ITA, "Forecast for International Travel," chart 2.

<sup>5</sup> USDOC, ITA, "Forecast for International Travel," chart 10; and USDOC, Bureau of Economic Analysis (BEA), "Travel, Passenger Fares, and Other Transportation, 1998," *Survey of Current Business*, Oct. 1999, p. 71.

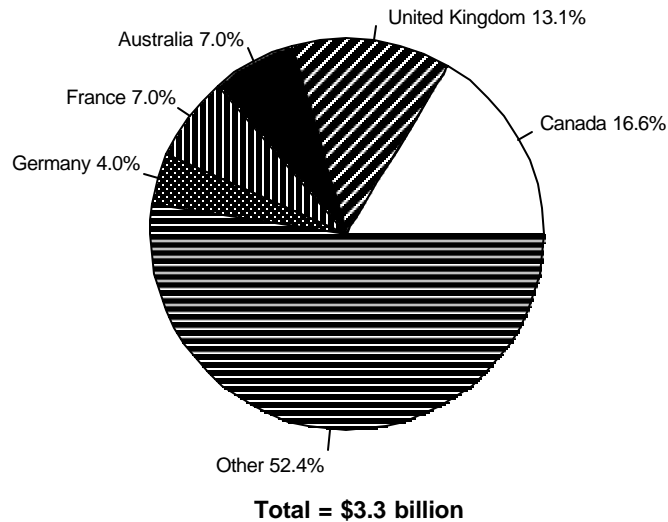
<sup>6</sup> BEA reported data on 1997 affiliate purchases using the NAICS (North American Industry Classification System), not the SIC (Standard Industrial Classification) system used to report 1997 affiliate sales data and all affiliate transactions data prior to 1997. As a result, it is not feasible to calculate an analytically sound affiliate transactions balance or the growth rate of affiliate purchases in 1997. For more information on the transition from the SIC to the NAICS, see text box 2-1.

**Figure 20-3**  
**Travel and tourism affiliates: Sales of services by majority-owned affiliates of U.S. firms, 1992-97**



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, p. 93; Oct. 1998, p. 115; Oct. 1997, p. 137; Nov. 1996, p. 111; and Sept. 1995, p. 104.

**Figure 20-4**  
**Travel and tourism affiliates: Sales by majority-owned affiliates of U.S. firms, by principal markets, 1997<sup>1</sup>**



<sup>1</sup> Total may not equal 100 percent due to rounding.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, p. 93.



Europe each accounted for approximately one-third of U.S. affiliate purchases of travel and tourism services (figure 20-5).<sup>7</sup>

## Summary and Outlook

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In 1998, the United States experienced the third decline in its cross-border travel surplus since 1988. Bilateral surpluses with Japan and Canada decreased most, which may have resulted from the continuing Asian recession and the decreased value of the Canadian dollar against the U.S. dollar. A slight increase in exports was forecast for 1999. Preliminary estimates for 1999 are that the number of Mexican visitors likely increased by 1.4 percent, the number of Canadians by 1.8 percent, and the number of Europeans by 1.8 percent. The number of Asian visitors likely experienced a decline of approximately 0.3 percent in 1999, but this is far less than the 19-percent decline in the number of Asian visitors recorded in 1997.<sup>8</sup>

Forecasts for the pace of international growth in the travel and tourism services industry vary, depending on the geographic region and sub-sector in question. Industry sources predict aggressive U.S. investment in the European lodging industry, but a cautious approach to investment in the Asia/Pacific region.<sup>9</sup> Continued rapid expansion of time-shares in lodging and franchising of restaurants is also forecast.<sup>10</sup> Eco-tourism<sup>11</sup> also appears to be an area of increasing interest in the tourism market.<sup>12</sup>

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<sup>7</sup> Data on affiliate purchases of travel and tourism services from Canada, France, and the Netherlands were suppressed by BEA in order to avoid disclosure of individual company data.

<sup>8</sup> USDOC, ITA, "Forecast for International Travel," chart 1.

<sup>9</sup> Frank H. Andorka Jr., "Hot Global Markets," *Hotel and Motel Management*, Aug. 11, 1997, p. 87; Maria P. Vallejo, "Cendant Eyes Euro Expansion of HoJo, Days Inn," *Business Travel News*, Mar. 8, 1999, p. 10; and "Financial Crisis Dampens Global Development Plans," *Business Travel News*, Sept. 14, 1998, pp. 21-22.

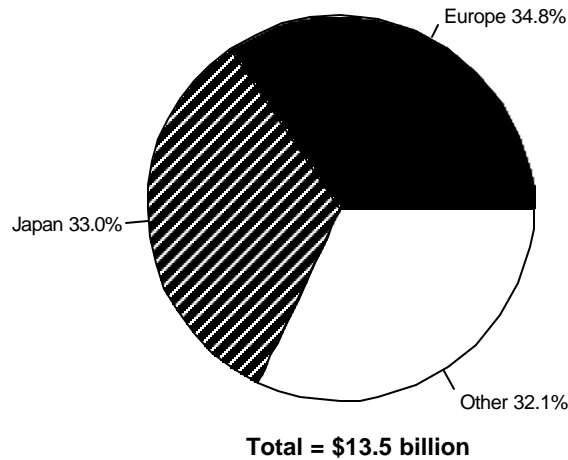
<sup>10</sup> USDOC, "Hotel Management and Operations: An Industry Policy Roundtable," industry discussion, Sept. 22, 1999; and Roberta Maynard, "Why Franchisors Look Abroad," *Nation's Business*, Oct. 1995, p. 65; Ben Van Houten, "Harvest Time," *Restaurant Business*, Aug. 15, 1997. Time-shares are linked sets of properties in different locations. The owner of a particular property can exchange usage of it for a temporary period for the use of another property, or rent the property out. The exchange or rental is usually coordinated by a management company.

<sup>11</sup> Ecotourism is defined as organized travel to cultural sites, historical sites, or sites of natural beauty which causes little or no environmental damage to those locations. Ercan Sirakaya, Vinod Sasidharan, and Sevil Sonmez, "Redefining Ecotourism: The Need for a Supply-Side View," *Journal of Travel Research*, Nov. 1999, found at Internet address <http://www.proquest.umi.com/>, retrieved Feb. 2, 2000.

<sup>12</sup> Harry Maurer and Elisabeth Malkin, "Betting on the Eco-Tourism Craze...and on Adventure Travel, Too," *Business Week*, Mar. 1, 1999, found at Internet address <http://www.proquest.umi.com/>, retrieved Oct. 13, 1999; and Glenn Withiam, "Ecotourism Begins at Home," *Cornell Hotel and Restaurant Quarterly*, Oct. 1998, found at Internet

(continued...)

**Figure 20-5**  
**Travel and tourism affiliates: Purchases from majority-owned affiliates of foreign firms, by country of ultimate beneficial owner,<sup>1</sup> 1997<sup>2</sup>**



<sup>1</sup> 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.

<sup>2</sup> Total may not equal 100 percent due to rounding.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, p. 95.

Trends observed in the travel and tourism industry include liberalization, international consolidation, and reorientation due to the advent of electronic commerce. The negotiation of "open skies agreements" liberalizing a number of overseas air transportation markets may lead to decreases in the price of air fares which, in turn, may lead to increases in overseas tourism. The agreements signed in 1999 continue a trend toward greater openness in the global air transportation sector. Argentina, Bahrain, the Dominican Republic, Pakistan, Portugal, Qatar, Tanzania, and the United Arab Emirates signed open skies agreements with the United States, while China, Mexico, and Russia signed more limited liberalization agreements.<sup>13</sup>

Many mergers, acquisitions, and joint ventures were undertaken in the travel service, food service, and lodging industries in 1998 and 1999, both in domestic and international markets. The trend in mergers and acquisitions accelerated rapidly from the level of activity in 1997.<sup>14</sup> For example, U.S.-owned Host Marriott Services was acquired by Italian catering company AutogrillSpA for \$530 million in August 1999, thus creating the largest travel concessionaire in the world. Bass, a British hospitality firm, purchased Inter-Continental from the Japan-based Saison

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<sup>12</sup> (...continued)

address <http://www.proquest.umi.com/>, retrieved Oct. 13, 1999.

<sup>13</sup> For more information on recent open skies agreements, see ch. 5 of this report.

<sup>14</sup> Marty Whitford, "Top 100 Hotel Companies," *Hotel and Motel Management*, Sept. 21, 1998, found at Internet address <http://www.proquest.umi.com/>, retrieved Oct. 26, 1998.

Group in 1998 for \$2.9 billion.<sup>15</sup> Accor Company of France, owners of Motel 6, acquired U.S. franchise Red Roof Inns in 1999 for \$1.1 billion. The deal made Accor the third-largest owner of guest rooms in the world, behind New York-based Cendant and Bass, and ahead of Marriott and U.S.-based Best Western.<sup>16</sup> Other recent acquisitions within the U.S. market include Starwood Hotels & Resorts' purchase of ITT Sheraton in early 1998, and Hilton's purchase of Promus Hotels in 1999 for a reported \$4 billion. Industry analysts report that consolidation within the lodging industry allows firms to take advantage of greater economies of scale with regard to marketing and cross-selling products from different divisions.<sup>17</sup>

The advent of electronic commerce appears to have important implications for the future of the travel and tourism industry. The easy accessibility of on-line price information, map programs, and other tourism information has affected the way in which travel and tourism services are supplied. One industry source estimates that 19 million U.S. households conducted on-line travel research in 1998, while 5 million households booked reservations online.<sup>18</sup> Most major airlines and travel agencies now engage in online ticket sales, thus reducing the transaction costs included in ticket prices.<sup>19</sup> Online booking was expected to account for at least 4 percent of airline travel in 1999, continuing the steady increase from 0.5 percent in 1996. In fact, in combination with price caps by airlines, cruise lines, and trains on travel agent commissions, online booking of tickets may have led to major declines in the profitability and number of travel agent firms. Between 1996 and 1998, the number of U.S. retail travel agents reportedly fell from 33,593 to 32,694. Moreover, those travel agents who remain in business will see their role in the travel and tourism industry change. Specifically, travel agents may become more

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<sup>15</sup> Bill Carlino, "Autogrill SpA to Acquire Host Marriot Services," *Nation's Restaurant News*, Aug. 2, 1999, found at Internet address <http://www.proquest.umi.com/>, retrieved Sept. 14, 1999; "Year in Review," *Travel Weekly*, vol. 58, No. 1, sec. 1, Dec. 31, 1998-Jan. 4, 1999, pp. 1, 4, 5; and Grant Flowers, "Promus Buy Will Provide Hilton with New Markets and Brands," *Travel Weekly*, vol. 58, No. 73, sec. 1, Sept. 13, 1999, p. 1.

<sup>16</sup> Marty Whitford, "Red Roof Purchase to Propel Accor to No. 3 in Guestrooms Worldwide," *Hotel and Motel Management*, Aug. 1999, found at Internet address <http://www.proquest.umi.com/>, retrieved Sept. 29, 1999.

<sup>17</sup> Megan Rowe, "Is Bigger Better?" *Lodging Hospitality*, Apr. 1999, found at Internet address <http://www.proquest.umi.com/>, retrieved Sept. 16, 1999.

<sup>18</sup> Forrester Research, as cited in "Facts Machine: Travel," chart, *Red Herring*, No. 71, Oct. 1999, p. 35.

<sup>19</sup> Passenger carriers achieve a cost savings of nearly 75 percent each time they sell a ticket through a proprietary Internet site rather than through a travel agent. Perry Flint, "Alliance Paradox," *Air Transport World*, Apr. 1999, p. 34.

specialized providers of information regarding the quality and booking of complex tourist packages.<sup>20</sup>

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<sup>20</sup> Michael Utley, "Travel Agents Forced to Find New Ways to Retain Market Share," *The Press-Enterprise*, Aug. 21, 1999, found at Internet address <http://today.newscast.com/>, retrieved Sept. 13, 1999; William H. Miller, "Airlines Take to the Internet," *Industry Week*, Aug. 16, 1999, found at Internet address <http://www.proquest.umi.com/>, retrieved Sept. 13, 1999; Stacy Collet, "United Plans Full-Service Travel Site," *Computerworld*, July 26, 1999, found at Internet address <http://www.proquest.umi.com/>, retrieved Sept. 14, 1999; "Year in Review," *Travel Weekly*; David J. Wardell, "The Impact of Electronic Distribution on Travel Agents," *Travel & Tourism Analyst*, No. 2, 1998; "Survey: Personal Relationships Outweigh Emerging Technologies," *Travel Weekly*, vol. 58, No. 69, Aug. 30, 1999, p. 1; and Scott McCartney, "Airlines Lift Rates on Leisure Fares, Pare Commissions," *Wall Street Journal*, Oct. 12, 1999.

# CHAPTER 21

## WHOLESALE SERVICES

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### Introduction

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Wholesalers serve as intermediaries, purchasing merchandise from manufacturers that they subsequently resell to retailers. Frequently established by parent manufacturing concerns, wholesaling affiliates also act as representatives of the parent in foreign markets. In addition, wholesaling affiliates are often active in licensing patents and trademarks to foreign retailers in exchange for royalties and license fees (see discussion of intangible intellectual property, chapter 15). The majority of wholesaling transactions take place through foreign-based affiliates. For this reason, data collection agencies focus solely on such 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, 1992-97

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In 1997, sales of wholesale services by foreign-based affiliates of U.S. firms totaled \$14.8 billion, representing 6 percent of total U.S. sales of services through affiliates (figure 21-1). Sales of wholesaling services declined by 2 percent in 1997, slightly slower than the average annual decline of 3 percent recorded during 1992-1996. Depreciation of European and Asian currencies against the dollar appears to explain the decrease in sales of wholesaling services in these markets, while slower economic growth in other key markets largely explains the overall decline.<sup>1</sup> In 1997, sales of wholesaling services declined by 29 percent in Japan, 19 percent in the Netherlands, 17 percent in Germany, and 15 percent in France.<sup>2</sup> These countries are key markets for U.S. sales of wholesaling services, representing 18 percent of such

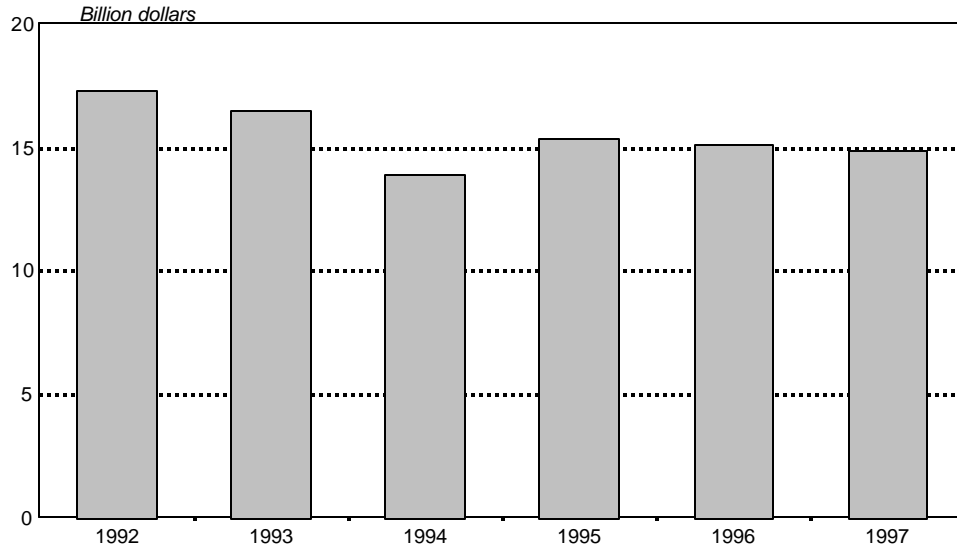
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<sup>1</sup> U.S. Department of Commerce (USDOC), Bureau of Economic Analysis (BEA), *Survey of Current Business*, July 1999, p. 21. In 1997, the Japanese yen declined by 11 percent against the U.S. dollar, while the Dutch guilder depreciated 16 percent, the German mark depreciated 15 percent, the French franc depreciated 14 percent, the Canadian dollar depreciated 2 percent, the British pound depreciated 5 percent, the Brazilian real depreciated 7 percent, and the Venezuelan bolivar depreciated 17 percent. Federal Reserve, "Foreign Exchange Rates (Annual)," statistical release, Jan. 4, 1999, found at Internet address <http://www.bog.frb.fed.us/>, retrieved Dec. 16, 1999.

<sup>2</sup> USDOC, BEA, *Survey of Current Business*, Oct. 1999, p. 93.

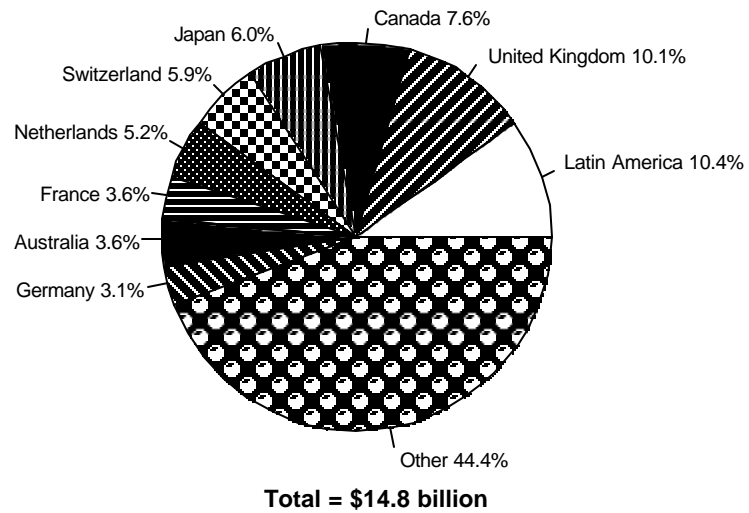
sales in 1997 (figure 21-2). However, other trading partners demonstrated robust

**Figure 21-1**  
**Wholesale affiliates: Sales of services by majority-owned affiliates of U.S. firms, 1992-97**



Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, p. 93.

**Figure 21-2**  
**Wholesale affiliates: Sales by majority-owned affiliates of U.S. firms, by principal markets, 1997<sup>1</sup>**



<sup>1</sup> Total may not equal 100 percent due to rounding.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Oct. 1999, p. 93.

growth. In 1997, sales in Latin America grew by 90 percent, sales in the United Kingdom by 18 percent, and sales in Canada by 3 percent. Strong economic growth in these markets seems to have wholly offset the effects of currency depreciation. In the case of Latin America, economic growth of 5.4 percent,<sup>3</sup> coupled with demand for professional and commercial equipment, led to strong sales of wholesaling services. In addition, U.S. firms established 55 new wholesaling affiliates in various markets in 1997, which likely muted the effects of the overall decrease in global sales of wholesaling services.

Purchases of wholesale services from U.S. affiliates of foreign firms totaled \$12.1 billion in 1997, representing 6 percent of total purchases of services through such affiliates.<sup>4</sup> U.S. residents purchased services valued at \$5.2 billion from foreign-owned wholesalers of motor vehicles and parts, while they purchased services valued at \$1.8 billion from wholesalers of professional and commercial equipment and supplies. U.S.-based wholesaling affiliates with parents in Japan, the United Kingdom, and Germany accounted for most purchases of wholesaling services by U.S. residents (figure 21-3). Japanese-owned affiliates accounted for \$4.8 billion, or 40 percent, of all wholesaling services purchased from U.S. affiliates of foreign firms; British-owned affiliates accounted for \$3 billion, or 25 percent; and German-owned affiliates accounted for \$2.4 billion, or 20 percent.

## Summary and Outlook

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In 1997, foreign-based wholesaling affiliates of U.S. firms recorded sales of \$14.8 billion, while U.S.-based wholesaling affiliates of foreign firms recorded sales of \$12.1 billion. U.S. manufacturers of professional and commercial equipment enjoy a strong competitive position in global markets, and foreign-based wholesaling affiliates of such firms will likely register increasing sales as their parent manufacturing firms continue to establish operations abroad. Wholesaling affiliates established by U.S. manufacturers of commercial equipment, including computers, computer peripherals, and medical equipment, are most active in foreign service markets. Markets outside the United States account for the majority of sales in the computer-based technology industry. Ingram Micro, MicroAge, and Tech Data, the three largest U.S. wholesalers of computers and computer related equipment and services, all have extensive international operations.<sup>5</sup>

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<sup>3</sup> United Nations, *World Economic and Social Survey, 1999*, (New York: United Nations, 1999), p. 35.

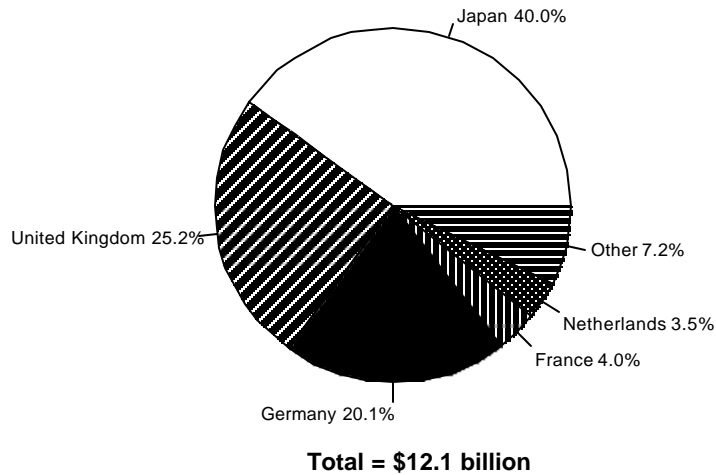
<sup>4</sup> BEA reported data on 1997 affiliate purchases using the NAICS (North American Industry Classification System), not the SIC (Standard Industrial Classification) system used to report 1997 affiliate sales data and all affiliate transactions data prior to 1997. As a result, it is not feasible to calculate an analytically sound affiliate transactions balance or the growth rate of affiliate purchases in 1997. For more information on the transition from the SIC to the NAICS, see text box 2-1.

<sup>5</sup> Ingram Micro, Inc., Form 10-K, found at Internet address <http://www.sec.gov/>, retrieved Sept. 21, 1999.





**Figure 21-3**  
**Wholesale affiliates: Purchases from majority-owned affiliates of foreign firms, by country of ultimate beneficial owner,<sup>1</sup> 1997<sup>2</sup>**



<sup>1</sup> 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.

<sup>2</sup> Total may not equal 100 percent due to rounding.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business* Oct. 1999, p. 95.

Sales of equipment and services by foreign-based wholesaling affiliates of U.S. firms are most influenced by economic growth, consumer demand, and currency fluctuations. U.S. firms are also affected by restraints on their ability to establish affiliates in foreign markets. In addition, foreign-based wholesaling affiliates may be restricted from selling certain products, sometimes because sales of such products are reserved for the state or state-controlled companies. Furthermore, restrictions on the foreign provision of related services, such as transportation, warehousing, and express delivery, hamper the operations of foreign-based wholesaling affiliates.<sup>6</sup>

While the overall number of wholesale firms is increasing, 50 percent of wholesale trade revenues are earned by only 1 percent of wholesale companies.<sup>7</sup> Consolidation between wholesalers is continuing, as large wholesale distributors who can capitalize on economies of scale, and pass on cost savings to the consumer, enjoy a favorable competitive position in global markets.<sup>8</sup> Wholesaling firms are actively acquiring distributors in foreign markets. For instance, Ingram Micro, a wholesale distributor of computer technology-based goods and services, purchased a majority share of Electronic Resources Ltd., a Singapore-based distributor, in February 1999.<sup>9</sup>

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<sup>6</sup> Organisation for Economic Co-operation and Development (OECD), Working Party of the Trade Committee, "Wholesale Trade Services," TD/TC/WP(99)18/REV1, June 4, 1999, pp. 17-19.

<sup>7</sup> Distribution Research and Education Foundation, *Facing the Forces of Change: Four Trends Reshaping Wholesale Distribution* (Washington, DC: Distribution Research and Education Foundation, 1998), p. 30.

<sup>8</sup> Tech Data Corp., Form 10-K, found at Internet address <http://www.sec.gov/>, retrieved Sept. 21, 1999.

<sup>9</sup> Ingram Micro, Inc., Form 10-K.

Similarly, strategic alliances among wholesalers are affording such firms access to new markets without establishing a new operation or acquiring another company.<sup>10</sup>

The Internet and other electronic technologies have driven noticeable change in the wholesaling industry. Business-to-business trading is expanding rapidly over the Internet, eliminating the need for certain intermediation services provided by wholesalers.<sup>11</sup> However, there are limits to disintermediation, since it is not cost effective for retailers to seek out direct relationships with all of their manufacturers.<sup>12</sup> Further, while some direct selling by manufacturers to retailers does occur, it is unlikely to strongly affect wholesalers that provide information and value-added services to their customers.<sup>13</sup> In fact, disintermediation resulting from the growth of electronic commerce has been moderate to date, and it is predicted that the impact is unlikely to exceed that caused by the growth of the mail order industry.<sup>14</sup>

Internet-based information technologies are promoting and facilitating supply chain integration. As a result, wholesalers are better able to predict demand and supply goods specifically targeted toward certain consumers. For example, Nissan's manufacturing plants are linked to its suppliers, enabling the company to customize its products for a consumer with minimal delay.<sup>15</sup> Like Nissan, Tech Data has developed a "virtual warehouse" through which consumers can customize orders, thus reducing their inventory.<sup>16</sup> Ingram Micro, on the other hand, has developed Impulse, an online system that provides computer resellers with low-cost purchasing, inventory, and support services.<sup>17</sup>

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<sup>10</sup> "NAW's New DREF Study Highlights Four Major Trends," *Supply House Times*, Dec. 1998, found at Internet address <http://proquest.umi.com/>, retrieved Sept. 21, 1998.

<sup>11</sup> OECD, "Wholesale Trade Services," p. 13.

<sup>12</sup> Sara Procknow, "Distribution Survival: Implement, Integrate Four Trends," Nov. 22, 1998, found at Internet address <http://www.manufacturing.net/>, retrieved Sept. 16, 1999.

<sup>13</sup> Distribution Research and Education Foundation, *Facing the Forces of Change: Four Trends Reshaping Wholesale Distribution*, p. 18.

<sup>14</sup> OECD, *The Economic and Social Impact of Electronic Commerce: Preliminary Findings and Research Agenda* (Paris: OECD, 1999)

<sup>15</sup> OECD, "Wholesale Trade Services," p. 14.

<sup>16</sup> Tech Data Corp., Form 10-K405.

<sup>17</sup> Ingram Micro, Inc., Form 10-K.

# **CHAPTER 22**

## **RENEWED SERVICES TRADE NEGOTIATIONS IN THE WTO**

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When the General Agreement on Trade in Services (GATS) entered into force on January 1, 1995, it broke new ground as the first multilateral, legally enforceable agreement covering trade and investment in services. The GATS establishes a framework of rules for trade in services and provides for commitments by individual countries to liberalize market access with respect to specific service sectors. However, the GATS framework does not fully address trade impediments that may result from a government's regulatory process, and specific commitments vary widely by country and largely just prevent countries from adopting more restrictive practices. Thus, the GATS did not bring about widespread liberalization of trade in services, but instead laid a foundation from which to proceed.

Recognizing that further work would be needed to liberalize trade in services, GATS signatories agreed that broad services trade liberalization would commence some five years later. The mechanism effecting this commencement is article XIX of the GATS framework, which reads as follows:

Members shall enter into successive rounds of negotiations, beginning not later than five years from the date of entry into force of the WTO Agreement, and periodically thereafter, with a view to achieving a progressively higher level of liberalization.

The inability of World Trade Organization (WTO) ministers to launch broad, multi-sector negotiations during the Seattle Ministerial meeting does not abrogate article XIX of the GATS. While it remains to be seen how enthusiastically new services negotiations will be pursued in the near term, negotiations nevertheless began in January 2000 with the ultimate objective being to achieve progressive liberalization of international trade in services.

### **GATS Structure**

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Structurally, the GATS may be divided into two major sections: a general framework and schedules of specific commitments (hereafter referred to as schedules), which are augmented by supplemental schedules, lists of exemptions to most-favored nation (MFN) treatment, and other annexes. The general framework

contains broad disciplines that apply to all service sectors.<sup>1</sup> These include obligations regarding MFN treatment, transparency, domestic regulation, and dispute settlement. Unlike other trade agreements, the general obligations do not include the important principles of market access and national treatment, which are addressed separately in the schedules.

## ***General Framework Obligations***

### **MFN Treatment**

The GATS obligation regarding MFN treatment is contained in article II, which states that each Member shall treat the services and service suppliers of any other Member no less favorably than the services and service suppliers of any other country.<sup>2</sup> This means that all foreign service providers must be treated in the same manner, regardless of their national origin. However, this does not mean that foreign service providers need be treated as well as domestic service providers; i.e., they need not receive national treatment.

Exemptions to MFN treatment are permitted, but they must be clearly described in a separate list, annexed to the agreement. The MFN exemption list must include the following information: the sector name, the description of the measure inconsistent with MFN, the country/countries to which the exemption applies, the duration of the exemption, and the reason for the exemption. Often these exemptions are taken when some countries have been granted special or preferential access to a sector, such as when two neighboring countries accord each other preferential treatment with respect to transportation services. In principle, MFN exemptions can only be taken for 10 years and are subject to review after five years.

### **Transparency and Domestic Regulation**

Domestic regulation often creates significant barriers to services trade. Many service industries are heavily regulated. From telecommunications to finance to medicine, government regulation plays an integral role in defining the industry and determining which firms can participate and under what terms and conditions. The ongoing global wave of regulatory reform is indicative of a shift in favor of market disciplines, but fundamental regulatory functions endure. Foreign service firms can be adversely affected by explicit discriminatory policies (e.g., foreign equity caps) or

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<sup>1</sup> Coverage of air transport services is circumscribed, however, as traffic rights and services directly related to the exercise of traffic rights are excluded from the scope of the GATS.

<sup>2</sup> The full text of the GATS can be found at Internet address <http://www.wto.org/wto/eol/e/pdf/26-gats.pdf>.

market access limitations (e.g., economic needs tests<sup>3</sup>), as well as limitations that result from a non-transparent policy process (e.g., regulations change without notice, publication, or any private sector input into the process). Some impediments to services trade may include:

- C Measures that limit national treatment by providing more favorable treatment to local firms than to foreign firms.
- Certification requirements that limit national treatment or market access for professional services like medicine, architecture, engineering, and accounting by applying criteria based on nationality or specific university coursework rather than knowledge and ability.
- Measures that limit market access by preventing private service providers from operating, as in cases where the government restricts private provision of education and health care services.
- Screening procedures that may limit market access, such as economic needs tests, licensing requirements, or investment approval policies, particularly if the criteria used are not objective and transparent.
- Limitations on market access resulting from direct market participation by regulatory agencies, such as in instances where the telecommunications or electric power regulator is also a service provider, and, therefore, a potential competitor.
- Limitations on market access and national treatment presented by non-transparent rule-making procedures.

The GATS addresses transparency and regulatory barriers to services trade in articles III and VI. Article III requires WTO Members to publish promptly relevant measures of general application that may affect services trade and to notify the WTO's Council for Trade in Services of significant changes in laws, regulations or administrative guidelines with bearing on services trade. In addition, Members are obligated to respond promptly to information requests from other Members and to establish an enquiry point for use by other Members.

Domestic regulation obligations require WTO Members to avoid using their regulatory powers in such a way as to create services trade barriers. Members are to ensure that measures of general application are administered in a reasonable, objective, and impartial manner. In addition, for sectors in which a Member has listed a specific commitment to grant market access or national treatment (see below for more detail on these commitments), Members must ensure that licensing and qualification requirements or technical standards are based on objective and transparent criteria, are not more burdensome than necessary, and, in the case of licensing procedures, are not in themselves a restriction on the supply of the service.

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<sup>3</sup> Economic needs tests assess the impact of proposed investment on the domestic social, political, and economic environment. The findings of these tests are often subjective, which reduces regulatory transparency and leaves foreign regulators with broad discretionary powers.

## **Dispute Settlement**

Article XXIII of the GATS provides for the settlement of disputes between Members through the WTO dispute settlement mechanism. Under the dispute settlement mechanism, a dispute may be brought before a panel by any Member if it perceives that another Member has failed to uphold its commitments. The findings of the panel are subject to an appeal process. Ultimately, in cases where the panel or the appellate body concludes that a measure maintained by a Member is inconsistent with the agreement, the Member may then choose whether to change its measure to satisfy the GATS obligations or provide compensation to the Member that brought the case. If adequate compensation cannot be negotiated, the Member that invoked the dispute settlement procedures may suspend some of its trade concessions, which effectively means they may retaliate by denying services trade privileges (such as market access) or even by raising tariffs on goods imported from the Member that violated the agreement.

## ***The Schedules of Specific Commitments: Obligations and Structure***

As mentioned previously, market access and national treatment obligations are not contained in the general framework of the GATS, but in the separate schedules of specific commitments. In its schedule, each country makes commitments to adhere to the GATS market access and national treatment obligations on a sector-by-sector basis.<sup>4</sup> This is called a “bottom-up” or “positive list” approach because it begins from a base in which no industry sectors are included, and builds upward as individual sectors are added one by one. Each country chooses whether to include a sector, in which case the sector will be identified by name and often by the applicable United Nations Central Product Classification (CPC) code.<sup>5</sup> Then each country specifies which modes of supplying the service will be bound by the market access and national treatment obligation. Modes of supply are important because they capture the manner in which services are provided and thereby facilitate the process of identifying and subsequently disciplining restrictions to services trade.

## **Modes of Supply**

Under the GATS definition, services may be provided through one or more of the following modes of supply: cross-border supply, consumption abroad, commercial presence, and presence of natural persons. Three of these modes are means of

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<sup>4</sup> To simplify the presentation of sector specific commitments that apply to every service sector, most countries provide a “horizontal commitments” section at the beginning of their schedule. These horizontal commitments generally apply to measures governing foreign investment and the temporary entry and stay of foreign citizens.

<sup>5</sup> Negotiators worked from a list of service sectors developed by the Secretariat which included cross-references to the UN CPC codes. This list is identified by the WTO document code MTN/GNS/W/120.

providing services across borders:

- Cross-border supply occurs when a service is provided in one country to a customer in a second country without either party traveling, such as when a U.S. securities broker purchases shares in New York in response to a telephone request from a client in London.
- Consumption abroad occurs when a customer travels abroad to the service provider's country in order to receive a service, such as when an individual from Venezuela travels to Miami to receive medical treatment.
- Presence of natural persons occurs when the service provider travels to the customer's country on a temporary basis to provide a service, such as when a U.S. engineering consultant travels to Brazil to provide advice on the construction of a wastewater treatment plant.

The remaining mode, commercial presence, refers to the provision of services through foreign-based affiliates. This mode is particularly significant because, in order to establish a foreign affiliate, there usually must be some form of foreign direct investment. Thus, through the commercial presence mode, the GATS became the first multilateral agreement to extend trade disciplines to foreign investment.<sup>6</sup>

## **Limitations to Market Access and National Treatment Obligations**

After listing an industry sector and indicating which modes of supply will be subject to the market access and national treatment obligations, countries may use their schedules of commitments to limit the scope of these obligations. Such limitations are permitted only to provide for *existing* measures that are inconsistent with these disciplines. This enables countries that are not ready to fully liberalize a particular sector to make partial commitments to the market access and national treatment obligations by effectively freezing the existing level of restrictiveness. For example, a country could make a commitment to accord market access and national treatment through a commercial presence for foreign insurance companies, but then indicate that both market access and national treatment remain limited by an existing law that restricts foreign ownership to no more than 49 percent of local establishments. In this case, the country has committed to partially adhere to the market access and national treatment obligations. In addition, the country is now obligated to ensure a standstill; in other words, future measures can not reduce the admissible level of foreign ownership below 49 percent. Thus, the actual coverage of the market access and national treatment obligations under the GATS can only be determined through a detailed examination of the schedules of commitments. This also means that there are wide variations from one country to another, making it difficult to assess the commercial value of commitments or to compare commitments across sectors and from one country to another.

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<sup>6</sup> World Trade Organization (WTO), "General Agreement on Trade in Services - The Design and Underlying Principles of the GATS," found at Internet address <http://www.wto.org/wto/services/services.htm>, retrieved Dec. 14, 1999.





## Supplemental Schedules

At the conclusion of the Uruguay Round in 1994, services negotiators determined that they had not made significant progress in a number of areas. As a result, they decided to pursue extended negotiations concerning movements of natural persons, maritime transport services, basic telecommunication, and financial services. Negotiations in all sectors have concluded, and significant progress was achieved in the basic telecommunication and financial services sectors.<sup>7</sup> As a result of these extended negotiations, many countries created supplementary schedules of commitments and MFN exemption lists, which then became part of the bundle of documents that constitute each country's GATS obligations.

## Value of GATS Commitments

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A country's complete set of GATS commitments thus consists of several documents, which principally include the general framework, the schedules of commitments, supplemental schedules, and lists of MFN exemptions. All of these documents must be consulted in order to determine the commercial significance of a country's commitments under the GATS. Consequently, it is difficult to develop objective indicators to compare the extent to which WTO Members have bound their service sectors through the GATS. For example, there is no way to measure how a 49-percent foreign equity restriction in telecommunication services compares with an economic needs test for establishing a retail shop. However, some general observations may be made.<sup>8</sup>

Industry sectors *least* effectively covered by the GATS schedules include:

- Private education (e.g., private programs, distance learning).
- Private health care (e.g., health care facilities management, private hospitals, physician and nursing care, telemedicine).
- Audiovisual (e.g., film, television, and music production and distribution)

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<sup>7</sup> Joseph Papovich, Assistant U.S. Trade Representative for Services, Investment, and Intellectual Property, "Services in the New Round," testimony before the House Commerce Committee, Subcommittee on Telecommunications, Trade, and Consumer Protection, Washington, DC, Nov. 4, 1999, found at Internet address <http://www.usia.gov/topical/econ/wto99/se1104.htm>, retrieved Nov. 18, 1999.

<sup>8</sup> The following observations were drawn from the USITC series of studies that examined the GATS commitments of 62 countries across a range of service sectors. The studies include: *General Agreement on Trade in Services: Examination of Major Trading Partners' Schedules of Commitments* (USITC publication 2940, Dec. 1995), *Examination of South American Trading Partners' Schedules of Commitments* (USITC publication 3007, Dec. 1996), *Examination of the Schedules of Commitments Submitted by Asia/Pacific Trading Partners* (USITC publication 3053, Aug. 1997), *Examination of the Schedules of Commitments Submitted by Eastern Europe, the European Free Trade Association, and Turkey* (USITC publication 3127, Sept. 1998), and *Examination of the Schedules of Commitments Submitted by African Trading Partners* (USITC publication 3243, Oct. 1999).

- through cinemas, broadcasting, or cable television).
- Transportation (e.g., road/trucking, rail, maritime, and air).
- Distribution (e.g., wholesaling and retailing).
- Energy.
- Environment.
- Express delivery.
- Foreign legal consultancy.

On a regional basis, the quality of commitments tends to be highest among the developed countries, followed by Eastern Europe and the Asia/Pacific region. South America and Africa provided the fewest commitments. In the Asia/Pacific region, India appears to have provided the fewest commitments, with commitments scheduled by ASEAN Members being only slightly more inclusive. Asia/Pacific countries tended to be willing to commit to developmentally oriented sectors such as construction, architecture, and engineering, but were less forthcoming with services such as audiovisual, private education, and private health care. India and the ASEAN Members also tend to maintain the most restrictive policies on foreign investment in services, often by limiting foreign equity to a minority position or requiring joint ventures. Perhaps as a result, service sectors in most of these countries account for a smaller portion of GDP than average for low and middle income countries.<sup>9</sup>

In Latin America, only Argentina and Mexico made commitments across a broad range of service sectors, whereas most other countries made commitments covering less than 20 percent of the range of industries. The commitments are generally of minimal value in all but the travel and tourism service sectors. Audiovisual, education, health, and transportation services received the poorest coverage, with distribution services faring only somewhat better. In some cases, the limited scope of these commitments may not reflect actual market conditions, but a reluctance to make binding commitments due to other negotiating objectives (e.g., Chile may have wished to avoid entering into WTO obligations in 1994 to preserve leverage for NAFTA accession talks that were being considered at the time, and Brazil may have been holding out for concessions in agricultural products like oranges).

Eastern European countries tended to provide a consistent level of industry coverage that only moderately lagged behind the position of developed countries. The European Union (EU) accession process may be partially responsible for these relatively inclusive commitments, as it provided a model for regulatory reform that in some respects is compatible with GATS principles. However, pressure from EU Members may also be partially responsible for the fact that none of the Eastern European countries scheduled commitments on audiovisual services. Health care, transportation, and courier services also generally lack adequate coverage in Eastern European schedules.

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<sup>9</sup> The World Bank, *World Development Indicators 1998* (Washington, DC, 1998).

# Renewed Negotiations

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## *Long-Term U.S. Objectives*

As noted, the GATS broke new ground by establishing a framework of rules applicable to trade and investment in services and by setting a baseline from which future negotiations would proceed. The ultimate objective of future negotiations could include the improvement of both the general framework and the schedules.

One major U.S. proposal for improving the general framework obligations is strengthening provisions on domestic regulation under article VI so that they more effectively promote transparency in the regulatory process and better ensure that, while preserving the ability of governments to meet legitimate

regulatory objectives (e.g., public safety and welfare), neither regulations nor their implementation procedures unnecessarily restrict trade.<sup>10</sup> Suggested provisions include those that encourage foreign regulators to apply equal treatment to foreign and domestic firms and follow due

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<sup>10</sup> Preparations for the 1999 Ministerial Conference, Communication from the United States of America, found at Internet address <http://www.usia.gov/topical/econ/wto99/se0728.htm>, retrieved Nov. 18, 1999.

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Objectives for improving the schedules might include:

- Increasing the number of industry sectors listed in each country's schedule, which would extend market access and national treatment commitments over a greater share of the global economy.
- Increasing the number of countries that have signed the supplemental agreements on financial and telecommunication services.
- Extending coverage of commitments to all segments of each sector (e.g., ensuring that commitments on construction services apply to the whole sector, and not simply to the construction of off-shore oil platforms, as is sometimes now the case with the GATS).
- Deepening the substance of listed commitments (e.g., removing limitations such as foreign equity caps or restrictions on the form of establishment that qualify the terms under which U.S. firms are granted market access and national treatment in a bound sector). Deeper commitments could be pursued in most sectors, including audiovisual, construction, distribution, energy, express delivery, finance, private education and training, private healthcare, telecommunication, travel and tourism, and the various professional service sectors.
- Improving the industry classification system to better reflect actual economic activity (e.g., redefining "courier" services to include relevant aspects of customs brokerage, ground transportation, and warehouse and storage services in order to more effectively capture the scope of integrated service providers).

- Ensuring that services made possible through the development of new technologies are adequately addressed under the GATS, such as distance learning made possible through the Internet; home entertainment products delivered by satellite and the Internet; and advanced health care provided directly to homes or rural clinics via telemedicine.
- Formalizing the treatment of horizontal commitments such that all countries address the same elements in a consistent manner.
- Incorporating references to applicable laws and regulations within the schedules of commitments to enhance transparency and understanding of the nature of limitations to market access and national treatment.

WTO negotiators are exploring at least three different approaches to achieving future liberalization. Negotiators will likely employ, to some degree, the time-honored “request-offer” approach, through which each WTO Member identifies priorities for liberalization in the economies of selected other Member countries and then presents formal requests while offering compensatory concessions. Since such a process is highly laborious and may result in separate negotiations for each industry sector and mode of supply, there may be some consideration of different approaches that offer a means of bundling sectors or issues together so that they may be negotiated at a more comprehensive level. For this reason, alternative “horizontal” and “sectoral” approaches have also been proposed.

A horizontal approach might involve pursuing liberalization across all industries. For example, negotiators could choose a particular mode of supply, such as commercial presence, and negotiate a broad commitment to accord a certain level of treatment across all service sectors (i.e., horizontally), such as agreeing to a common permissible level of foreign ownership.<sup>11</sup> Alternatively, a sectoral approach could involve targeting key industry sectors such as energy or environmental services. For the selected sectors, a model set of commitments could be developed that presents an ideal position of full market access and national treatment.<sup>12</sup> Members could then base their own commitments on this ideal, listing only limited exceptions or necessary phase-in periods.

Another device which could facilitate negotiations of highly regulated sectors could be the development of pro-competitive regulatory reference papers. Such a paper was used effectively to support the extended negotiations on basic telecommunication services. Essentially, these papers provide a set of broad regulatory principles against which countries could compare their regimes and determine whether and to what extent to bind themselves. Principles contained in the regulatory reference paper on basic telecommunication services include:

- Prevention of anti-competitive practices.

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<sup>11</sup> Papovich, “Services in the New Round.”

<sup>12</sup> Ambassador Richard Fisher, Deputy United States Trade Representative, “Services in the World Trading System,” speech to the World Services Congress, Atlanta, GA, Nov. 1, 1999, found at Internet address <http://www.usia.gov/topical/econ/wto99/se1101.htm>, retrieved Nov. 18, 1999.

- Interconnection rules that favor competition.
- Non-discrimination and transparency in the implementation of universal service obligations.
- Transparency or public availability of licensing criteria.
- Independence of regulators from any market competitors.
- Non-discrimination in the allocation of scarce resources such as band width.

The regulatory reference paper facilitated negotiations by enabling countries to reach agreement on what constitutes effective market access in the telecommunication sector, eliminating the need to negotiate over the details of specific regulations for each country. The development of similar pro-competitive regulatory principles for other industries, such as the electricity service industry, may likewise help negotiators achieve meaningful trade liberalization.

## **Conclusion**

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The foregoing discussion has described how trade negotiators will likely continue to pursue the goal of services trade liberalization. The specific objectives of the current round of talks include improvements to the basic framework of the agreement, stronger commitments to liberal trade principles by WTO Members, and broader coverage of service industries. Some of these objectives will likely be achieved more rapidly than others, and perhaps new objectives will emerge. However, as with merchandise trade, services liberalization will likely be a long, gradual process. The steps being taken now build upon a foundation developed five years ago, and these efforts will in turn lay the groundwork for future liberalization.



## **Appendix A**

### **Activities Captured in Official U.S. Data on Cross-Border Trade in Services, by Industry**



**Appendix A**

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

Service	U.S. Exports	U.S. Imports
<b>Accounting and management consulting</b>	Includes accounting, auditing, bookkeeping, management, consulting, and public relations services provided 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
<b>Advertising</b>	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.
<b>Air transportation</b>  <i>Passenger fares</i>  <i>Freight</i>  <i>Port</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 receipts of U.S.-operated air carriers for the international transportation of U.S. exports, and receipts of U.S.-operated carriers transporting foreign freight between foreign points.  Includes goods and services purchased in U.S. airports by foreign-operated carriers.	Includes payments to foreign ocean and air carriers by U.S. residents traveling between the United States and foreign countries.  Includes payments to foreign-operated air carriers for international transportation of U.S. imports.  Includes goods and services purchased in foreign airports by U.S.-operated carriers.

**Appendix A--Continued**

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

Service	U.S. Exports	U.S. Imports
<b>Architectural, engineering, and construction</b>	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.
<b>Audiovisual</b>	Includes nonresidents' rentals of films and tapes from U.S. residents.	Includes U.S. residents' rentals of films and tapes from nonresidents.
<b>Banking and securities</b>	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. Excludes deposit taking and lending services.	Same
<b>Computer and data processing</b>	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
<b>Education</b>	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.
<b>Energy</b>	Not available.	Not available.

**Appendix A--Continued**

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

Service	U.S. Exports	U.S. Imports
<b>Environmental</b>	Not available. <sup>1</sup>	Not available. <sup>1</sup>
<b>Health care</b>	Inpatient and outpatient fees charged to foreign residents; excludes fees for ambulatory treatment or drugs provided outside a hospital. <sup>2</sup>	Not available.
<b>Insurance</b>	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.
<b>Intangible intellectual property</b>	Includes management services and intangible intellectual property provided 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
<b>Legal</b>	Includes legal advice or other legal services.	Same
<b>Maritime<sup>3</sup></b>		
<i>Freight</i>	Includes receipts of U.S.-operated ocean carriers for the international transportation of U.S. exports, and receipts of U.S.-operated carriers transporting foreign freight between foreign points.	Includes payments to foreign-operated ocean carriers for international transportation of U.S. imports.
<i>Port</i>	Includes goods and services purchased in U.S. sea ports by foreign-operated carriers.	Includes goods and services purchased in foreign sea ports by U.S.-operated carriers.
<b>Retail</b>	Not available.	Not available.

See footnotes at end of table.

**Appendix A--Continued**

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

Service	U.S. Exports	U.S. Imports
<b>Telecommunication</b>	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.
<b>Travel and tourism</b>	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. <sup>4</sup>	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. <sup>5</sup>
<b>Wholesale</b>	Not available.	Not available.

**Appendix A--Continued**

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

Service	U.S. Exports	U.S. Imports
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<sup>1</sup> Data reported in ch.12 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.

<sup>2</sup> BEA revised its methodology and used newly available source data to determine total medical exports. Inpatient estimates were obtained by data collected from State regulatory agencies, hospital associations, hospitals with international medical centers, and emergency rooms. Inpatient fees include all hospital staff physician fees, tests, drugs, and room and board. Outpatient charges include outpatient surgery, physical rehabilitation and therapy, dermatology, AIDS treatments, and consultations. USDOC, BEA, *Survey of Current Business*, July 1999, p. 69.

<sup>3</sup> 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.

<sup>4</sup> 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.

<sup>5</sup> Ibid. Tourism imports were revised based on the results of a one-time survey that compared expected travel expenditures to post-trip expenditures. The survey results indicate that U.S. travelers' expected expenditures understate post-trip expenditures in Latin America and the Asia-Pacific region. Accordingly, data for 1998 were revised upward, increasing travel payments by \$1.7 billion. Data for 1997 were adjusted using one-half the value of the adjustments in 1997. Estimates for the years prior to 1997 were not adjusted. USDOC, BEA, *Survey of Current Business*, July 1999, pp. 69-70.

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; OECD, *Services Statistics on International Transactions*, p. 119; USDOC, BEA, *Survey of Current Business*, July 1999, pp. 69-70.

## **Appendix B**

### **Activities Captured in Official U.S. Data on Affiliate Transactions by Industry**





**Appendix B**

**Activities captured in official U.S. data on affiliate transactions by industry**

Service	Sales	Purchases
<b>Accounting and management consulting</b>	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.	Accounting, tax preparation, bookkeeping, and payroll services; other accounting services; management of companies and enterprises; management, scientific, and technical consulting services, such as providing advice and assistance to businesses and other organizations on management, environmental and other scientific and technical issues.
<b>Advertising</b>	Advertising preparation and placement services, including outdoor advertising services, advertising solicitation, and other miscellaneous advertising activities.	Advertising agency services, such as the creation and placement of advertising in various media, advice, creative services, account management, production of advertising material, media planning, and buying; design and implementation of public relations campaigns; media buying and selling; display advertising; direct mail advertising; advertising distribution services; and other services related to advertising.
<b>Architectural, engineering, and construction</b>	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.	Architectural services, such as planning and designing residential, institutional, leisure, commercial, and industrial buildings and structures; landscape architectural services; engineering services, such as advice, preparation of feasibility studies and designs, provision of tech services during construction or installation, and inspection and evaluation; drafting services; building inspection services; geophysical surveying and mapping services; surface surveying and mapping services; analytical testing services; building, developing, and general contracting; heavy construction; and special trade construction.
<b>Audiovisual</b>	Motion picture, television tape, and film production, distribution and associated services; operating motion picture theaters; and video tape and disk rentals.	Motion picture, video, television program, and commercial production and distribution; exhibition of motion pictures and videos; post-production services, such as editing, film/tape transfers, subtitling, credits, closed captioning, computer-produced graphics, animation and special effects, and developing and processing motion picture film; musical recording production and distribution; music publishing; and sound recording and related services.

**Appendix B--Continued**

**Activities captured in official U.S. data on affiliate transactions by industry**

Service	Sales	Purchases
<b>Air transportation</b>	Not available.	Not available.
<b>Banking and securities</b>	Non-deposit-taking financial services, such as financial leasing; mortgage banking and brokering; securities and commodity brokering and dealing; originating, underwriting, and distributing securities; buying and selling commodity contracts; operating security and commodity exchanges; providing clearinghouse services; operating investment management companies, unit investment trusts, and face-amount certificate offices; and miscellaneous investment activities. Excludes lending services.	Non-depository credit intermediation such as credit card issuing, sales financing, cash loans or credit through credit instruments, consumer lending, real estate credit, international trade financing, secondary market financing, and other nondepository credit intermediation; activities related to credit intermediation, such as mortgage and nonmortgage loan brokering, financial transactions processing, reserve, and clearinghouse activities, and other activities related to credit intermediation; securities, commodity contracts, and other financial investments and related services; funds, trusts, and other financial vehicles.
<b>Computer and data processing</b>	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.	Electronic data processing services, such as processing and preparing reports using consumer supplied data, automated data entry services, and providing time-sharing services; computer systems design services such as writing, modifying, testing, and supporting software, planning and designing computer systems that integrate computer hardware, software, and communication technologies; on-site management and operation of clients' computer systems and/or data processing facilities; and professional and technical computer-related advice and services; other computer-related advice and services.
<b>Education</b>	Not available.	Instruction and training provided by specialized establishments such as schools, colleges, universities, professional schools, and training centers; includes management on a contractual basis if the establishment both manages the operation and provides the operating staff.

**Appendix B--Continued**

**Activities captured in official U.S. data on affiliate transactions by industry**

Service	Sales	Purchases
<b>Energy</b>	<p><i>Petroleum</i><sup>1</sup></p> <p>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.</p> <p><i>Electricity</i></p> <p>Generating, transmitting, and/or distributing electrical energy.</p> <p><i>Gas</i></p> <p>Distributing natural gas for sale, except for pipeline transportation of natural gas from the extracting site, which is captured under petroleum services.</p> <p><i>Sanitary</i></p> <p>Distributing water for sale; and sanitary services including irrigation systems.</p>	<p><i>Mining</i></p> <p>Oil and gas extraction, including those establishments that operate and/or develop oil and gas field properties either for themselves or for others on a fee or contract basis, and all activities related to the preparation of oil and gas up to the point of shipment; developing, mining, and preparing anthracite, bituminous coal, or lignite; support activities for oil and gas field services and coal mining on a contract or fee basis.</p> <p><i>Transportation</i></p> <p>Pipeline transportation of crude oil, refined petroleum products, and natural gas. The pipeline transportation of natural gas includes storage.</p> <p><i>Utilities</i></p> <p>Electric power generation, transmission, and distribution; natural gas distribution.</p>
<b>Environmental</b>	Not available. <sup>2</sup>	Not available. <sup>2</sup>
<b>Health care</b>	<p>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.</p>	<p>Ambulatory health care services provided directly or indirectly to ambulatory patients; hospital services, including medical, diagnostic, and treatment services provided to inpatients; nursing and residential care facilities; and social assistance.</p>

See footnotes at end of table.

**Appendix B--Continued**

**Activities captured in official U.S. data on affiliate transactions by industry**

Service	Sales	Purchases
<b>Insurance</b>	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.	Insurance services such as underwriting annuities and insurance policies and investing premiums to build assets used against future claims, as provided by insurance carriers such as direct life, health, and medical insurance carriers, direct property and casualty insurance carriers, direct title insurance carriers, other direct insurance carriers, and reinsurance carriers; the sale of insurance policies or annuities through agencies or brokerages; and the provision of employee benefits and other insurance related services, such as claims adjustment and third-party administration.
<b>Legal</b>	Legal advice or legal services.	The provision of legal expertise in various areas of the law; includes notary services; specialized legal or paralegal services provided by legal practitioners other than lawyers and attorneys; title abstract and settlement services; and other legal services.
<b>Maritime</b>	Not available.	Not available.
<b>Retail</b>	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; building materials and mobile homes; new and used automobiles, boats, and recreational vehicles; computers and computer software; and other miscellaneous goods.	Retailing services include selling merchandise to the general public, businesses, or institutional consumers through fixed point-of-sale store locations or nonstore outlets. These businesses include motor vehicles and parts dealers; furniture and home furnishings stores; electronics and appliance stores; building material and garden equipment and supplies dealers; food and beverage stores; health and personal care stores; gasoline stations; clothing and clothing accessories stores; sporting goods, hobby, book, and music stores; general merchandise stores; miscellaneous stores, such as florists, office equipment and supplies retailers, pet stores, stationery and gift stores, used merchandise stores, art dealers, and mobile home dealers; and nonstore retailers such as electronic shopping and mail order houses, vending machine operators, and direct selling establishments.
<b>Telecommunication</b>	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.	Operating, maintaining, or providing access to facilities for the transmission of voice, data, text and full motion picture video between network points, and includes telecommunications reselling services provided through wired and wireless networks.

**Appendix B--Continued**

**Activities captured in official U.S. data on affiliate transactions by industry**

Service	Sales	Purchases
See footnotes at end of table.		
<b>Travel and tourism</b>	Commercial lodging services, including the provision of meals by hotels and motels, rooming and boarding houses, camps and recreational vehicle parks, and membership hotels and lodging houses.	Travel arrangement and reservation services, including travel agency services such as the sale of travel, tour, and accommodation services; tour operator services, such as arranging and assembling tours; other travel arrangement and reservation services; convention and visitors bureau services; accommodation services including traveler accommodations, recreational vehicle parks and recreational camps, and rooming and boarding houses; food and drinking services as provided by full-service restaurants, limited-service eating places and restaurants, food service contractors, caterers, and mobile food service providers; and alcoholic beverage drinking places.
<b>Wholesale</b>	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; and nondurable goods.	Wholesale services include selling goods for resale, capital and durable non-consumer goods, and raw and intermediate goods to wholesalers, retailers, and other businesses. These goods include new and used motor vehicles and motor vehicle parts and supplies; furniture and home furnishings; lumber and other construction materials; professional and commercial equipment and supplies; metals and minerals; <sup>3</sup> electrical goods; hardware, and plumbing and heating equipment and supplies; machinery, equipment and supplies; and miscellaneous durable and nondurable goods.

<sup>1</sup> For affiliate sales, 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). Under the new North American Industry Classification System (NAICS), affiliate purchases of petroleum are no longer treated as a separate data category. Instead, petroleum related activities are distributed among Mining, Utilities, Transportation, Wholesale Trade, and Retail Trade. USDOC, BEA, *Survey of Current Business*, Aug. 1999, p. 24.

<sup>2</sup> Data reported in chapter 12 are from industry sources. Affiliate purchases data on waste management and remediation services was suppressed by BEA to avoid disclosure of individual company data. Activities for affiliate sales and purchases include hazardous and solid waste management services; environmental consulting and engineering services; remediation and industrial services; analytical services; and water treatment works.

<sup>3</sup> This industry also includes metal service centers that perform value added functions such as sawing, shearing, bending, leveling, cleaning or edging on a custom basis as part of a sale.

Sources: 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; and USDOC, BEA, *Guide to Industry and Foreign Trade Classifications for International Surveys*, Oct. 1997, pp. 1-49.