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*The new approach to international trade in services in view  
of services specificities : Economic and regulation issues*

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THE NEW APPROACH TO INTERNATIONAL TRADE IN SERVICES IN VIEW OF  
SERVICES SPECIFICITIES: ECONOMIC AND REGULATION ISSUES.

Abstract :

The paper deals with the issue of integration and trade of services industries. It argues that the specificities of services producing industries compared to goods producing industries explain several difficulties of the new approach to international trade in services. First, the paper discusses the definition of services to remind that long distance trade of services is quite difficult, even if new information and communication technologies have made it easier in some cases. Second, the paper shows that the balance of payments presents an incomplete and confusing image of trade in services. Third, the paper describes the four modes, pertaining to the new approach to trade in services, developed for GATS. It outlines that some of these modes are distorting traditional economic concepts. The last part of the paper focuses the consequences of the Mutual Recognition Principle (MRP), the Country of Origin Principle (COP) in relation with Freedom of Establishment and Free movement of Services principles. It is argued that even if COP is a natural following of MRP –basically developed to deal with trade in goods–, the shift to services brings new drawbacks not yet extensively assessed.

## INTRODUCTION

Over the past decade, several initiatives have been taken to enhance international trade in services, namely GATS negotiation and within EU, the directive on services. These initiatives give rise to numerous theoretical questions stemming from the specificities of service production. Indeed, as intangible entities, services are unlikely to be traded like goods.

The communication addresses various essential issues that should influence regulation policies regarding trade liberalisation in services industries. One aims at a simple but awkward question: what is under consideration when speaking of international trade in services? Another follows quite naturally: is it possible to apply standard GATT principles to services, especially the mutual recognition one? And finally, are expectations pertaining to the rapid growth in services exchanges truthfully legitimated? Major regulation policies depend on the answers we may propose to these questions.

The paper is organised as follows. The first section discusses the definition of services with new Information and Communication Technologies (ICT) and the dematerialisation process in mind. Its purpose is to clarify what is a services activity and what is not. The issue at stake is the weight of the services sector in contrast with goods producing industries.

The second section deals with the trade in services as it appears in the balance of payments. The issue is to understand what shows the balance, if it is possible to compare data from Balance Of Payment (BOP) and Systems of National Accounts (SNA), and what is the importance of services industries in the trade of services.

Third, the paper describes the four modes, pertaining to the new approach to trade in services, developed for GATS. These modes are contrasted to traditional economic concepts of international trade. The paper specifically analyses the third one, its meaning and consequences for economics and international negotiations.

The last section of the paper focuses on the Mutual Recognition Principle (MRP), the Country of Origin Principle (COP) in relation with the European directive on services. The paper intends to relate the problems met by COP to the specificities of services production, several regulations policies issues are envisaged.

### 1. DEFINITIONS OF SERVICE AND THEIR CONSEQUENCES FOR ECONOMIC POLICY

Trade in services does not correspond to trade in goods, at least in a common sense. This situation derives from services specificities. Several clarifications are required. The section will first describe the common view of services, then advocate an enhanced one and suggest its consequences for economic policy.

#### 1.1 THE TRADITIONAL VIEW

A service is non-storable and intangible; it is thus a flow (Broussolle 2000). Its production is introduced by the client's initiative, quite often to his contact or the one of the good where the service is embedded. Because it is a flow, the service is not separable from the person or the good it was applied to. The old example of the haircut is illustrative, but the case

of professional services, repair services or telecommunications is akin. It means that the service is transferred while produced. That is a consequence of its non-storability.

However, it does not mean the consumer and the producer should unavoidably be in the same place, at least, not in the common sense. When a person uses a phone (correspondingly attends a radio or TV broadcast), obviously, he is consuming the service while it is being produced, but even if he is linked to the producing system, he is not in the same place as the system. Thus, the non-storability characteristic implies solely immediacy of production and consumption. Therefore, Bhagwati (1987, see Van Welsum 2003) rightly points out that services do not automatically need the movement of consumers or producers, whereas it is quite common. Still, the consumer and the producer must be “on the line”. It does not mean either all services should be consumed at once (i.e. are perishable), their effect may last, thus some services are durable.

For a long time, even if Hill (1977) proposed a fine and helpful definition (Box n°1), international classification of services lacked precision and mostly relied on an empirical basis. Any activity, which was not usually recognised as industrial or agricultural, was deemed to be a service. Evidently, this routine gave way to a collection of activities that were not entirely sound. The development of the Information and Communication Technologies (ICT) increased the problem, meanwhile raising new interrogations. On the one hand, they weakened the link between the consumer and the producer, the consequences of this aspect will be addressed further. On the other hand, they allowed the dematerialisation of information goods, giving them the appearance of services.

#### **Box n°1: traditional definitions of Services**

**Hill (1977, p. 318)**

*The service is ‘a change in the condition of a person, or of a good belonging to some economic unit, which is brought about as the result of the activity of some other economic unit, with the prior agreement of the former person or economic unit’*

**World Investment Report (WIR 2004 p. 145)**

*“Services are usually perceived as intangible, invisible, perishable and requiring simultaneous production and consumption, while goods are tangible, visible and storable and do not require interaction between producers and consumers”.*

## 1.2 AN ENHANCED VIEW

The updating of the national account classification system in 1993 offered an opportunity to revamp the old taxonomy and enhance its accuracy.

As Hill (1999) reminds, the old view had several drawbacks: it did not explain the critical reason why a service was not storable; it seemed also to put a great weight on the criteria of immateriality and immediacy of consumption (Box n°1). Some researchers have hence pointed that the non-storability criterion was questionable (for instance, see Van Welsum 2003). As an illustration, she argues that power generation and more specifically electricity, which is not storable, could be regarded as a service. She adds that the consumption of expertise and consultancy services may spread over time, thus contradicting the immediacy requirement. Others have claimed that information “goods” may be disconnected from their “carrier”, thus losing materiality (books, movies, music, software...), becoming quasi services.

Following Hill's suggestions, an improved definition of services was implemented in the System of National Accounts (SNA) to overcome these problems (Box n°2). Hill (1999 pp. 441-42) stresses that service "(...) *is some change in the condition of one economic unit produced by the activity of another unit. (...) Because it is not an entity, it is not possible to establish ownership rights over a service and hence to transfer ownership from one economic unit to another*". This definition underlines that non storability and intangibility are not a categorization per se; they derive from the non separability and, above all, the impossibility to establish ownership rights over services. Let us also note, that intangibility does not mean that service is truly immaterial because it is necessarily applied to a good or a person. Hill's proposition carries however some drastic upshots that not everyone has yet adopted.

The enhanced definition is merely a juridical one. Every production non isolable from the producer or the consumer is a service production, because no ownership rights may be applied to it. In consequence, the sold entity described in the contract is often something else than the service itself. It could be a right to access, the availability of means or staff working time or the producing time of the producer. In every case, it is not the service itself that is truly specified and sold but its means of production. Whenever it is possible, the service sold is defined by a standardised description. Yet, it must be reminded that the final service will be known only when it is produced, and some discrepancies may occur with what was planned. The criterion being a juridical one, also expresses the idea that some productions may take either the form of a service or of a good, depending on the historical, economic, technical or institutional circumstances. For instance, cars may be purchased or rented, thus sold as a good or as a service (right to access for a definite period).

The criterion is truly instructive for standard services: it is not possible to establish ownership rights over (or isolate) services sold by transportation services, hairdressers, banks, repair activities... To better understand the approach, is it necessary to break down the production process and to delineate precisely when the production truly occurs. Three steps are commonly distinguished: establishment production capacities, production and sale<sup>1</sup>. It is worth remembering that in service activities, the production occurs only when the recipient is present. Production is nevertheless often confused with production capacities. But, an empty running train or an idle telecommunication line do not produce any service, even if they are true producing capacities. Idle facilities are simply waiting for the customer.

The production of a map or of a report should not be considered as a service production, not because the map or the report are material entities, they could be digitalized, but because they are isolable from either the producer or the recipient and that ownership rights may be applied to them.

Similarly, if electricity is not to be considered a service, it is not that it would be storable or a material entity. In fact, it is because electricity is isolable from its producer or recipient, and thus prone to ownership rights. This point of view is consistent with the fact that energy is sold by the quantity consumed (kw per hour) and not by the time of connection to a power line (payment through a lump sum subscription). And last, electricity production occurs in the absence of a client. In fact, even though not easily, electricity may be stored.

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<sup>1</sup> This analysis is consistent with the definitions given by SNA 1993, for instance: « The production and exchange of goods are quite separate activities. Some goods may never be exchanged, while others may be bought and sold numerous times. The separation of the production of a good from its subsequent sale or resale is an economically significant characteristic of a good that is not shared by a service. »

### **Box n°2: Services enhanced definition**

#### **SNA 1993 manual, line 6.8**

*“Services are not separate entities over which ownership rights can be established. They cannot be traded separately from their production. Services are heterogeneous outputs produced to order and typically consist of changes in the condition of the consuming units realised by the activities of the producers at the demand of the customers. By the time their production is completed they must have been provided to the consumers.”*

#### **Information goods or services? SNA 1993 manual, line 6.13**

*“There is a group of industries, generally classified as service industries, that produce outputs that have many of the characteristics of goods, i.e., those concerned with the provision, storage, communication and dissemination of information, advice and entertainment in the broadest sense of those terms—the production of general or specialized information, news, consultancy reports, computer programs, movies, music, etc. The outputs of these industries, over which ownership rights may be established, are often stored on physical objects—paper, tapes, disks, etc.—that can be traded like ordinary goods. Whether characterized as goods or services, these products possess the essential common characteristic that they can be produced by one unit and supplied to another, thus making possible division of labour and the emergence of markets.”*

The main effect of this approach is to reduce the number of authentic services activities (Broussolle 2001). It should halt the propensity to constantly enlarge the services industries' cluster and definitely prevent from including construction, public utilities such as gas, electricity and water supply in it (see WIR 2004 p. 145). In addition, the classification of many information activities such as computer programs, movie, music ... is questionable (Cave 2002 p. 8). As pointed by OECD (2000 p. 7), “Copies of movies and most other performances can be recorded and mass-produced for further consumption like manufactured products”. These activities should no more be considered as services industries, they should instead either be regarded as information goods producing per se, a new category, or as plain goods producing industries.

### **1.3 CONSEQUENCE OF THE ENHANCED VIEW FOR ECONOMIC ANALYSIS AND POLICY**

The System of National Accounts (SNA) and the Manual on Statistics of International Trade in Services (MSITS) keep trace of the former debate (see Box n°2), but preserve the old classification. It is truly deceptive, because it gives an inaccurate perception of services growth and weight in the economy. On the basis of standard statistics on value added or employment in services industries, most authors believe that the future of modern economies lies in boosting services activities. To a certain degree, that is quite true, but the development of services should not be opposed to the development of goods. The weight of services industries is overestimated by standard statistics (OECD 2000, COM). Indeed, as previously pointed, some industries are wrongly classified as services activities, in addition their growth stems partly from industry outsourcing.

The opposition commonly stressed between the quick growth of services industries, their economic dynamism, and the shrinking importance of goods activities is not so much relevant (Fontagné & Lorenzi, 2005). The statistical growth of services industries (employment and value added), to the detriment of goods producing is, to a certain extent, a statistical artefact related to sub-contracting and outsourcing. Due to these phenomena, a

fraction of activities previously included in goods producing, are subsequently classified in services producing (temporary workers, security, cleaning, accountancy...). Flacher & Pelletan (2005) established that in France, for the 1996-2001 period, if activities that were outsourced<sup>2</sup>, were placed back in the industry sector, then no decline in goods producing would be experienced. Besides, this result holds whichever statistical convention they apply. An increase of goods producing employment and value added may even be found (Flacher Pelletan, 2005 p. 294-95). This upshot would yet be more obvious if information goods producing activities were accepted as goods producing activities. Finally, it should also be remembered that a long-standing economic trend consists in a shift from service to self-service, using goods. Several services activities are thus supplanted by goods producing activities (for instance: laundry services superseded by washing machine).

## 2. THE TRADITIONAL VIEW OF INTERNATIONAL TRADE IN SERVICES

The traditional view of international trade in services is based on the Balance of Payment (BOP) statistics and principles. The following section will explain why the BOP is not satisfactory enough an instrument to draw accurate comments about services industries international trade.

It is essential to first understand on what grounds the BOP is built, it will next allow enlightening what we know about international trade in services, with regard to services industries.

### 2.1 THE BALANCE OF PAYMENT PRINCIPLES POORLY MATCH WITH NATIONAL ACCOUNTS

The Balance Of Payments (BOP) describes the trade between countries. It has mainly been developed for macroeconomic and economic policy purposes. The BOP accompany national accounts and markedly allow computing the effect of trade on major economic figures, through balance of imports and exports (physical or financial movements), especially their impact on the exchange rate. International trade is thus viewed between resident and non resident firms, regardless of their owner's nationality. Therefore the balance of payment adopts the custom officer's point of view, which scrutinizes the financial or commodity flows that cross the border.

The BOP traditional partition of current transactions was not between goods and services, but between commodities and "invisible", later on transformed in services. Implicitly, this means that the main characteristic of services for the BOP is their immateriality, and conversely, that every invisible transaction be related to services. Both points of view lack groundings and have been proven erroneous (see ahead).

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<sup>2</sup> That is: Logistic, Computer services and telecommunication, Engineering and Research & Development, Human resources, Professional services, Marketing & communication, Waste treatment & recycling, Other business services.

**Box n°3a: international trade in services according to the balance of payments**

<b>1.2</b>	<b>Services</b>
1.2.1	Transportation (sea, air, other)
1.2.2	Travel
1.2.3	Communication Services
1.2.4	Construction Services
1.2.5	Insurances Services
1.2.6	Financial Services
1.2.7	Computer information Services
1.2.8	Royalties and license fees
1.2.9	Other business services
1.2.91	International merchanting
1.2.92	Other commercial services
1.2.93	Leasing
1.2.94	Miscellaneous business services
1.2.10	Personal, cultural and recreational services
1.2.10.1	Audiovisual services
1.2.10.2	Other personal services
1.2.11	Government services n. i. e.
<b>1.3</b>	<b>Income</b>
1.3.1	Workers' remittance
1.3.2	Investments revenue
<b>3.</b>	<b>Financial account</b>
3.1	Direct Investments

The statistics on trade in services provided by the BOP (Box n°3a) do not adequately suit the classification of industries developed for SNA (Box n°3b).

First, several services industries, such as repair services, hotels and restaurants, retail trade or several personal services are not, or poorly, featured in the BOP classification. Obviously they do not figure in the classification because international trade is very uneasy in their cases. This aspect will be discussed further.

Second, some items are confusing, they mix services and commodities. The travel entry is the prominent one. It covers all the expenditure of travelers in a country whether related to leisure or business purposes. These expenditures may obviously concern goods as well as services. The construction services item is another one (Whichard 2000 p. 15).

Third, the services that cross the border may be issued from other industries than services industries. This statement may be a striking one, as this situation is not yet familiar. For instance, the royalties and license fees entry, is not primarily connected with services industries (see below).

The differences between the BOP and SNA approaches stem primarily from the fact that the BOP is mostly a product based classification, while the SNA is an industry based classification (Box n°3b).

The construction services offer a striking example. Formally the BOP entry should be related to services i.e. the “work performed on construction projects and installation by employees of an enterprise in location outside the economic territory of the enterprise”



(OECD 2005a p.11). However, the value computed includes also the goods and materials, imported (BOP) and even bought locally for the construction (EBOPS<sup>3</sup>); in consequence, the entry refers more to construction than services activities. This example shows that the same activity operated at home, or abroad, may be classified as producing industrial or service revenue. It is quite confusing; a consistent approach would have been to categorize the international revenue according to the classification of the industry, construction would have stayed construction. Some similar hitches, viewed in the perspective of GATS, may be found in WTO (2006 p.21) for instance: “should fruit-pickers be viewed as temporary agricultural labourers or as suppliers of fruit-picking services?”

**Box n°3b: service industries in the French industry taxonomy compliant with International Standard Industries Classification (ISIC)**

50	Trade and automotive repair
51	Wholesale and intermediary trade services
52	Retail trade and home repair
55	Lodging and eating places
60	Ground transportation
61	Water transportation
62	Air transportation
63	Support transport services
64	Post and telecommunication
65	Financial intermediation services
66	Insurances
67	Financial and insurance support
70	Real estate
71	Rental without operator
72	Computer services
73	Research & development
74	Business services
75	Government administrative services
80	Education
85	Health & social services
90	Waste collection, treatment, and disposal
91	Communities' Activities
92	Recreational, cultural and sport services
93	Personal services

## 2.2 WHAT DO WE KNOW ABOUT INTERNATIONAL TRADE IN SERVICES WITH REGARD TO SERVICES INDUSTRIES?

As a result to Balance Of Payment (BOP) limitations, it is not relevant to derive, without any care, comments about international trade of services industries, from the trade in services described by the BOP. In fact there are no systematic links between services traded and services industries, and ironically, goods producing industries tend to generate more international trade in services than services producing industries.

<sup>3</sup> Extended BOP for trade in services according to GATS standard, see below.

Thanks to statistical work carried out by INSEE and Banque de France, we are able to give some hints pertaining to the relative weight of goods and services producing industries in the trade in services.

In France, goods producing industries contribute roughly for 85.6 % of services imports and for 65.8 % of exports of services (table n°1). Hopefully enough, in some cases services industries are playing a significant role for trade in services: communication services; computer and communication services, personal, cultural and recreational services. However, we may notice that these entries do not generate a sizeable amount of trade. Moreover, if three services item bring a substantial flow of trade in services, two of them are dominated by goods producing industries (business services and even transportation). The case of the third one (Travel), is not so clear at it seems, because 55 % of tourism returns, evaluated through money exchanges, are attributed *conventionally* to restaurants and hotels. For the moment, we do not know how travellers use their money, albeit we may soundly suppose that they obviously need visiting, lodging and eating-places.

Table n°1

Comparative weight of services producing firms in the international trade of France in 2003

	Services industries/total of trade in % for each entry		Value of exchange distribution compared to the total of transactions in % : (exp + imp)/2
	Imports	Exports	
<b>Total of current transactions</b>	<b>6,12</b>	<b>8,75</b>	<b>100,00</b>
<b>Goods</b>	<b>36,45</b>	<b>37,90</b>	<b>63,44</b>
<b>Services*</b>	<b>14,39</b>	<b>34,23</b>	<b>16,00</b>
-Transportation	1,98	1,26	3,77
- Travel	7,01	56,79	5,28
- Communication services	99,94	99,46	0,40
- Construction services	31,12	49,09	0,37
- Insurances services	1,84	2,72	0,40
- Financial services	3,65	3,90	0,26
- Computer and information services	37,58	86,25	0,22
- Royalties and license fees	20,57	15,84	0,57
- Other business services	19,41	23,74	4,19
- Personal, cultural and recreational serv.	77,77	71,40	0,37
- Government services n.i.e.	0,74	1,43	0,16

\* Broad sense (tertiary). Source Insee 2005

Finally, trade in services is low comparatively to trade in goods but more surprisingly, the services producing industries do not generate much trade in services. All these considerations show that trade in services is specific, and need explanations.

AS FAR AS INTERNATIONAL TRADE IS CONCERNED, SERVICES INDUSTRIES ARE POOR TRADERS.

Although the presence of consumer and producer in the same place is not an absolute requirement, long distance exchange capabilities of services industries are still restricted. Even after new ICT revolution, long distance trade remains difficult for services. In most cases, the service must be produced on site; either consumer or producer has to move. In these circumstances, no service crosses the border. In addition, as Wölfl (2005) states, some services are not international trade oriented and will not be in a near future, because of a local or regional market, accordingly with the consumers' demand. It does not mean services activities are not internationalising, but when doing so, they follow a different path.

Internationalisation of services uses mainly Foreign Direct Investment (FDI) (table n°2). We may say that the movement of the producer takes the place of the movement of the output.

Table n°2  
Foreign Direct Investment (FDI) flows in France per industries in 2003  
(reinvested profits not included, millions of euros)

	Foreign investments in France			French investments in the rest of the world				
	Gross	Sales	Balance*	Sales	Gross	Balance*		
	investments		%		Investments	%		
	(1)	(2)	(3)=(1)-(2)	(4)	(5)	(6)=(4)-(5)		
<b>Whole economy</b>	135 878	98 223	37 655	<b>100,00</b>	119 487	166 578	-47 091	<b>100,00</b>
Of which : trade	8 226	8 732	-506	<b>1,34</b>	8 361	16 673	-8 312	<b>17,65</b>
Of which : Services	71 507	49 229	22 278	<b>59,16</b>	60 987	85 501	-24 514	<b>52,06</b>
Transportation	1 322	315	1 007	<b>2,67</b>	708	1 521	-813	<b>1,73</b>
Telecommunications	3 884	3144	740	<b>1,97</b>	18116	16 096	2 020	<b>4,29</b>
Other business serv.	55 087	36 621	18 466	<b>49,04</b>	33 590	51 593	-18 003	<b>38,23</b>
Of which : computer	1 397	194	1 203	<b>3,19</b>	361	1 435	-1 074	<b>2,28</b>
R & D	226	60	166	<b>0,44</b>	60	257	-197	<b>0,42</b>
Advertising	277	88	189	<b>0,50</b>	196	263	-67	<b>0,14</b>
Legal, accounting, management (incl. holdings)	48 007	33 672	14 335	<b>38,07</b>	30 370	45 183	-14 813	<b>31,46</b>
Financial serv. (holdings not incl.)	5 192	4 791	401	<b>1,06</b>	6 084	12 494	-6 410	<b>13,61</b>
Real estate activities	5 098	3 608	1 490	<b>3,96</b>	808	1 618	-810	<b>1,72</b>
Eating & lodging	490	386	104	<b>0,28</b>	642	976	-334	<b>0,71</b>
Other personal serv.	434	364	70	<b>0,19</b>	1 039	1 203	-164	<b>0,35</b>

\* No minus mark = entry of capital, minus mark (-) = exit of capital

Data origin: balance of payments Banque de France, Source Insee 2005

Note that in this table a FDI means that a firm has acquired at least 10 % of the total equity capital.

The World Investment Report of the UNCTAD, shows that, on average, services accounted for about two-thirds of total FDI inflows (and 70 % of outflows) over the years 2001-2002 (WIR 2004 p. 98). A large, but declining proportion of outward FDI in services is controlled by goods rather than services industries, (41 % for the United States, 20 % for Japan, but 10 % for Germany). This reflects the globalization of corporate service functions in the manufacturing and the primary sectors rather than the global expansion of services activities. It is obvious for trading and financial services, when not belonging to banking and insurance sectors. However, with services deregulation, the industries' composition of FDI evolves towards a greater share of services activities and among them finance is decreasing. France is in line with these comments: investments in trade and services accounts for about two-third or more of total investments (inward as outward), the leading domain is business services, of which noticeably: legal, accounting and management (table n°2). Let us notice that the Trade sector (retail & wholesale) generates important flows of investments, while not appearing per se in the BOP. It is worth also mentioning that this picture is not all-encompassing, because non equity forms of investments such as franchising, partnerships, management contracts, are common in services. These forms of internationalisation are quite a terra incognita, from a statistical point of view.

Finally, trade in services is low comparatively to the weight of services industries in the economy, even if it is growing fast. Due to statistical rationales, the figures given by the BOP are unlikely to be properly linked to the figures provided by SNA. Favouring trade in services does not mean supporting services industries, since a great deal of trade in services comes from goods industries (Nivlet 1993 p.2). Moreover, the importance, and above all, the autonomy of services producing industries in the economy are often overestimated. As far as government programs are concerned (OECD 2000 p.34 sq.), contrary to some proposals<sup>4</sup>, it is not desirable to switch government support from goods industries to services industries. It would cut off one of the growth motives for international trade, as well as national output and employment, for instance in business, communication, transportation and financial services, for they strongly interact with goods industries. Albeit their meagre importance in international trade, services industries are internationalising at a quick pace, but they rely on different mechanisms, as for instance, direct investments or non-equity exchanges.

Given all the previous factors, there are few hopes that international trade in services will reach the weight of trade in goods, that is, unless the definition of trade is altered.

### 3. THE GENERAL AGREEMENT ON TRADE IN SERVICES' NEW APPROACH ON TRADE IN SERVICES

The 1995 General Agreement on Trade in Services (GATS) originated a new approach for international trade in services, and delineated four ways (labelled mode) of trade. There are thus now two concepts of international trade in services. Even if the agreement is specifically dedicated to services, GATS does not suggest any definition of services industries (Whichard 2000 p. 12). This section will describe and analyse the four modes and show that they introduce new concepts, some misleading.

#### 3.1 THE FOUR GATS MODES OF TRADE IN SERVICES (CHART N°1)

Mode 1: cross border supply. According to this mode, a firm from a country A provides a service to consumers living in a country B. It may concern for instance telecommunications or financial services.

In this mode, a service actually crosses the border. It is the traditional form of trade (OMC 1999, p. 3), with jointed symmetrical movements: a “physical” one and, in the opposite way, a monetary one.

Mode 2: consumption abroad. In this case, the recipient of the service moves from a country A to a country B to purchase a service.

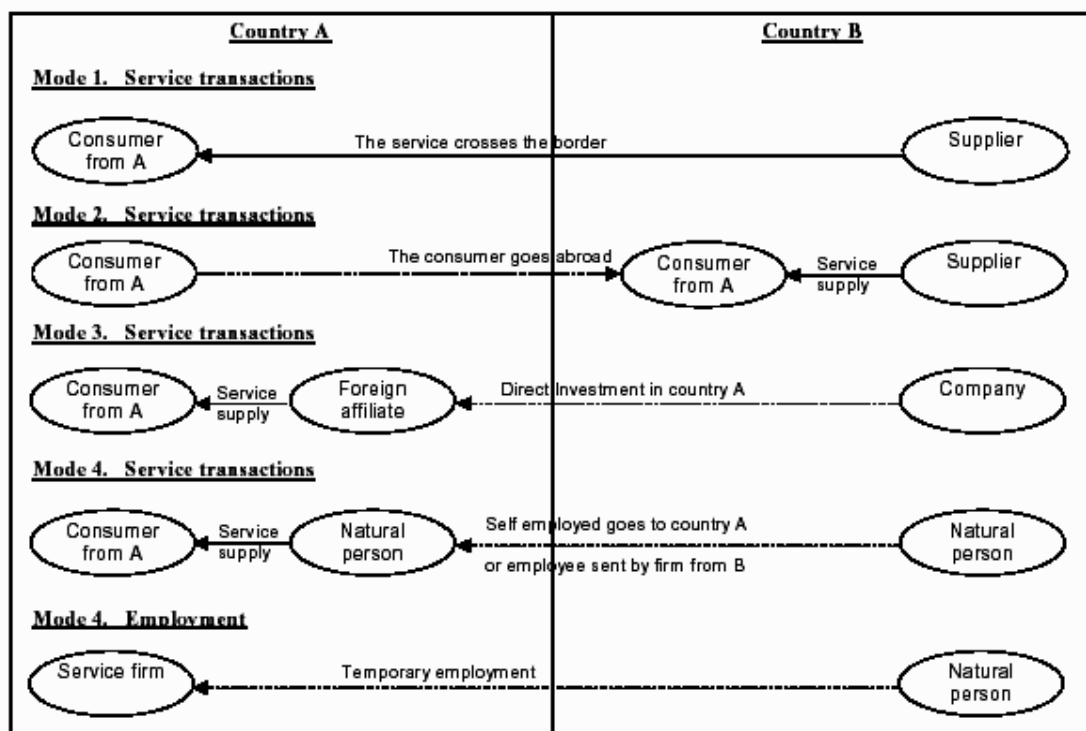
Every economic agent from a country A, who acquires a service in a country B (hotels, hairdressing, cultural services, repair services, health...), falls in this category. Properly speaking, the service per se is not crossing the border but rather, the service embedded in its receiver when the agent comes back home. However, when the purchased service is “perishable”, that is, when its consumption drains immediately all its outcomes (for instance lodging or transportation), no service crosses the border as the foreign consumer goes back

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<sup>4</sup> “Tax policies need to be reviewed and modified to accord service firms the same sort of incentives and accommodations that are available to manufacturing firms (OECD 2000 p. 35). Furthermore, quoting Nakamae 1999, the report advocates that it should be advantageous to “facilitate a major shift of resources from manufacturing to services industries” (OECD 2000 p. 35).

home. Nevertheless, perishable service or not, a monetary transaction enters the producer's country, in counterpart of the purchase.

Chart n°1  
The four modes of trade in services according to GATS



source : MSITS (2002 p. 35)

**Mode 3 :** commercial presence. This category is deemed to be the most important for future trade development (OMC 1999 p. 3). It pertains to foreign investment in services industries in order to provide on location. In the economic literature, it is known as Foreign Affiliates Trade in Services (FATS).

When the investment is financed by imported capital, two consecutive monetary movements are to be experienced. First, prior the investment, an entry of funds and second, distributed in time, flows of revenue (WIR, 2004 p. 28). When the investment is financed through local resources, only revenues cross the border.

This mode may apply, and still does, to virtually every services industry. We may note that within this mode, the service is produced and consumed in the same country. The financial flows that cross the border are investment or income ones; they are not counterparts of a produced service.

**Mode 4 :** presence of natural persons. This mode occurs in a context where an individual moves temporarily into the territory of the consumer to produce a service (OCDE 2004). The individual may either be self-employed or employee.

This mode does not pertain to immigration, as the individuals involved are confined only to one mission and for its definite period. Yet, the posting period is not clearly fixed in GATS regulations, many authors envisage a maximum of five years. It could be regarded as

not such a transitory interval. Within the EU, posting of workers may last three years and be renewed once.

Note that, in several circumstances, the difference between mode 3 and 4 is not easy to determine. Even a temporary supply could need some local investment. Conversely, an investment could quickly be sold, rendering it temporary. In the both situations, the statistician who wants to categorise the services must know the initial intentions or contracts.

Within this mode, the service is produced and consumed in the destination country. A monetary movement however crosses the border. Whoever is concerned, self-employed or only posting worker, the movement roughly corresponds to revenue or wages. The payment may therefore be regarded as well as trade in services or rather income flow (see further).

### 3.2 ASSESSMENT OF MODES ECONOMIC CONCEPT

GATS negotiators have defined the four modes of supply regardless of the statistics available or their underlying principles. Their decision happens to be somewhat a revolution in trade economics, and perhaps a not wholly acknowledged shift in the meaning of economic concepts. This subsection intends to assess the change and their effects for international negotiations on services.

The first part will address how the BOP may shed some light to measure the four modes. The second part will consider economic and theoretical issues raised by the Foreign Affiliates Trade in Services (FATS) perspective drawn from mode 3.

#### THE BOP BRINGS POOR LIGHT TO MEASURE THE FOUR MODES.

Since 1995, statistician economists have made great efforts to propose data about the four modes, which at the beginning were not available. The last version of Balance of Payment Manual (BPM5) and a specific evolution (Extended Balance Of Payment on Services, EBOPS) are attempts to comply with GATS requirements. However, the result is far from an achievement, as pointed out by a recent WTO working paper: “a satisfactory linkage of statistics with GATS mode of supply is not feasible at present” (WTO 2006 p.11). Some authors are less subtle (Raghavan 2001) <sup>5</sup>.

Nevertheless, service transactions between residents and non-residents, as captured in the balance of payments accounts described in the BPM5 system, broadly cover mode 1, mode 2, and part of mode 4.

Mode 1 applies when a service is delivered from a supplier abroad to a consumer in his territory of residence. Most balance of payments transactions recorded under transportation, communication services, insurance services, financial services, and royalties and license fees are included in this mode.

There are nonetheless circumstances where specific balance of payments service transactions involve several modes of supply, such as when an architect designs a construction project, delivers it through a telecommunications means and has to make some visits to the consumer country during the implementation phase. Besides, several items

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<sup>5</sup> « UN services data collection won't help GATS negotiators ».

Table n°3  
Statistical coverage of GATS mode of supply

BOP available items	Corresponding main GATS mode	Inadequacies
Transportation	1 Cross border supply	excl. supporting and auxiliary services to carriers in foreign ports (mode 2)
Travel	2 Consumption abroad	includes also goods and is not subdivided into the different categories of services consumed by travellers
Communications services.	1 Cross border supply	Incl. residually mode 4
Construction services.	?	Shared between 3 Commercial presence and 4 Presence of natural persons. EBOPS include also the materials bought abroad.
Insurance services.	1 Cross border supply	Incl. residually mode 4
Financial services.	1 Cross border supply	Incl. residually mode 4
Computer and information services.	1 Cross border supply	includes also mode 4
Royalties and license fees.	1 Cross border supply	(BOP complies with GATS requirements, but it is questionable whether this item should rather refer to income's property)
Other business services.	1 Cross border supply	includes also mode 4
Personal, cultural, and recreational services.	1 Cross border supply	includes also mode 4
Government services, not included elsewhere	not covered	/
Foreign Direct Investments	3 Commercial presence	FDI statistics cover a larger subset, not only (majority) controlled companies; does not exclude goods producers. Not distributed between <i>modes 3 and 4</i>
Labour flows ( <i>compensation of employees</i> Current transfers ( <i>workers' remittances</i> ))	4 Presence of natural persons	no true relationship with <i>mode 4</i> but of interest for labour mobility

Compiled from manual MSITS 2002 and WTO 2006

encompass mixed modes of trade, for instance computer and information services may pertain altogether to cross border supply and presence of natural persons, if not to commercial presence. The fourth mode of supply, as defined by GATS, goes beyond the notion of “services transactions” in BPM5. In order to gauge mode 3 (FDI), international statistical organisations have launched, as a proxy, a Foreign Affiliates Trade in Services (FATS) specific survey, which to some extent is still incomplete and inaccurate. For instance, the criterion for FDI is not the same in GATS and the international statistics; the latter requires a purchase of 10% of equity capital, when the former requires a majority control. Table n°3 summarises the knowledge and insufficiencies to meet, when referring to present international

trade statistics. In addition, table n°4 gives a rough approximation of the share of each mode of GATS trade in services.

Table n°4  
Sales by GATS Modes of Supply: Statistical Approximation (2000)

Mode of supply	Proxy	Rough estimate (billion US \$)
1 Cross border	BOP : commercial services (excl. travel)	1 000
2 Consumption abroad	BOP : Travel export	500
3 Commercial presence	FATS statistics: turnover	2 000
4 Presence of natural persons	BOP: compensation of employees	50

Source: Karsenty (2002 p.18)

The definitions issued by GATS raise several other questions, which are worth mentioning, even if it is not the purpose of this paper to analyse them. In order to comply with GATS, the BPM5 shifts the item royalties and license fees, from owner's income to services (OECD 2005 p.14). This shift has been under discussion on theoretical grounds (Whichard 2000 p.13, Hill 1997). The BOP is based on a year round basis. This criterion introduces several difficulties, for instance a resident for BOP may be temporary for GATS. Another point stems from the fact that it is quite difficult to determine the ultimate beneficial owner of foreign affiliates. Similarly, it could be difficult to determine whether the activity of a self-employed relates to modes 4 or 3.

#### ILLUMINATING NEW CONCEPTS?

Whether the adaptation of the Balance of Payment classification carried out to match GATS modes requirements is of interest to measure genuine international trade in services is questionable.

As oddly warned in the introduction of the MSITS manual (MSITS 2002 p.8): "Although the present manual extends the scope of the term international trade in services, the manual does not suggest that these extensions be regarded as imports or exports". Indeed, the new approach seems to blur the meaning of international trade, and hinders a clear understanding of what is international trade, and what is not.

Properly speaking, only the first (cross border) and the second (consumption abroad) modes match common international trade in services standards, other modes relate to capital or income movements (Box n°3a). In these two previous cases, a monetary transfer crosses the border counterpart to a purchase of service. It is no wonder Modes 3 (commercial presence) and 4 (presence of natural persons) are evidences of internationalisation, but speaking of trade about them tends to blur economic concepts.

First, the case for mode 4 is complex, since, depending on the characteristics of the mission undertaken, it could be regarded as mode 3 -when the mission is lasting beyond one year -, or else as workers remittance (income transfer). In other circumstances, it could be true trade in services, when self-employed are concerned. Second, the case for Mode 3, which has



taken the form of Foreign Affiliate Trade in Services (FATS), is however straightforward; it should not be considered as international trade.

Primarily, neither mentioning services nor goods, FATS is dealing with Direct Investment, which is not trade. Trade means a swap between economic entities, whether “physical” or monetary. An investment is not a swap, but a unilateral movement.

Secondly, the GATS approach regards the trade of the Affiliate in Service as international trade, depending on the nationality of a firm (MSITS 2002 p.57). Several shortcomings show how misleading this idea is.

It means that *internal* trade becomes *international* trade, depending on the nationality of the owner. This seems particularly weird, even when not taking into account practical problems (like for instance: how to separate FATS services firms from goods producing ones; what is the proper statistical level for units ranking in FATS; who is the ultimate owner...?). GATS methodology seems to forget that the meaning of the terms national or international relates to countries, with their acknowledged official borders. Following GATS approach, trade between services firms established on the same territory could peculiarly be considered as international trade. It looks like inaugurating the concept of “ethnic” trade within trade statistics! Considering that the owner’s nationality of an affiliate may vary from year to year, even within a year, it would alter the relative economic substance of “inner” services and “outer” services economy. In consequence, over time comparisons would lose salience.

The monetary movements for direct investments are traditionally classified in the BOP, under the chapters: financial account (initial investment) and income (revenue drawn from the investment) (see Box n°3a). It would be surely misleading to count turnover of the FATS (computed for GATS) as international trade, since only a slight part of it crosses the border and affects international macroeconomics figures.

Moreover, if the GATS option were to be confirmed in economic statistics, it would be worth questioning why not applying it to goods. Indeed, if the owner’s nationality, rather than national territory, were of interest to delineate international trade, why would it not be valid as well for goods producing industry? In fact, as statisticians are, presently, unable to produce data pertaining only to services industries, they are already, *nolens volens* (i.e. unwillingly or willingly), doing so.

Finally, following GATS approach would lead to a complete transformation of the international trade notion. Instead of accounting for trade between countries, statistics would account for trade between national firms, wherever they are established, thus abolishing geographical borders. The relevant economic boundaries would be that of firms, i.e. expressing the ever-moving contour of trans-national-firms.

There is no doubt enhancing knowledge about direct investments is of prime interest, but the very terms of international trade should not be granted to GATS mode 3.

#### WHAT IS AT STAKE BEHIND THE CONCEPTUAL SHIFT?

When *internal* trade converts into *international* trade, internal legislations or regulations become an issue of international negotiations. The slip of meaning, as well as the issue at stake, are clearly revealed by the following quotation from WTO (WTO 1999 p. 1): “(...) given the importance of the weight of trade in services that is performed *inside* national economies, (...) its guidelines [GATS] will, from the beginning, necessarily have an influence on internal national laws and regulations”<sup>6</sup>. The rules that govern commercial presence are

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<sup>6</sup> Our translation from French: « (...) en raison de l’importance de la part du commerce de services qui s’effectue à l’intérieur des économies nationales, (...) ses prescriptions [AGCS] auront forcément une incidence, dès le début, sur les lois et réglementations intérieures nationales ».

indeed much different from tariffs or duties and other measures that mainly affect trade in goods at the border. The same paper explains further on (1999 p. 3): “it is only gradually that GATT has addressed sensitive questions pertaining to national policies, such as subsidies or technical norms. On the contrary, from the beginning, GATS has had to cope with internal policy matters such as establishment rights, which are inherent to the commercial presence of foreign interests. In doing so, (...) GATS has conquered a new field”<sup>7</sup>.

The ways, means, as well as the consequence of the transformation will be appraised in the next section.

#### 4. THE EUROPEAN DIRECTIVE ON SERVICES, MUTUAL RECOGNITION AND COUNTRY OF ORIGIN PRINCIPLES

The new approach to trade creates some difficulties that have impeded, in turn, the European directive on services. The main one stems from the Mutual Recognition Principle (MRP), related to modes 3 and 4, and its consequences with services. In the GATS framework, mutual recognition so far refers to skills and diploma recognition (OCDE 2003), within the EU its aim is much broader. It may be seen as anticipating further GATS negotiations (Sauvé & Stern 2000), besides, the writers of the directive had these upcoming negotiations in mind<sup>8</sup>. Let us first describe the MRP and its extension, the Country of Origin Principle (COP), and next, analyse the problems brought about by their application to services.

##### 4.1 FROM THE MUTUAL RECOGNITION PRINCIPLE TOWARDS THE COUNTRY OF ORIGIN PRINCIPLE

The Mutual Recognition Principle has been developed for international trade in merchandises (COM 2002b; JOCE 2003). In the EU, the concept relates to the 1979 “Cassis de Dijon” decision of the European Community Justice Court (ECJC). This case law derives from articles 23 and sq. of the European Community Treaty (ECT), which concerns the custom union and commodity trade. The principle is however commonly thought to apply directly to free supply of services (COM 2002b p. 6).

According to its simplest version, the principle means that the recipient country of merchandise should acknowledge the validity of the regulation of the origin country and not impose its own. The underlying justification relies on the conception that, when the purpose of a host country’s regulation is achieved by the rules of an origin country, the host country should recognise the foreign regulation as akin to its own (OCDE 2003 p. 9). The principle

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<sup>7</sup> Our translation from French : « Ce n'est que progressivement que le GATT a touché à des questions de politique nationale sensibles telles que les subventions et les normes techniques. En revanche, dès le début, l'AGCS a dû s'atteler à des questions de politique interne telles que les droits d'établissement qui sont inhérents à la présence commerciale d'intérêts étrangers. Ce faisant, et en posant des règles multilatérales qui garantissent aux entreprises et aux personnes physiques la possibilité de s'établir sur un marché étranger, l'AGCS a conquis un terrain nouveau ».

<sup>8</sup> « Les échanges de services au niveau international font l'objet de négociations internationales, en particulier dans le cadre du GATS. A cet égard, il faut souligner que l'UE constitue un marché très ouvert en comparaison de beaucoup de ses partenaires commerciaux. La proposition n'interfère pas avec ces négociations qui visent à faciliter les échanges en matière de services et **qui soulignent la nécessité pour l'UE d'établir rapidement un véritable Marché intérieur des services pour assurer la compétitivité des entreprises européennes et pour renforcer sa position de négociation** ». Directive 2004, paragraphe : cohérence avec les autres politiques de l'UE (p. 16).

has been extended to include diploma and skills. This extension does not raise theoretical difficulties.

As the OECD (2003 p. 10) puts it, the process is often employed as a substitute to the harmonisation of regulations and norms. Indeed, in the EU, it is only applied to fields where no harmonisation has yet occurred or is foreseen.

Elaborated for commodities, the mutual recognition principle is primarily concerned with the output or the final product, which was the point with the famous example of Cassis de Dijon. In addition to technical norms, the principle drives to recognise label. The recognition of the product quality is indeed coupled with label recognition. In the case of Cassis de Dijon, the debate aimed at determining if a less than 25° of alcohol beverage could be labelled liquor.

The Country of Origin Principle (COP) is an extension of the MRP, yet it rather differs in two ways.

First, unlike mutual recognition, which may be restricted, COP is granted automatically. In the case of mutual recognition, not only the host state may assess the technical regulations of the country of origin, but also the recognition may be complemented with specific requirement (OCDE 2003, JOCE 2003).

Second, COP regards these regulations, which are internal and applied to the producer. It is consistent with the idea often stated that “barriers to service sector development (...) are rather of a domestic nature” (OECD 2000 p. 32). The purpose of the COP is therefore to accept as equivalent the regulations in the origin country implemented to its producers. It is no more the output that is under scrutiny, but the process of production. Obviously, the two points are closely linked; still, it is not without significance to focus on one rather than on the other.

The shift derives from the fact that output regulations in many services industries are not easy to set and implement, if not impossible. Indeed, numerous services are specifically adapted to the consumer or to the merchandise, to which they are applied and thus versatile. In this perspective, these services are not standardised. Besides, since the service is not separable (final service is inbuilt in a person or a good), and since the production is performed in connection with the client (the result may depend on his activity), it is often difficult to normalise the final service itself. In these circumstances, the mutual recognition principle thus evolves quite naturally in the COP (OCDE 2005 p.11). Moreover, as the European Commission points it, local regulations may give its very form to a service, thus delineating its “commercial model”. Indeed, the regulations are embedded in the commercial service which may be offered and that a services firm may wish to export. Let us think, for instance, of the bundle of services a firm is permitted to offer to consumers (see below the Caixa bank case) or of the extent in opening days and hours in retail trade.

The regulations that might fall under scrutiny of international negotiations and could be modified rank to a much wider array than those concerned with goods. COP principle is much more intrusive than MRP (Sauvé Stern 2000 p. 16), because it affects all rules pertaining to the organisation of production with an all-encompassing view, as for instance to consumer protection, health... and in specific ways, industrial relations. Let us also note that OECD 2000, among other services barriers, unexpectedly points out regulations aiming at upholding decency and protecting privacy.

## 4.2 SERVICES BRING SEVERAL SPECIFIC DIFFICULTIES IN IMPLEMENTING THE MUTUAL RECOGNITION OR COUNTRY OF ORIGIN PRINCIPLES

The wide range of domains encompassed by the Country of Origin Principle (COP) brings out unusual troublesome difficulties that became apparent with the directive on services. These worries have not completely disappeared with the removal of COP from the directive.

As noticed before, the extent of the rules under scrutiny expands sharply, rendering the implementation of COP very sensitive. However, the main problem with services producing industries comes from the necessity to produce on location. This situation urges to welcome on the same territory, at the same time, regulations that could be differing.

The French Conseil d'Etat, in its recommendation n°371, (18/11/2004), raised several legal problems and warned against juridical hazard brought about by the COP: “the simultaneous implementation of several national laws, set in competition, on the same territory raises several questions of principle (...) of constitutional significance such as: national sovereignty, equality before the law and the legality of offences and penalties”, (Conseil d'Etat 2005, p. 178)<sup>9</sup>. The efficiency of control upon regulation compliance was weakened with the first version of the directive, due to the disconnection between the service-producing country and the service-controlling one.

From an economic point of view, the implementation of genuine COP could open the same resident market to firms compelled to different regulations albeit regulations are part of their overall operational costs and thus generate prices. Consequently, the principle would set an unfair competition framework, where rules are different for each local player. Furthermore, especially within an EU enlarged to 25 or more members, if no harmonisation is previously set, the principle favours countries where regulations are less demanding, regardless of their purpose or efficiency. This competition between laws may enhance productive efficiency; nevertheless, it also may weaken production quality and, for instance, protection offered to the consumer (Schwellnus 2006). This concern is stronger in the case of services, which indeed are predominantly “experience goods”. Since they are non-storable, the final service is discovered at the end of the production process, thus rendering the ex-ante choice of the consumer poorly informed. It is worth mentioning that in a theoretical world where information was perfect and the consumer's resources unlimited, such worries would not be relevant.

Facing strong hostility, the COP was formally withdrawn from the EU directive. However some fears persist. Assessing them will be the occasion to explain why if MRP (respectively COP) is easily accepted for goods, it is not so for services.

### THE FINAL DIRECTIVE STRATEGY AND ITS DRAWBACKS

The main feature of the final EU directive is the systematisation of the case law concerning free movement of services and freedom of establishment. In the first one, the extent of stay is deemed shorter than in the latter, in this respect, a parallelism may be drawn with GATS modes 3 and 4. As they differ only in the duration of local stay, let us only deal with one of the two rights. Albeit ways differ, the current orientation may drive to the same actual results as the COP. Some explanation is required, let us first remind what free movement of services is.

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<sup>9</sup> Our translation.

The free movement of services principle proscribes a member state to prevent a foreign services firm from supplying its services (Box n°4). It is of little knowledge that the case law goes further than the treaties and common thoughts or practises: treaties are rather indefinite (Box n°4), common sense supposes thus that the principles require, non-discriminatory rules or procedures. However, quite unnoticed is the fact that the case law tends to forbid demanding a foreign firm to compel with local economic regulations because it renders “less appealing” trade between member states (Box n°4). When the regulations of member states differ, an assumption of trade barrier happens. Indeed, the case law doctrine sees every discrepancy as potential barriers to trade (correspondingly establishment) inside EU. To be more specific, the only rules that remain compelling are those that protect health, public order and overriding reasons related to public interest. The case law is now systematised by the directive as it appears for instance in article 16 (Box n°4). When foreign firms want to provide services in local markets, they are entitled to follow their original regulations. If their “commercial model” is not allowed in the host country, they may prosecute the state, on ground of trade barrier. Since the motives to preserve a regulation are scarce and narrow, the host state is likely to lose its case, and its regulation to be adapted. This process may be illustrated by the case of Caixa Bank vs France (CJCE 2004).

In France, a law passed during the 1960’s, when the government wanted to spread banks accounts among the citizens, forbade paying interest rate on check accounts. In counterpart, checks were to be free of charge. This long-standing regulation had not evolved, it became somewhat an implicit compromise line between banks and consumers’ associations. Even if the contempt rule was compelling for all banks, regardless of their nationality, and thus obviously not discriminatory, the ECJC estimated that it was a barrier to *freedom of establishment*. Indeed, although favourable to consumers (since the gain from free checks far outruns the revenue potentially drawn from low interest rates), the rule was neither protecting health, nor public order, nor overriding public interest motives. The regulation has since been removed.

Let us note that, no true economic prejudice was at stake. Ironically enough, the Spanish bank was already established for some years. Moreover, ever since the decision, the bank has not gained any significant market share. Finally, on a sound economic basis, the ECJC should rather have called the despised rule an obstacle to free supply of services. Yet, the treaties only acknowledge free movement of services and freedom of establishment. Given that the bank did not intend to supply a cross border service and that it was already established, the case referred to neither.

Box n°4: Free movement of services and Freedom of establishment

Freedom of establishment

Article 43 ECT

*Dans le cadre des dispositions visées ci-après, les restrictions à la liberté d'établissement des ressortissants d'un Etat membre dans le territoire d'un autre Etat membre sont interdites. Cette interdiction s'étend également aux restrictions à la création d'agences, de succursales ou de filiales, par les ressortissants d'un Etat membre établis sur le territoire d'un Etat membre.*

*La liberté d'établissement comporte l'accès aux activités non salariées et leur exercice, ainsi que la constitution et la gestion d'entreprises et notamment de sociétés au sens de l'article 48, deuxième alinéa, dans les conditions définies par la législation du pays d'établissement pour ses propres ressortissants, sous réserve des dispositions du chapitre relatif aux capitaux.*

Free movement of services  
Article 49 ECT

*Dans le cadre des dispositions visées ci-après, les restrictions à la libre prestation des services à l'intérieur de la Communauté sont interdites à l'égard des ressortissants des Etats membres établis dans un pays de la Communauté autre que celui du destinataire de la prestation.*

*Le Conseil, statuant à la majorité qualifiée sur proposition de la Commission, peut étendre le bénéfice des dispositions du présent chapitre aux prestataires de services ressortissants d'un Etat tiers établis à l'intérieur de la Communauté.*  
*TCE consolidé*

Synthesis of the case law pertaining to articles 49 & 43 :

Les mesures nationales susceptibles de gêner ou de rendre moins attrayant l'exercice des libertés fondamentales garanties par le traité doivent remplir quatre conditions: qu'elles s'appliquent de manière non discriminatoire, qu'elles se justifient par des raisons impérieuses d'intérêt général, qu'elles soient propres à garantir la réalisation de l'objectif qu'elles poursuivent et qu'elles n'aillent pas au-delà de ce qui est nécessaire pour l'atteindre.

Article 16 of directive (excerpts)

*Les États membres ne peuvent subordonner l'accès à une activité de service ou son exercice sur leur territoire à des exigences qui ne satisfont pas aux principes suivants :*

- a) la non-discrimination: l'exigence ne peut être directement ou indirectement discriminatoire en raison de la nationalité ou, dans le cas de personnes morales, en raison de l'État membre dans lequel elles sont établies;*
- b) la nécessité: l'exigence doit être justifiée par des raisons d'ordre public, de sécurité publique, de santé publique ou de protection de l'environnement;*
- c) la proportionnalité: l'exigence doit être propre à garantir la réalisation de l'objectif poursuivi et ne pas aller au-delà de ce qui est nécessaire pour atteindre cet objectif.*

In this respect, the directive may be seen like a mechanism to modify service regulations, which will reach an end when relevant regulations are akin, its long-term target being that of the less demanding country. We are very close to some foreseen results of COP. The foremost divergence seems that several legislations are not implemented at the same time. However, this eventuality was only one of the various options allowed by COP. If the most dramatic, it was certainly not the most likely to occur. To be sure, local rules would have been adapted to prevent unbalanced internal competition. Nevertheless, with the new directive, competition among various national legislations, although indirect, remains opened.

THE STRATEGY FACES TRUE SHORTCOMINGS BECAUSE IT TENDS TO IGNORE THE SPECIFICITIES OF SERVICES.

Many authors are welcoming the competitive process, since they anticipate lower prices, weaker administrative burden, more jobs and more choice for consumers... (OCDE 2000, COM 2000, OCDE 2005b). It is definitely an option, but this view is too much influenced by the commodity way of thinking.

It has already been stated that prospects on service economy are overstated, and that the competition between regulations may both be unbalanced between countries and

detrimental to the consumer's welfare, it is at present necessary to evoke other kinds of problems.

As Pisani-Ferry states (2005 p. 78): "the more one moves from trade in goods to get closer to services supply and the more inextricably mixed become economic matters, legal national orders and differing social models"<sup>10</sup>. Indeed, national regulations are a mix of economic, social and historical concerns. They express collective preferences, compromises that the society has reached. They are an attempt to find a balance among various public opinions and tendencies, which currently, as European harmonisation has halted, are still articulated at a national level. Similarly, as expresses Wöfl (2005 p. 53): "The services sector has traditionally been a highly regulated sector. (...) Some of these regulations may be or may have formerly been justified (...) by the wish to satisfy non-economic objectives where competition was not perceived to be possible or appropriate." Thus, far more than duties or quotas, services' regulations are not an exclusive economic problem. The extent of opening days and hours in the retail and department store branch, and especially the case of Sunday opening, is an illuminating example (COM 2002 p. 65, Wöfl 2005 p. 54). If this issue were to be ignored, negotiators would meet fierce opposition and great disappointment.

Given that services regulations are not only technical matters, a well-shared state of mind is that contrary to goods coming from and produced abroad, services offered "at home" should comply with "home" regulations. A close reading of the articles 43 and 49 shows that when dealing with freedom of establishment and especially free movement of services, treaties share this state of mind. They do not refer to free "at home" supply of services. The European Treaty (article 50) and the project of Constitution for Europe, keep open trace of this conception. Article III-145 states : « *sans préjudice de la sous-section 2 relative à la liberté d'établissement, le prestataire peut, pour l'exécution de sa prestation, exercer, à titre temporaire, son activité dans le pays où la prestation est fournie, dans les mêmes conditions que celles que ce pays impose à ses propres ressortissants* » (Sénat 2005). This way of thinking is still very strong. As the Commission observes (COM 2002a p. 43), even foreign services firms widely consider that they should abide by local rules.

Obviously, this state of mind cannot understand why "foreign" regulations should modify "home" regulations for "at home" supply. This domestic regulation issue is addressed in GATS article VI. Sauv e and Stern (2000 p. 14 sq) acknowledge the aforementioned problem, and rightly point that one risk at stake is "unduly curtailing national regulatory freedom", but do not seem to fully appraise its acuteness.

#### THE EFFICIENCY ISSUE

The process is often warranted by efficiency improvement in the services sector, but in some way, these prospects are overstated. Yet, compelling with local regulations raises a not so significant efficiency problem.

On the one hand, prospects of economies of scale and efficiency enhancement often rely on the diffusion of new Information and Communication Technologies (ICT). However, from an international trade perspective, ICT give an impulse only to cross border supply, hence, since the main way of services internationalisation is commercial presence, producing meagre potential results<sup>11</sup>.

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<sup>10</sup> « Plus on s' loigne du commerce des biens pour se rapprocher de la prestation de services et plus se trouvent m l s indissolublement des consid rations  conomiques, des ordres juridiques nationaux et des mod les sociaux diff rents ».

<sup>11</sup> Let us remember that services industries account only for a rough 20% of all cross border services transactions.

On the other hand, MRP or COP should also improve efficiency through economies of scale and strengthening of competition. Sure enough, multiplying lines of production to adapt to different regulations is costly and impedes economies of scale. It is certainly true in the case of goods producing industries, but not so obvious in many services industries. Let us remember that economies of scale are paired with concentration and mass production in big units, and thus storability. In numerous services, especially those concerned with commercial presence, it is necessary to install new local production units to address local markets. Dedication of output to the customer and emphasis put on quality upgrading also induce adaptation to local consumers' demand and thus proximity. Consequently, the foreseen returns of economies of scale are fairly curtailed (Wölfl 2005). However fortunately, commercial presence offers an easy opportunity to adapt to various regulations and needs. Moreover, the services specificities mentioned ahead often give way to a competition relying on product differentiation rather than mere prices. A new supplier is quite often seen as offering a new form of service; it is especially true for services offered by foreign firms and if COP is applied. Therefore, given the consumption rate of growth, an increase in commercial presence could turn chiefly into more diversity of supply rather than concentration, or economies of scale or a drop in prices. At least, the forecast result is questionable knowing that cross border supply and commercial presence are the main way of international trade in services.

Finally, following the new approach to international trade in services brings several difficulties stemming from the shift from trade in goods to trade in services. Moreover, its foreseen results, upon prices and economies of scale, are most probably overestimated.

## CONCLUSION

GATS launched a new approach to international trade in services, somewhat followed by the European directive. This new approach gives rise to numerous prospects, but the paper tried to show that it encounters severe difficulties and carries disproportionate expectations.

The paper revisits Hill's (1999) services definition. The standard conception of services is too loose and agglomerates firms that are not producing services with authentic ones. Likewise, many business services derive from industrial functions that were outsourced and are still dependent on goods producing activities. Consequently, the weight of the service sector is somehow overestimated, as well as its growth autonomy. Economic policy should continue to be concerned with, and back goods producing industries. Macroeconomic knowledge would also be greatly improved if information goods were no more mixed up with services industries in national accounts.

Trade in services is truly low comparatively to the weight of services industries in the economy, but data are deceptive. Contrary to a common routine, trade in services is not to be primarily related to services industries, since the major share of it stems from goods producing industries. Thus, promoting trade in services does not chiefly mean supporting or addressing services industries. Albeit their meagre importance in international trade, services industries are internationalising at a quick pace, but they rely on different mechanisms, such as for instance direct investments or non-equity exchanges. Consequently, there are few hopes that trade in services will reach the weight of trade in goods, that is, unless the definition of trade is altered.



In a way, GATS has followed the aforementioned path, delineating four modes of trade in services, but at least two of them are confusing or distort economic concepts. For instance, although the commercial presence mode is, without doubt an expression of internationalisation, it should not be regarded as trade. Likewise, the Foreign Affiliate Trade in Services perspective, which tends to inaugurate “ethnic” international trade and to obliterate geographical borders, brings a prominent problem. Statisticians have tried to match international data from Balance Of Payment with GATS requirements. However, the process meets many theoretical, as well as, practical drawbacks and the current result is not solid.

To facilitate trade in goods and avoid a harmonisation process, earlier international negotiations developed the Mutual Recognition Principle (MRP) dealing with technical norms diversity. In the case of services, the MRP evolves in the Country of Origin Principle (COP). Contrasting with the MRP, the COP relates to the process of production, because technical normalisation of final services is uneasy and scarce. As services production is very much shaped by local regulations, the new approach tackles domestic regulations. These circumstances give rise to several difficulties, both theoretical and practical. With COP or similar process, the eventuality of an unbalanced competition, harmful to consumers and local firms, may not actually be discarded, i.e. taking into account imperfect information and services specificities. Similarly, the extent of economies of scale and drop in prices, when local markets are so important to many services firms, is questionable. Moreover, the regulations under scrutiny relate to a wide array, many of them not essentially passed for economic reasons. International negotiations hence become internally intrusive. Finally, the approach implemented by the European directive, challenges a well-established opinion considering that, if foreign production may conform to foreign regulations, local production should comply with local regulations.

All these elements show that the move from trade in goods to trade in services is not straightforward. The new approach seems to go too fast in overtaking difficulties, probably overstates prospects for services economy and above all lacks of acute data or research (i.e. caring of services specificities) that could enable to anticipate fully its consequences. Given the embedding of services in local regulations, revitalising the harmonization process prior to launching COP, or a similar horizontal process, would probably be wise.

Building a simple and global economic framework to deal with trade in merchandises and services is definitely an essential aim, but it should not ignore the consequences of the services idiosyncrasies.

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